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EXECUTIVE SEARCH AND RECRUITING

What Keeps You Up at Night?

- Running Short of Cash
- Missed Financial Projections
- Inability to Sell Business for What It's Worth
- Unpleasant Surprises

5 Financial Levers that Can Help Business Owners Sleep Better

By **Rich Bond**

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Observations from 40+ Years

Business owners and presidents of private companies tell me they love their independence and feel they are contributing to their community by employing local people. They literally glow when they talk about their businesses.

These same individuals also tell me their companies' financial results are often a disappointment and that they have too many unpleasant surprises. They wind up with too many sleepless nights worrying about what might happen next.

I have often seen companies with good people and strong products generate disappointing financial results because many of the operating decisions were based on the *wrong* financial input.

These companies made decisions based on what *had happened*, rather than what *will be happening* and how things could be improved.

Basing decisions only on historical information dooms an organization to making the same mistakes over and over.

Many large companies have developed financial levers that lift profits and increase enterprise value. The finance executives act as full strategic partners to the management team. Much of the progress has been enabled by better software, which is now available to companies of almost any size as the software has gotten better and cheaper.

As a recruiter, I have been able to help companies hire and retain financial professionals, who have enabled their companies utilize financial levers that increased profits and improved enterprise value, allowing the owners and presidents to sleep soundly at night.

Some of these successes are laid out in the 5 case histories that follow. Each case illustrates one of the most effective financial levers available.

Is your business running you?

Case Histories from 5 Privately Held Businesses

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.

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.

A company's largest (or oldest) customers are rarely the most profitable.

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 30% 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 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.

$1 million in excess inventory was turned into cash.

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. Provide Sophisticated Financial Information to Create Value

Every company wants to maximize its enterprise value, as it enables the business to finance growth or to be sold for a good price. Establishing enterprise value, even for a public company, can be a complex undertaking. When looking to raise outside capital or to find a potential buyer, you need to be able to gather and document detailed financial information. Sophisticated buyers require detailed statements, reports, and analytics most private businesses cannot provide. Not being able to provide this information will either kill the sale or reduce what the buyer will pay. That means you need to have the right financial software and a CFO or controller who can use it to generate the data and analyses required. The better the financial information, the higher your enterprise value can be.

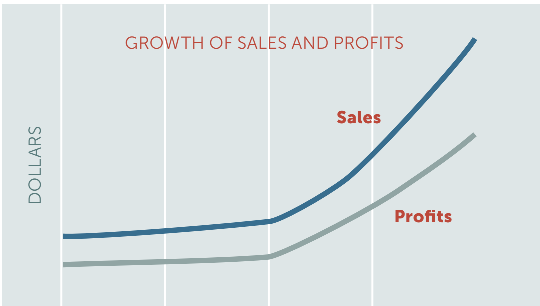
We were retained to find a replacement for the retiring controller of a company with sales of $120 million. Throughout the 10 years the controller had been in his job, company sales tripled largely through acquisitions. During the recruitment, the president, who was the son of the founder, told us that he had been approached by a private equity firm interested in buying the business. He said he wanted to wait to sell to make sure he got the best possible price. The individual we recruited had previously worked for two other companies that were sold to PE firms, so he knew what was needed. He worked with the executive vice president to install sophisticated financial analytics that helped the management team to increase profits and speed sales growth. When the founder's health was failing less than two years later, necessitating the sale of the company, it was sold for almost twice what they expected.

4. Invest Strategically in Your Business

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. Because we focused on selling our services to "A" accounts, we had a 50% share of the big company market segment but only had a 10% share of the "B" market segment. Realizing that the "B" segment was as large as the "A", we put together a plan to penetrate this new market. We hired a full-time salesperson, focused the half-time salesperson on sales, 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. We were able to sell the business back to the franchisor for the highest price they ever paid.



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

Finance done right is not a "one size fits all" practice. A good finance person needs to learn enough about the business he or she is working in to make meaningful recommendations.

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 Financial Levers discussed in this paper can work for any business. Their effectiveness 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 such levers over time. As the 5 case histories illustrate, financial management is more of an art than a science. Your finance people cannot work in a "silo" or see themselves primarily as cost cutters. An excellent financial team can actually become a profit center for your business.

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 use the 5 financial levers and become your true strategic business partner.

> **"If you think it is expensive to hire a professional to do the job, wait until you hire an amateur."**
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> **— Red Adair, American oil well firefighter**

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**.

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