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Last Updated: May 12, 2026

The Software Fundamentals Glossary

The Fundamentals

The Metrics

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How to Use This Guide

Every year, we publish our cornerstone report on what growth and efficiency looks like across our portfolio of enterprise software companies and select public software companies. However, the different terms and metrics used to describe software business performance are often confusing and not well-documented. We often get questions from both new and established founders and finance teams on the best ways to calculate a certain metric.

We are excited to share this glossary of common industry terms and metrics as a companion tool to our annual Topline Growth & Operational Efficiency report. This is not intended to be a definitive guide to software accounting. Rather, we hope to share some best practices and common approaches we often see companies use to most cleanly define and track these metrics on an ongoing basis. We also believe this is a topic that will benefit from increased knowledge sharing and welcome any additional considerations or best practices you may have.

Access our latest State of Software Report here.

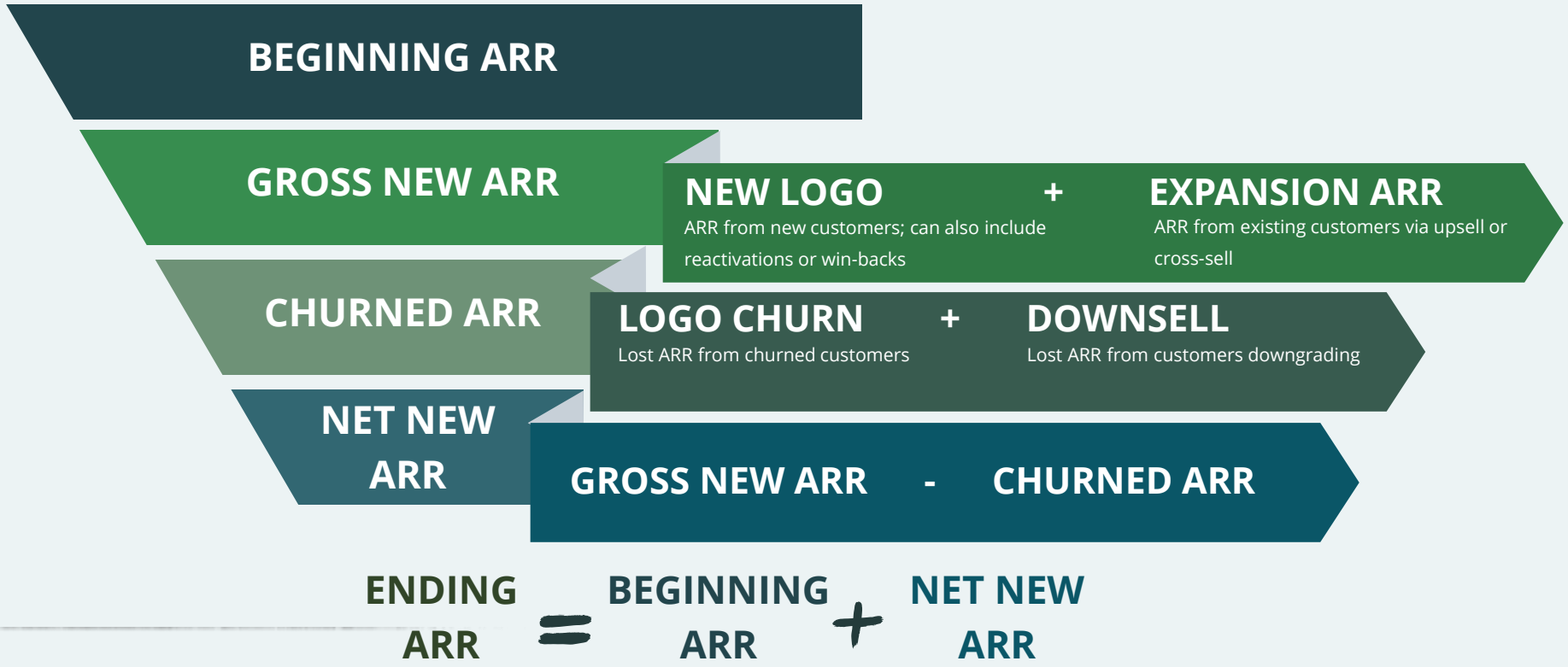
Compass by ICONIQ

Use our interactive tool to benchmark your company against many of these metrics

For more detailed guides to metrics and reporting best practices by function, we invite you to explore our functional guides:

