Gene Siciliano

Multi-Vitamins For Your Business

So you own your own business, and you're pretty much the senior management team. You've looked at the economy and your company's marginal bottom line, and decided you need some preventive medicine if not a flu shot. You decide to call a management meeting to see what your team thinks can be done to keep you out of trouble. Your sales manager, plant manager, and controller all come with their best ideas, and you have to evaluate those ideas before you decide what strategy to follow.

Their suggestions:

- *your sales manager thinks you should lower prices so the sales team can sell more,*
- *your plant manager thinks you should borrow money and acquire the latest technology in manufacturing equipment in order to boost productivity,*
- *your controller thinks you should cut costs so that you spend less (although it may not be clear on where those cuts should come from).*

You know in your heart that none of these strategies is the magic bullet, but you don't have any strong answers of your own because you're too busy running the business. Let's see if we can help to focus your thinking. Here's how we suggest you evaluate your sales manager's idea:

Your sales manager's suggestion: Many sales people would rather see lower prices because it makes your products easier to sell – at least if they're selling based on *price* and competing based on *price*. But that strategy without careful thought can seriously dilute gross margins and damage the company's profits irretrievably. Competing on price will eventually reduce your products to a commodity where only the lowest price wins.

A better idea: Most surveys of customer buying motivation put price down the list of reasons buyers buy, after things like quality, reliability and service. Selling the attributes you are most proud of in your product – and teaching your sales force to sell those attributes – is much more profitable and with far less risk. As for proper pricing, there is a concept in financial accounting called Contribution Profit, which is roughly equivalent to selling price less variable direct and indirect costs. It represents the actual contribution to the company's bottom line that comes from making a sale. Until you know that number, approach any sales price reduction with great caution, and only as a last resort.

Your plant manager's suggestion: A dedicated plant manager who sees production efficiency as the ultimate path to profitability – not necessarily a bad idea when taken in context – may think the key to improved productivity is to acquire the latest technology in manufacturing equipment, even if it means borrowing money to buy the equipment. A good plant manager will want to produce the best product possible, with the highest productivity and the latest equipment. They will not typically grasp the amount of profit improvement or time it will take to pay for that expensive new equipment, and in honesty that's not an analysis that you would expect from your plant manager. But if you can't get that analysis done by your finance staff you shouldn't buy the equipment and a good banker is unlikely to lend you the money in any event, because they want to know that answer too.

A better idea: Effectively managing a capital acquisition program for your business requires an understanding of Return on Investment ("ROI") and its more advanced cousin Discounted Cash Flow ("DCF"). These tools will tell you whether or not that new equipment will pay for itself in 3 years, or 5 years, or 20 years (by which time you may not care). A comparison of what you'll pay out with what you'll save in productivity gains, adjusted for the time value of money, is the magic that should guide such decisions. If you know it, your banker will be impressed and likely glad to lend the money. If you don't, your banker will try to estimate it for you, and will likely add something to the interest rate to compensate for the added risk of lending to someone who doesn't realize how important such decision making tools are to your business.

Your controller's suggestion: Controllers and accountants in general are trained to recognizing the value of cost cutting as a way to boost the bottom line. They will tell you that a dollar in added sales will add only a fraction of a dollar to your profits, while a dollar in cost reduction adds a full dollar to profits. *And they'd be right*. But that doesn't make it always the right answer, and often it's actually the wrong answer. Cost cutting solely to avoid spending money is likely to cause more damage than good because it's focused on the wrong problem.

A better idea: A client company we worked with some years ago had avoided replacing collection department staff turnover in order to lower labor costs and thus raise reported profits in preparation for selling the company under a profit-based formula. Yikes! A good example of a bad cost cutting idea. Instead we supplemented the remaining collection staff with strong collection professionals and in short order improved collections so much that we added $5 million to the ultimate selling price.

Cost cutting must be selective and is best planned in advance. Even in challenging times, e.g., a recession, prudent investing is often better than ill advised cost cutting. Develop a budgeting system that allocates your resources in the best possible manner, making spending decisions and setting key targets ahead of time, not when you're trying to improve next month's profits "on the fly." put your money where your budget – that is, your advance strategic thinking – says would be best for the company. Budgeting is not about cutting costs, it's about allocating resources in the best possible manner, based on thoughtfully considered choices.

It's sound management to get your team's views about important decisions. But recognize their thinking is based on their work experience, not yours. Take their best ideas and mold them to where you feel your company needs to go.

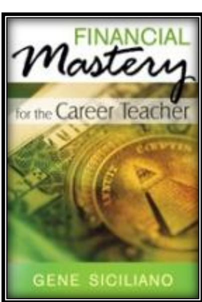
If you want an independent opinion from an outsider who's done a lot of profit improvement programs over the years, call us at 310-645-1091 or 888-788-6534.

Or e-mail me for more information.

Gene Siciliano, ***Your CFO for Rent®***

Finance for Non-financial Managers, 2nd Edition, McGraw-Hill 2014, covers 14 key topics in the increasingly demanding world of business finance. This new and significantly expanded revision includes a wealth of new material, following on the heels of the best selling original. Because managers can no longer afford to be non-financial.

Gene brings his extensive financial management acumen and plain language writing style to the world of personal finance with ***Financial Mastery for the Career Teacher,*** Corwin Press 2010. Written at the urging of an educational publisher, the guidance and strategies in this book will work for professional people well beyond the education industry.



Gene Siciliano is the founder and president of Western Management Associates, source of ***Your CFO for Rent*** ® services for over 25 years. The firm provides interim and part-time CFO/Controller services, executive coaching and guidance in operational finance and exit strategy. Gene and his team of seasoned CFOs and controllers have a clear mission in their work with CEOs and owner/operators of privately owned companies. Our value proposition:

- Increase the company's net worth and profitability by improving the management team's financial proficiency and bottom line results, and
- Develop and execute strategies that will make your company more appealing to a buyer or investor, if and when the time comes for an ownership transition.

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