



A Management Update from Your CFO for Rent

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Five Things Every Small Business Owner Should Know About the Business



As everybody knows, nearly everyone has advice for the small business owner, some of it sound, and some not so sound. But when all is said and done, there are a handful of basic financial questions that you need to always have the answers to, after you've put the monthly financials in the drawer.

If you have a trusted CFO, controller or financial advisor that looks out for some of these, that may be just fine, as long as the daily decisions that you make take these indicators into account – which means your trusted advisor must keep you informed.

Here is the list that gets my vote for the 5 most important financial questions. Notice we ask the questions but we don't provide the answers, because none of these are "one answer fits all" questions. Anyway, here's my list:

1. How much profit do you really make on each of your 10 largest customers? Why? Because the profit you make on those big customers determines in large measure the profitabil-

ity of your business. Consider how often they buy, how large their orders, and how well they pay. Those are the obvious things. But now consider also the special price concessions you might give them in appreciation for their business. Do you extend special services to them in delivery, warranty support, or other customer service?

Do you extend payment terms or wait longer before you call Accounts

This is rarely the
true cost of a
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Payable? Do you process special turnaround orders or accept smaller orders than you really want to?

Each of these extras cost your company money or time (that is, money) – both real costs of servicing that account. This is not to say you shouldn't do it, but know how profitable that account is in order to make the best decision for your company. The largest customer isn't always your

most profitable (check out "The Joys of Having a Gigantic Customer" in our Spring issue.) Are you giving those concessions because you're building a relationship that will pay off "later?" **Ask your customer when they will be willing to pay you more money tomorrow for what they pay less for today.**

2. How much does each product you sell really cost you? Why? Because if you lose money on every product you sell, it's really hard to make it up on volume. I am amazed at how many companies figure their all-important Gross Profit on a product by deducting from the selling price only the direct costs of manufacture or purchase. Often this is calculated for an entire department, or even entire factories, rather than for the individual product itself.

Unfortunately, this is rarely the true cost of a product you sell. Consider the costs to receive, package, warehouse, and deliver the product. How about servicing the warranty on its performance? The development

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cost if it's your proprietary product?

And then there's the overhead cost of running your plant or warehouse – costs related to having the facility ready and manned for your operations, from the lights and extra insurance to the stock pickers' wages to the janitorial service and the maintenance contracts on your equipment. If one of your products requires a disproportionate amount of overhead costs, an average overhead calculation for your company as a whole will never give you the right answer. **Your most popular item could be a loss leader without your even knowing it.**

3. How quickly does your inventory revolve, or turn over, during a year? Funny things happen to inventory that doesn't move out of your warehouse pretty quickly. It disappears. Or it breaks. Or it becomes old, obsolete, or generally unusable. Or it just gets misplaced or lost, to be found soon after you've bought more. Or the market price comes down and you have to mark it down to sell it. All of these results take money out of your pocket without giving you any benefit in return.

The first step in preventing all these things from hitting your bottom line is to know

how quickly your inventory turns and to note any changes in that rate. This is step one in preventing inventory losses, followed closely by refining the overall turnover rate to an item-specific turnover rate, at least for high cost items. Why the detail? Because expensive items that don't move may be hidden by fast moving commodity items on your floor that have much lower margins.

4. How quickly do your receivables get collected? This sounds like a no-brainer to most folks including, I'm sure, nearly all my readers. So, ask yourself this: What is the average days' sales in your current accounts receivable balance (often called "DSO")? Need to look it up? Hm-m-m-m. Too often we believe the concept but don't follow the practice. Collections get out of hand without our realizing it, because we're busy selling more and "managing the growth."

Consider this: Decide how much interest-free money you are willing to lend to your customers as a percentage of sales, and stick to it. Follow the trend of your DSO and take action when it starts moving in the wrong direction, unless strong margin gains are available in return for extending terms, and then do it deliberately, not accidentally. As a follow-up, watch your A/R ag-

ing trends as well, because old balances look the same as new balances in a DSO calculation, and it's statistically proven that the older those balances, the less of them will be collected.

5. If your business does what you expect it to, when will your cash reach its highest point of the year? The lowest point? And how much cash will that be, roughly? Everyone seems to agree they'd like to know those answers, in order to plan for short-term borrowing needs, or to explore investment opportunities in advance. And yet few small business people believe they can get the answer in any way that's reasonably reliable or cost-effective.

Many CEOs track cash flow by following net income and the bank balance, neither of which is going to be very useful in predicting future cash needs for most businesses. Capital asset purchases, growth in inventory, receivables and payables, debt service, capacity expansion – all can have a profound influence on future cash balances, and all are reasonably predictable with a little work.

If you don't have the answers to these questions, and that bothers you, it might be time to call for help. *We help. 310-645-1091 or 888-788-6534.*



Your CFO for Rent

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Financial management consulting, executive coaching, management audits, business planning, seminars, & workshops for management teams