The ARR Funnel

Because of the recurring nature of software businesses, it can be challenging to see how well a company is actually doing. An ARR waterfall is one of the fundamental building blocks of financial planning, allowing us to understand where a company is at the beginning of period, the puts and takes of ARR in that period, and where you landed at the end of the period. We believe one of the best ways to measure the health of your business is to look at what happened with new customers (new logo ARR), your install base (expansion, churn rate), and the sum of all the above (net new ARR) on both a quarterly and annual basis.



Access our
ARR funnel template

Software Revenue Recognition

As you can see, these different ways to measure revenue are all similar but quite different based on the contract length and terms. Understanding and tracking these different metrics can allow companies to more confidently predict monthly revenues and also identify any concerning trends (e.g., a significant lag between bookings and revenue)

	Definition	Example
BOOKINGS	Dollar value from any customer agreements to spend money with you (usually with an executed contract)	A 2.5-year contract where Year 1: $600K, Year 2: $1.2M, Year 3: $1.2M. Contract is signed on Jan 1st with a time to live of 6 months and an upfront payment of $600K Bookings on Jan 1st: $3M
BILLINGS	Amount invoiced that is due for payment	Billings on Jan 1st: $600K $100K/month starting in Year 2
ACV / TCV	Annual contract value (ACV): Value of a contract over an annual (12-month) period. Total contract value (TCV): Total value of the contract which can be shorter or longer than the 12-month period	ACV: $1.2M per year (3M / 2.5 years) TCV: $3M
CARR	Contracted annual recurring revenue refers to the subscription revenue of all signed contracts (including customers not yet live)	CARR: $1.2M per year
MRR / ARR	Annual recurring revenue (ARR) is the annualized, recurring value of the contract that is live and being recognized as revenue. MRR = ARR / 12	MRR on Jan 1st: $0 $100K in MRR starting in Month 7, ARR = $1.2M
REVENUE	Dollar value of money that is recognized once services are delivered (per GAAP accounting policy)	Revenue on Jan 1st: $0 Revenue in Year 1: $600K ($100K/month starting in Month 7) Revenue in Years 2-3: $1.2M/year

Revenue Realization

Software Revenue Recognition | FAQs

Which topline recurring revenue metrics should I be tracking?

The metrics most suitable for your tracking will depend on your business model and other factors like scale. For example, certain metrics will make more sense for earlier vs. later stage companies. We often see earlier stage companies tracking both CARR and ARR since this can give the company and investors a holistic view of future revenue. Conversely, revenue becomes more important as companies scale and approach IPO readiness. However, if asked to pick the most important topline metric to track, we always recommend companies track both ARR and revenue as these metrics give the best sense of actual realized revenue.

What's the difference between deferred revenue, backlog, remaining performance obligations, and ARR?

These terms are often used interchangeably but are actually quite different. Deferred revenue refers to the dollars current customers have pre-paid for services to be delivered (these are recorded on the Balance Sheet). Once these services are rendered, the dollars become recognized as revenue. Backlog is the remaining value of contracted services that customers have not yet paid for. Together, deferred revenue + backlog = RPO (remaining performance obligations). On the other hand, ARR is an annualized value for contracted services so typically RPO will be greater than ARR for growing businesses.

What's the difference between ACV, TCV, and ARR?

Annual contract value (ACV) refers to the value of a contract over an annual (12-month) period, whereas total contract value (TCV) is the total value of the contract and can be shorter or longer than the 12-month period. TCV will also include non-recurring revenue such as one-time charges and professional services. While ARR and ACV will often be the same for a single customer, total ARR and ACV will be quite different as you think about customers with different lengths of multi-year contracts. For example, if we have Customer A with a 1-year $100K contract and Customer B with a 2-year $75K/year contract, Year 1 ARR is $175K and Year 1 ACV is $87.5K.

How should I track ARR for multi-year contracts? What about customer discounts or promotions?

