BOND&COMPANY

EXECUTIVE SEARCH AND RECRUITING

If you can't seem to take your business to the next level, it may be your financial information.

5 Analytical Processes That Will Make Your Business *Thrive* Rather Than Just *Survive*

By **Rich Bond**

Rich Bond

Rich Bond is a Wharton MBA who worked for Seagram for 11 years and ran a family business for two. In 1986, he founded Bond & Company, focusing on financial recruiting. Initially, Bond recruited for large public companies such as Pepsi, Nestle, and Black & Decker but now works primarily with small to middle-sized companies that are either privately owned or held in portfolios of private equity firms.

Over the years, Bond has seen the role of finance in many companies change from one of mere recording and reporting into that of a strategic partnership with management, helping the businesses to improve their profitability and grow more rapidly.

Bond calls what he does *Results-Based Recruiting* because he helps his clients hire and retain professionals who more than pay for themselves. He can share multiple cases documenting such contributions. **www.BondandCompany.com**.

5 Analytical Processes That Will Make Your Business *Thrive* Rather Than Just *Survive*

By **Rich Bond**

You have a solid business with a great product and/or a superior service but are still struggling to grow profitably or achieve the enterprise value you feel your business deserves. You have improved and expanded your product offerings and hired talented marketing and sales personnel, but your business is still *not* thriving.

Disappointing performance is often the result of relying on the same sort of financial information you received when the business was launched. The data only tells you what has happened. But you are *not* given any insights into how the results can be improved. As your business gets larger and more complicated, limited financial insight makes it harder to allocate resources optimally, which can choke growth and reduce profitability.

Actionable Financial Information = Better Financial Results

While better financial information can increase the value of your company, it cannot do so with inadequate products or poor staffing. A great controller cannot make a bad company grow, for example, but a weak controller can make it hard for a good business to grow and prosper.

Over the past 25 years, we have seen the dramatic difference actionable financial analyses have made in the growth and profitability in our client companies. Businesses we've worked with have used solid financial management and the analytical processes discussed in this paper to improve their profitability by 50% to 100%. One of our clients was able to use such analysis to increase his company's enterprise value and sell his business to a national private equity firm for much more than he expected.

Creating a stronger financial infrastructure will help you negotiate better bank terms, lower your audit fees, and significantly increase the value of your company, if you decide to sell it or bring in outside investors.

Getting actionable financial information normally requires the use of newer software, which has become much better and cheaper than ever before. A strong finance function will make use of such software and a variety of profit tools to undertake the 5 Analytical Processes that are crucial to business success. They are:

1. **Measure Customer Profitability**
2. **Use Operational Metrics**
3. **Take Control of Pricing**
4. **Identify Opportunities and Allocate Resources Effectively**
5. **Install a Financial Alert System**

Good financial management uses analyses to develop achievable, quantified strategies, rather than unachievable financial projections that are based on little more than guesswork. The 5 Analytical Processes examined in this paper are the basis of sound financial management. They are the same processes used by financial managers in public corporations with sophisticated finance functions. Today, a business of almost any size can take advantage of the 5 Analytical Processes, which can enable the organization to not only survive – but thrive over time.

5 Analytical Processes

1. Measure Customer Profitability

It's easy to identify your largest customers; all you have to do is look at sales. But sometimes, the largest customer or segment is the least profitable. Most businesses lavish attention on their largest customers, whether they are profitable or not. Profitable growth requires focus on profitable opportunities, not the biggest customers.

Are you leaving money on the table?

It is essential to establish the means to track customer profit contribution. A controller or CFO with the right tools can analyze each account to identify the various costs incurred by each customer, specifically in relation to meeting needs through product servicing, specific product customization, and/or discounting. Failing to do so can be like leaving money on the table. Here's how one company used this information to increase profits.

An electronics manufacturer got its start by selling to many small customers. As the company developed more sophisticated products, sales approached $10 million, but overall profitability lagged. The general manager replaced the bookkeeper with a controller who pointed out that small orders were 25% of sales but didn't add to the bottom line because they had the lowest product prices. Not only that, the company had to fulfill the small orders at night and on weekends, increasing costs. The controller recommended increasing prices for this segment, which led to a doubling of profits.

2. Use Operational Metrics

Business functions can be effectively managed only when they are *measured*. A good controller will track basic accounting metrics and compare them to the standards for the company's industry. The company's bank can be a reliable source for such standard metrics. For example, a standard measure for Accounts Receivable is the Days Sales Outstanding (DSO). If the DSOs are above average or are increasing, the controller can put programs into place to rectify the problem. A well-capitalized company can offer early-payment incentives that directly impact the bottom line. Another critical measure is Inventory and Supplies. What is the Inventory Turnover Rate – not just for the finished

$1 million in excess inventory was turned into cash.

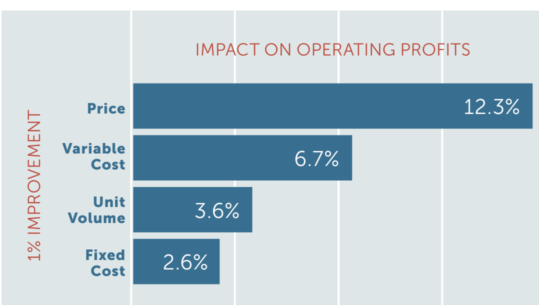
goods – but also for the raw manufacturing materials? To get a complete picture, the controller needs to measure Inventory Turnover by line item. Tracking the right metrics can enable a business to increase profits, free cash flow, and growth.

A $30 million manufacturing company, whose sales had stagnated, was able to study its inventory turnover in detail. The careful analysis enabled them to reduce inventory by over $1 million, while increasing the on-time order fill rate from 85% to over 90%. The additional working capital that was freed up helped the company grow sales to $50 million.

