Book-To-Bill Ratio

Idea In Short

- Book-to-bill is a ratio of orders received to the amount billed for a specific period
- The book-to-bill ratio reveals how quickly a business fulfills demand for its products
- The ratio also shows the strength of a sector and may be used to determine whether to purchase stock in a company

Businesses love metrics. Executives use metrics to measure the company's performance and determine how well their organisation is doing. Usually, companies focus on certain business metrics in particular. While there's nothing that makes one metric better or worse than another, the most important metrics in a business will change over time, depending on the company's stage of development and market conditions. Among the various metrics, the book-to-bill ratio is a metric that many executives closely watch because it gives an early indication of the company's direction - up or down. It is pretty simple math - take the bookings [orders] and divide this figure by the billings [revenue].

Definition

According to Wikipedia:

> The book-to-bill ratio, also known as the BB ratio or BO/BI ratio, is the ratio of orders received to the amount billed for a specific period, usually one month or one quarter.

According to Investopedia:

> The book-to-bill ratio reveals how quickly a business fulfills demand for its products. The ratio also shows the strength of a sector, such as aerospace or defense manufacturing. It may also be used when determining whether to purchase

stock in a company.

In consulting

This metric is also used in the consulting industry. On their last conference call, Accenture mentioned their book-to-bill ratio here:

> New bookings were $10 billion for the quarter, reflecting 19% growth in local currency over last year. Our consulting bookings were $5.9 billion, with a book-to-bill of 1.1 and represented an all-time high. Outsourcing bookings were $4 billion, with a book-to-bill of 0.9.

This means that Accenture had purchase orders for $5.93 billion of consulting work for the next quarter compared to the $5.18 of revenues in the current quarter.

Interpretation

This is a valuable tool for measuring the strength of the company:

- When this ratio is expanding (greater than 1), it indicates that an organisation is healthy with a backlog with new orders.
- Conversely, when this ratio is declining (less than 1), it is a strong indicator of impending trouble.

For example, a business that generates $1 million of new orders in a month, while billing its customers $800,000 in the same period results in a value of 1.25:

> $1,000,000 ÷ $800,000 = 1.25

Importance

This metric is especially important in industries where customer demand is volatile. In this case, the management needs to understand when to start scaling back capacity to meet

declining demand. Investors closely watch this figure, since a high value indicates a robust business that is attracting customers and is worthy of investment. Conversely, a declining value, especially across a number of reporting periods, is an indicator of possible bankruptcy. In some industries not all bookings result in revenues. Alternatively, this figure indirectly indicates a company's salesforce efficiency. You want to know how much revenue a company has booked, and how much revenue it has actually billed. Nevertheless, it's important to track of this metric.

Summary

- The book to bill is gives an early indication of where the company's business is headed (up or down)
- A high book-to-bill ratio indicates that an organization has a robust business model that is attracting customers
- A declining ratio (especially across a number of reporting periods) is an indicator of possible bankruptcy