If there is a ramp in multi-year contracts (i.e. Year 1 is $1M, Year 2 is $3M, Year 3 is $5M), the best practice we've seen in the portfolio is to log ARR at $1M for the first year (rather than an average of $3M across each year) to take into account any potential uncertainties in getting to the $5M. We have also seen companies log the first year ARR and the future ARR gets credited into the projected future year growth, so that when budgeting we can account for existing contracts expected to ramp up.

Many businesses will offer discounts to incentivize customers. The best practice is to account for any discounts when calculating ARR; for example, if a customer is receiving a 20% discount on an annual contract of $100K, the ARR recognized should be $80K. Similarly, a 6-month free trial offered as part of an annual contract should not be included in ARR calculations.

Categorizing Spend

Cost of Goods Sold

Where certain line items of spend are allocated will be dependent on each company's business model. For example, it may make sense for a company that has a Customer Success team that focuses more on implementation and customer support to allocate this team in COGS, whereas for other companies where Customer Success handles renewal / expansions, this team may roll up to Sales & marketing expenses. Similarly, user hosting costs can be found in either COGS or S&M. However, it is important to note that these changes will impact gross margin and any large accounting changes should have a justifiable reason.

Typical COGS Cost

- Hosting and infrastructure (e.g., servers, connectivity, security software, user hosting*)
- Third party fees (e.g., credit card / processing fees)
- Deployment / implementation resources
- Affiliate partner payouts
- Professional services
- Customer support
- Overhead (e.g., rent / facilities, office supplies)

Operating Expenses

Both people (onshore and offshore) and non-people related spend should be included:

Sales & Marketing

- Quota-carrying reps (AEs, BDR/SDRs, sales managers, etc.)
- Marketing (communications, PR, demand gen, events)
- Customer success*
- Agency partnerships
- Sales enablement / revenue operations
- Account management
- User hosting*

General & Administrative

- People / HR (Operations, Recruiting, L&D)
- Finance
- Legal / Compliance
- IT
- Executive team
- Analytics

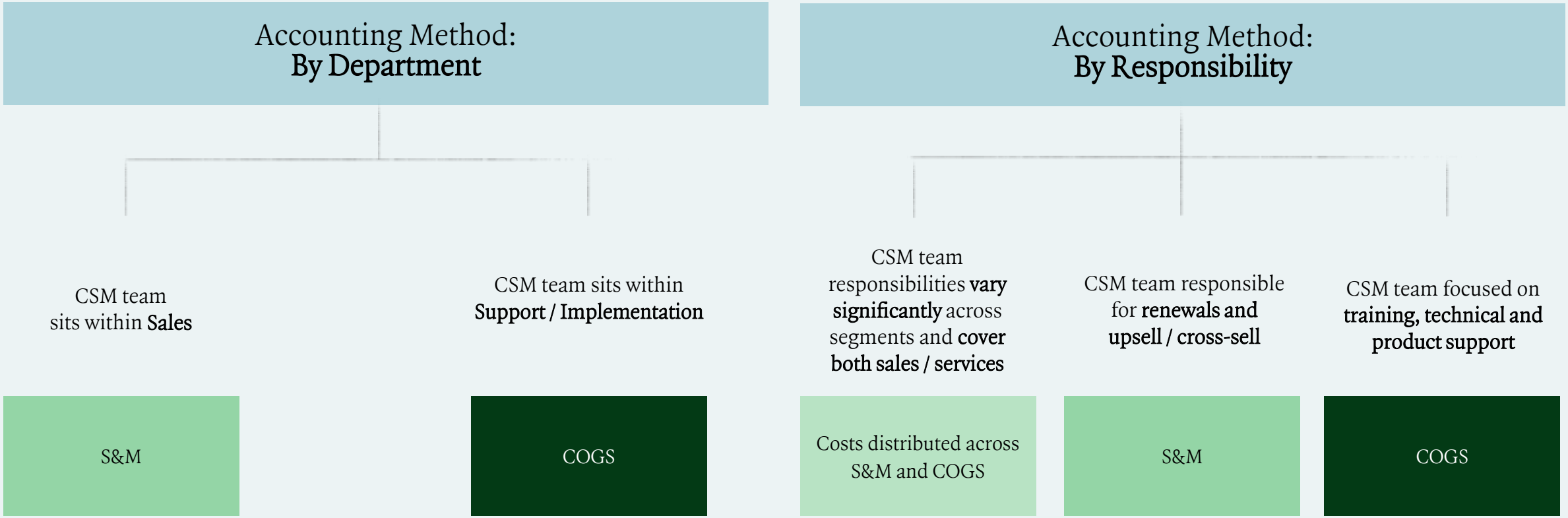
Research & Development

- Engineering
- Engineering operations
- Product design / management
- Quality assurance / testing
- Product support
- Data operations