3. Take Charge of Pricing

Price changes are 2X – 5X more powerful profit drivers than volume, fixed costs, or variable costs. A Deloitte study shows a 1% increase in prices drives a 12.3% increase in profit. Businesses that fail to track and control prices can have an annual price erosion of between 0.5% and 1% per year, which translates into a 6% to 12% profit reduction.

According to McKinsey, over 70% of large companies essentially ignore prices. The percentage of smaller companies doing so is even higher. A company needs to track prices to effectively control profitability. In many instances, it is possible to increase prices over time, if a product has a strong value proposition that is communicated by the company's marketing and sales force. Pricing can be controlled by companies large or small. Here are some examples of the power of pricing.



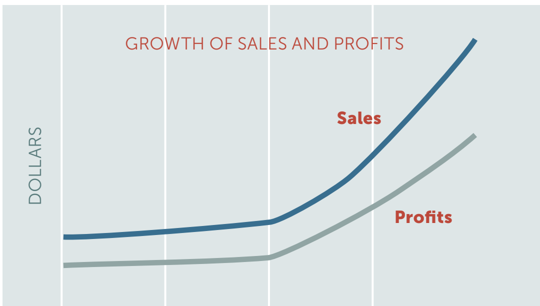
Source: Compustat, Deloitte Analysis from *Pricing and Profitablity Management*, 2011

Alarmed at falling market share, the salespeople at a submersible pump company asked management to lower prices so they could be more competitive and increase sales.But Management disagreed because a study showed that its $35,000 pump could operate twice as long between required maintenance shutdowns than its competitor's $25,000 pump. Each maintenance shutdown could cost up to $50,000. That meant the company's pump had a clear, quantified competitive advantage. As a result, the company raised the price and switched to selling the pump with a new value proposition based on the total cost of ownership. The new value-based approach resulted in increased sales and a recapturing of market share. Profits rose even more than sales. Lowering the price would have been a mistake, most likely leading to a "price war," which would have reduced profits and damaged the company's growth prospects.

One of our clients is able to charge a significantly higher price for their product because it is UL-certified, which allows their customers to buy insurance against possible catastrophe. Competitive products do not carry this advantage.

4. Identify Opportunities and Allocate Resources Effectively

Many companies are able to maintain growth using the same processes and strategies they have always used; however, those strategies often become less relevant or effective over time.



Taking a fresh look at the marketplace and available resources can have a dramatic impact. Performing a strategic assessment of the industry, the market, and available resources can reveal new opportunities that lead to dramatic profitable growth.

When I took over my family's 16-year old temporary help business, it had a great reputation. Annual sales were $2.5 million, despite having only a half-time salesperson. The business focused on selling our services to the "A" accounts. We had a 50% share of the big company market segment but only had a 10% share of the "B" market segment because we didn't actively sell to the smaller companies in our area. Realizing that the "B" segment was as large as the "A", we put together a plan to grow the business by penetrating the "B" accounts. We hired a full-time salesperson, relieved the half-time salesperson of her administrative responsibilities, and instituted a commission plan that paid four times more for new customer acquisitions. In two years, sales increased to $5.5 million, and profits doubled.

5. Install a Financial Alert System

Even high performing companies will encounter difficulties or setbacks. However, you can limit the damage – or even avoid it – by being able to read early warnings and taking appropriate corrective action. Financially sophisticated companies produce monthly statistics called Key Performance Indicators (KPIs). KPIs are generally four or five industry metrics that enable you to measure current performance vs. expectations or quantified goals. They are particularly useful when analyzed over time, as they can reveal trends that provide an early warning about developing, or even chronic, problems. KPIs allow management to take action to prevent profit shortfalls.

One of the most widely used KPIs is Gross Margin. A lower than planned gross margin can reduce profits by 10% or more. If a company catches this problem early, corrective action can be taken with price increases or by working with sales and marketing to improve the product mix and emphasize more profitable items. Some of the most valuable KPIs are business- or industry-specific. For example, in businesses where there is a lag between receiving an order and delivering or installing the product, a good measure of performance would be either orders or order backlog.

In one case, a company, which had significant production lead-times, was enjoying record quarterly sales and profits. Yet, the management delayed a major capital investment because they were concerned that the order backlog had declined for three consecutive months. Instead, they instituted saving measures. Within three months, sales for this company and its competitors had fallen by over 25%. This company weathered the industry downturn better than its competitors, preserved a solid level of profitability, and had fewer layoffs because their early warning enabled them to take action before sales declined.

Conclusion

Managing growth and profitability is not easy unless you have a solid plan and the ability to perform insightful and actionable analyses. Many private companies have not made the investment in either, and as a result, have a hard time achieving their goals. The 5 Analytical Processes outlined in this paper can work for any business when they are properly executed. The effectiveness of these processes will depend on two factors. One is the skill of the company's most senior finance person and his/her ability to work effectively with the management team. The second is the commitment by management to use analytics over time.

Managing growth and profitability is not easy unless you have a solid plan and insightful, actionable analyses.

Making the 5 Processes work is more of an art than a science. The analyses are effective when the management team works cooperatively. To be effective, people in the finance function cannot work in a "silo" or see themselves primarily as cost cutters.

Our knowledge of the financial talent pool, combined with our unique approach to recruiting, can save you a lot of time and help you hire a finance professional who can implement the 5 Analytical Processes and become your true strategic business partner.

BOND&COMPANY

EXECUTIVE SEARCH AND RECRUITING

227 Old Norwalk Road, New Canaan, CT 06840
203 221-3233 **richard.bond@bondandcompany.com**