Three Financial Problems to Derail Business Owners

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Business owners often get immersed in day-to-day operational activities and lose sight of key financial indicators that can impact the health and value of their company. Any good CFO will march through a checklist of items that, if managed effectively, can build value in the company and help it pursue profitable growth. Here are three financial problems that can derail business owners.

Dozing Off at the Cash Spigot

It's no surprise that cashflow is a core CFO hot button. Besides simply finding ways to boost cash, there are cash considerations that go well beyond the monthly bank statement and the cashflow forecast (if the business owner has one).

Is the business ***optimizing*** its cash management? This could mean being more selective on accepting a new client, a job, or buying equipment, all depending on the potential cashflow and ROI of the job or investment. The distress of fluctuating cash balances driven by seasonal trends can be forecasted and prepared for ahead of time, perhaps by identifying profitable opportunities to smooth variability and mitigate those dips. Similarly, if the business is flush with cash, is that cash being deployed for optimal return? An investment should return more than the company's cost of capital (a discounted cashflow analysis will help here), and not hijack working capital. And beware of investing in earnings-diluting activities (see below for more details). At a minimum, don't let that cash balance sit idle without earning ***something***, if you can help it.

If the business is tight on cash, does leadership know ***if and when*** it might run out? Run projections based on reasonable assumptions and consider risk-adjusting the results by 10%-15% to account for the unforeseen. Understand which levers can be pulled to increase cash: the company may be experiencing value erosion (more on that below), or might face working capital issues like aging inventory, bills being paid too soon, or idle assets to liquidate. Sometime, business owners don't fully know ***where*** the cash goes, stating "Revenue is higher and I'm not a wasteful spender, but what happened to my bank balance?" Think about how best to prepare to obtain financing from a bank or investors. Know what the bank wants to see ahead of time to make the credit decision easy for them, an approach that will also help nurture the banking relationship. Seek financing when the business is not desperate for money, and while financial statements are strong.

Value Eroding Behind Your Back

Are the company's products, services, and locations delivering profits that are accretive (rather than dilutive) to existing earnings? Key financial indicators that address this question include Gross Margin, the breakeven sales point, and EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) as a % of revenue. Wouldn't it be great to know your profit ***by client*****?** I find that plotting client margin on a bubble graph is often a revealing exercise. The results may encourage the business owner to revisit the client's pricing (raise price) or even drop the client.

Every business has a bottom line EBITDA as a % of sales. When resources such as labor, capital and other expenses are deployed in an activity that generates a lower EBITDA % of sales than the business as a whole, ***value erodes***. A business can't just "make it up on volume."

Every business should know its breakeven sales for products, services and locations. Slice and dice expenses into variable and fixed costs, then take those fixed costs and divide them by gross margin as a percentage of sales, to arrive and how much sales revenue is needed to achieve breakeven. Just remember, breakeven is not good enough! Strive to meet or beat your overall EBITDA % of sales and/or the goal set for the company. In fact, check industry benchmarks to see how the business stacks up against the competition, and determine why or why not the business is achieving that standard.

A Weakening of the Foundation

What indicators may be silently pointing to increased risk festering in the business? A "roll up your sleeves" CFO attack of a company's financials involves trending monthly historic data, preferably over two years of history plus the current year. Then run all kinds of ratios, such as gross margin, EBITDA % of sales, working capital measures such as inventory turnover, and much more. Update the spreadsheet with each new month's data. Why is this helpful? Seeing trends (plot them on a graph too) helps to reveal symptoms of problems that have yet to surface. Trends can also point to poor operating practices and a lack of oversight. Awareness of trends and what a solid number looks like will help the business owner routinely "inspect what he expects."

But history is just part of the story. A Company's systems should be "real time" enough to catch trend outliers as they happen. For example, in the restaurant business, a point of sale (POS) system can capture daily sales, average guest check value, waitstaff labor as a percentage of sales, overtime, and much more. Seeing a shift in these indicators can point to changing customer attitudes, dining behavior, the quality of customer service, and more. On a monthly basis, a prompt monthly close such as three days after month-end is also helpful to catch shifting business dynamics and provides flexibility to address issues before the current month adds to the problem.

At the end of the day, the business owner should take advantage of these financial tools to be aware of what drives value in the company, and how to spot shifting indicators that might compromise value, cash, and profitable growth. A CFO can help pull together the analysis and provide suggestions to drive the company forward and help to accelerate its growth.

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