Note: Under GAAP accounting policies, stock-based compensation is recognized as a non-cash expense on the income statement. Thus, just like wages stock-based compensation (SBC) is allocated to the relevant line items across COGs (i.e. direct labor) and Operating Expenses (i.e. SBC for R&D engineers, etc.)

Categorizing Spend | Where should Customer Success be allocated?

The customer success (CS) team is one of many accounting line items that can quickly become nuanced across different companies and business models. While there is not a straightforward answer for where to allocate CS employees and costs between COGS and Sales & Marketing, below is a framework we often see portfolio companies use to make this decision.



Growth & Attainment

Metric	Definition	Considerations
YoY ARR Growth %, Annual	$\left(\frac{\text{Year 2 ARR}}{\text{Year 1 ARR}} - 1\right) \times 100$	One of the most important metrics to track, ARR growth looks at the difference between current and last year ARR. The drivers of ARR growth (new logo vs expansion ARR) are also important to understand – both in terms of size and quality of customers, as well as variation by sales motion. It is also helpful to understand the drivers of growth in the context of today's AI-driven market, as AI companies tend to win new logos quickly but also see a higher risk of experimental revenue.
Topline Attainment %, Annual or Quarterly	$\frac{\text{Current Quarter Net New ARR}}{\text{Net New ARR Forecast}}$	One of the most important measures of both topline health as well as business predictability is topline attainment, which measures the actual dollars achieved each quarter against the original plan set at the beginning of the year. Attainment is influenced not only by GTM effectiveness, but also by how aggressive and accurate a company forecasts future growth. We typically recommend looking at the attainment metric on a cumulative incremental basis rather than within a standalone quarter which can often be impacted by seasonal fluctuations. For example, Q2 topline attainment should viewed as Q1 + Q2 (1H) attainment, or in other words the net new ARR generated in Q2 - beginning of year ARR.

Revenue & Logo Retention (1 of 2)

Metric	Definition	Considerations
Gross Dollar Retention %, Annual or Quarterly	$1 - \frac{\text{Churn + Downsell}}{\text{Average of Beginning ARR + Ending ARR}}$	Recurring revenue is the engine of software businesses. Gross dollar retention assesses dollars lost from your existing customer base via churn or downgrades. We typically see companies use beginning ARR as the denominator or the average of beginning and ending ARR to smooth out any inconsistencies across quarters (recommended approach). For certain businesses (e.g., companies where predominant upsell/downsell motion is seats organically expanding or contracting), looking at only logo churn may be the right metric.
Net Dollar Retention %, Annual or Quarterly	$1+ \frac{\text{Expansion - Downsell - Churn}}{\text{Average of Beginning ARR + Ending ARR}}$	We believe net dollar retention (NDR) is one of the most important gauges of business health for software companies and the efficiency of their revenue generation. NDR accounts for expansion, downsell, and churn which renders it a robust measure product-market fit and GTM motion. We typically use annualized-quarterly net retention to better capture quarter-over-quarter changes, which is particularly important when companies are smaller in scale and greater variation in net retention (%) is driven by a smaller denominator. Especially when looking at inconsistent periods, we will use the average of BOP and EOP ARR in the denominator. To understand net retention specific to a company or customer cohort, we recommend a cohort analysis of retention. It is also important to consider context for NDR as well, including pricing model (seat-based pricing vs usage- or outcome-based pricing) and revenue streams (durable vs experimental revenue), as these factors may spike NDR temporarily.

Revenue & Logo Retention (2 of 2)

Metric	Definition	Considerations
Quick Ratio Ratio	$\frac{\text{Total gross new ARR}}{\text{Total churned ARR}}$	The quick ratio measures the growth of recurring revenue over a certain period in comparison to the contraction. Not all growth is equal, so it is important to maintain a higher quick ratio which implies that your growth is healthy and efficient. Generally, the "optimal" software quick ratio is around 4x. [1]
Gross Logo Retention %, Annual or Quarterly	$\left(1 - \frac{\text{Churned Customers}}{\text{Beginning Customers}}\right) \times 100$	Logo retention indicates the percentage of customers a business retains over a period of time. For a software business, logo retention indicates the percentage of customers who renewed their accounts out of those due for renewal in a specific period.

[1]Based on ICONIQ network perspectives and quarterly financial and operating data from our private venture and growth portfolio companies

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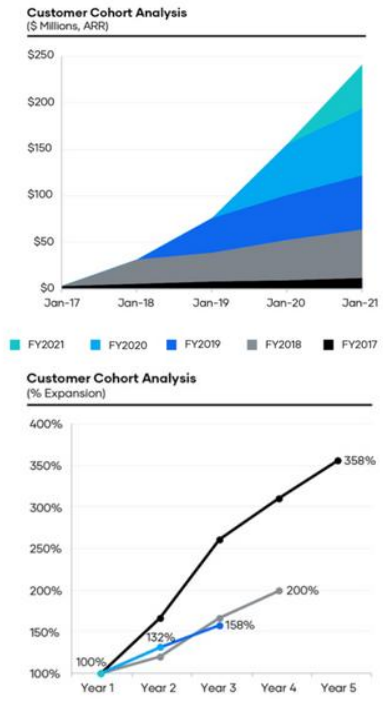
What's the best way to calculate net dollar retention?

There are two common approaches to calculating annual net dollar retention figures, each with different considerations. We typically recommend software companies track both in order to get a sense of holistic net retention for an isolated period of time as well as insight into customer behavior over time.

LTM Customer Cohort Expansion

- From the same quarter one year prior, a certain number of customers / subscribers are selected
- Looking at the trailing twelve months, the exact same group of customers are evaluated from the year prior to identify the total expansion net of churn and attrition to calculate a retention figure



Example Cohort Analysis From Hashicorp S-1 Filing

Annualized Quarterly Expansion vs. Churn / Downsell

- Quarterly "net expansion" is defined as ARR generated through expansion of existing customers in a specific quarter, less the churn/downsell within the same quarter
- Quarterly "net expansion" is then divided by beginning ARR (or sometimes average of beginning and ending ARR) for that quarter to reflect a quarterly net retention
- The quarterly net retention figure is multiplied by 4 to reflect an annualized net retention figure (typically indexed to 100%)

Unit Economics: ARR per Customer

Metric	Definition	Considerations
New ARR per New Logo Customer $, Annual or Quarterly	$\frac{\text{New Logo ARR}}{\text{Gross New Logos}}$	This metric looks at how many dollars each new customer is generating and is one that we like to look at as a proxy for average contract value.
Average Revenue per User (ARPU) $, Annual or Quarterly	$\frac{\text{Ending ARR}}{\text{Ending Customers}}$	Average revenue per user (ARPU) is another great metric to understand how much average revenue each customer is generating. It's also important to note the differences between user types (trial / POC customers vs contracted), as trial customers may be experimental and are more likely to churn.
Churned ARR per Churned Customer $, Annual or Quarterly	$\frac{\text{Churned ARR}}{\text{Churned Customers}}$	Similar to the above metrics, this is another measure of revenue efficiency per customer. However, this looks at dollars lost per churned customer to understand the dollar-size impact of lost customers.

Unit Economics: LTV, CAC, and Payback

Metric	Definition	Considerations
New ARR per New Logo Customer $, Annual or Quarterly	$\frac{\text{S\&M Expense}}{\text{Gross New Customers}}$	For any business, you want to make sure you are earning more customers than the amount paid to acquire them. There are many flavors of CAC - the most common being blended vs. paid CAC. While blended CAC looks at all types of channels including non-direct like content marketing, paid CAC looks at only total acquisition cost via paid channels. For companies with a longer sales cycle, we've also seen some companies use a "time-adjusted CAC" calculation where you offset the CAC as needed by the sales cycle (i.e. use S&M expense from -1Q) and just make sure to consistently track each quarter in addition to regular CAC.
Payback Period Usually in # of months	$\frac{\text{CAC}}{\text{ARPU x Gross Margin}}$	Payback period calculates the number of months needed to pay back any customer acquisition costs - effectively showing your break-even point. Either ARPU or MRR can be used when calculating payback period.
Customer Lifetime Value $	$\frac{\text{ARPU x Gross Margin}}{\text{Customer Churn Rate}}$	LTV is a key measure of unit economics that allows us to make sure that the profit we are getting from a customer over their lifetime (LTV) is greater than the cost to acquire a customer (CAC). The formula shown on the left is the simplest way to calculate LTV. However, there are many flavors of this calculation specific to your business (e.g., if you have long customer lifetime values and negative churn, etc.) so LTV is a formula we often see being tailored to the company's model and customer profile. The most accurate way will be to look at customer LTV on a cohort basis.

How should LTV/CAC be calculated?

LTV / CAC is a great ratio that gives insight into a company's unit economics. However, the calculation will often be very dependent on the company's business model, customers, and finance model. Below is an example of a simplified approach that we like to use when calculating LTV and CAC for a given quarter:

Inputs

- **Gross Margin**
- **New Users** (acquired in a given period)
- **Sales & Marketing Expenses**
- **ARPU**
- **Customer Churn Rate**

Calculations

CAC	Total S&M expense from prior quarter	÷	New users acquired this quarter	
LTV (Simplified) Most accurate way is to look at LTV on cohort basis	ARPU x Gross Margin*	÷	Customer Churn Rate	**Typical Targets**
Payback Period	CAC	÷	ARPU x Gross Margin*	**~12 months**
LTV / CAC	LTV	÷	CAC	**~3X**

* As LTV measures revenue, it's important to understand the actual impact on profit by factoring in gross margin. This is especially important when calculating your LTV/CAC ratio. Let's say your Gross Margin is 60%, CAC is $2k, and lifetime revenue is $10k. This would imply your LTV/CAC is 5x which looks great on paper. However, when you take into account how much it actually costs to deliver services (your gross margin), you realize that the customer is really valued at $6k. Your LTV/CAC ratio is actually closer to 3x.

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FCF Margin & Rule of 40

Metric	Definition	Considerations
FCF Margin %, Quarterly or Annual	$\frac{\text{Free Cash Flow}}{\text{Revenue}}$	Free cash flow (FCF) margin measures FCF as a percent of revenue, a measure of profitability. FCF is defined as cash flow from operations less capital expenditures. There can be variability in FCF Q/Q so EBITDA is another important profitability metric that can be used as a proxy.
Rule of 40 %, Quarterly or Annual	Revenue Growth % + FCF Margin %	The Rule of 40 is a rule of thumb that measures your tradeoff between growth and profitability; a high-performing software company should generally meet or exceed 40%. Both revenue and ARR growth can be used for Rule of 40, but revenue is most commonly used. While either FCF or EBITDA margin can be used in the Rule of 40 calculation, we typically prefer to use FCF as it is ultimately what drives value for all companies. We typically only begin to place real weight against Rule of 40 metric for companies with at least ~$25M in ARR or annual revenue.

Burn & Runway

Metric	Definition	Considerations
Burn Multiple Ratio	$\frac{\text{Net Burn}}{\text{Net New ARR}}$	Burn multiple is one of many ways to measure capital efficiency - a metric that becomes increasingly important in the current environment. Other ways to look at this include the hype ratio (capital raised / ARR) or efficiency score (net new ARR / net burn). We prefer the burn multiple because the metric focuses on how much is being burned to generate each incremental dollar of ARR. We typically use FCF as the burn metric, but EBITDA and operating income can also be used as a proxy. A burn multiple under 1.5x is generally a great goal for companies to strive toward that are experiencing strong growth.[1]
Cash Runway Usually in months or years	$\frac{\text{Cash Balance}}{\text{Annualized FCF}}$	Visibility into cash flow is critical for any business. Runway defines how long your business can keep operating given available capital and current pace of burn. Tracking runway (usually in terms of months or years) allows leaders to keep an eye on burn rate and understand when cash infusions are next needed.

[1]Based on ICONIQ network perspectives and quarterly financial and operating data from our private venture and growth portfolio companies

Magic Number

Metric	Definition	Considerations
Gross Magic Number Ratio	$\frac{\text{Current Quarter Gross New ARR}}{\text{Prior Quarter S\&M Expense}}$	The “magic” of this metric lies in its ability to measure revenue generation against sales & marketing spend while accounting for the lag of a typical sales cycle in order to understand the efficiency of sales and marketing spend and teams at a more nuanced level. Timing used in the calculation may differ based on the length of your sales cycle (e.g., some companies may use last quarter or an average of past 2 quarters S&M) and it may also make sense to track magic number across different customer segments (e.g., SMB vs enterprise) if sales cycles are drastically different.
Net Magic Number Ratio	$\frac{\text{Current Quarter Net New ARR}}{\text{Prior Quarter S\&M Expense}}$	We typically find Net Magic Number to be the cleanest and most comprehensive view. Similar to gross magic number, net magic number looks at the impact of your sales and marketing spend against net new ARR (inclusive of expansion / upsell). Note: Gross and Net Magic Number calculations can be multiplied by a company’s gross margin % as well which will take into account the payback required to fully break even and helps normalize when comparing magic number benchmarks across different companies. This is especially helpful to accurately measure the GTM health of AI companies, given many AI companies have lower unit economics.

Headcount Productivity & Efficiency

Metric	Definition	Considerations
ARR per FTE $, Quarterly or Annual	$\frac{\text{Ending ARR}}{\text{Total FTEs}}$	ARR per FTE is another measure of efficiency to look at how much ARR is being generated per full-time employee and is an effective gauge of whether you are burning too much compared to employee productivity or have an opportunity to invest further.
OpEx per FTE $, Quarterly or Annual	$\frac{\text{Total OpEx}}{\text{Total FTEs}}$	Similar to ARR per FTE, OpEx per FTE is a great benchmark to assess how much you are spending per FTE. While helpful to look at in aggregate, comparing R&D OpEx per R&D FTE, S&M OpEx per S&M FTE, and G&A OpEx per G&A FTE is also a quick way to identify where spend might be too light or heavy. Analyzing OpEx per FTE based on company scale is also important since earlier-stage companies tend to pay a premium for certain resources, such as AI talent.
Productivity Ratio Ratio	$\frac{\text{ARR per FTE}}{\text{OpEx per FTE}}$	The productivity ratio is a metric that looks at the total average revenue generated per FTE in comparison to the total employee expenditures. Generally, companies should aim to achieve a productivity ratio greater than 1x. [1]

[1]Based on ICONIQ network perspectives and quarterly financial and operating data from our private venture and growth portfolio companies

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How do I track success in the age of AI?

*AI adoption is quickly becoming a core determinant of company performance, not just a productivity tool or a set of experiments. The companies that win with AI are treating it as a **systematic capability** across product, R&D, go-to-market, and operations, with clear ownership and measurable progress over time.*

The AI Adoption Index is core set of metrics for companies that are building and adopting AI products to:

- **Create visibility** into how AI is actually being adopted across the business, not just what's being piloted
- **Put a stake in the ground on measurement.** While AI impact can be difficult to quantify precisely, not measuring it at all is a bigger risk. This scorecard forces explicit thinking about where AI is expected to drive outcomes and how progress will be assessed over time
- **Separate signal from noise** by focusing on a small set of repeatable, outcome-oriented metrics
- **Enable board-level discussion** that goes beyond "we're using AI" to *where it's driving value, where it's stalled, and what needs to change*
- **Track progress over time**, making AI adoption something the company deliberately compounds quarter over quarter

Sample Summary AI Adoption Index:

AI Product Success	**% Revenue from AI Products** *% Pipeline Influenced by AI Features (if no standalone product)*
	AI Product Revenue YoY Growth Rate
	% Customers Adopting AI Products
	% Customers Paying for AI Products
	Competitive Differentiation Driven by AI Products (Management Self-Score, 1-5)
Internal AI Adoption	**ARR or Revenue per FTE**
	Total Employees
	% WAUs of AI Tools *Please choose mission critical tool (e.g. ChatGPT, Claude, newly approved priority tool for org)*
	Internal AI Maturity (Management Self-Score, 1-5)

Read more on the AI Adoption Index and function-specific metrics here

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