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How To Re-Evaluate Your Business During Difficult (Or Even) Good Times

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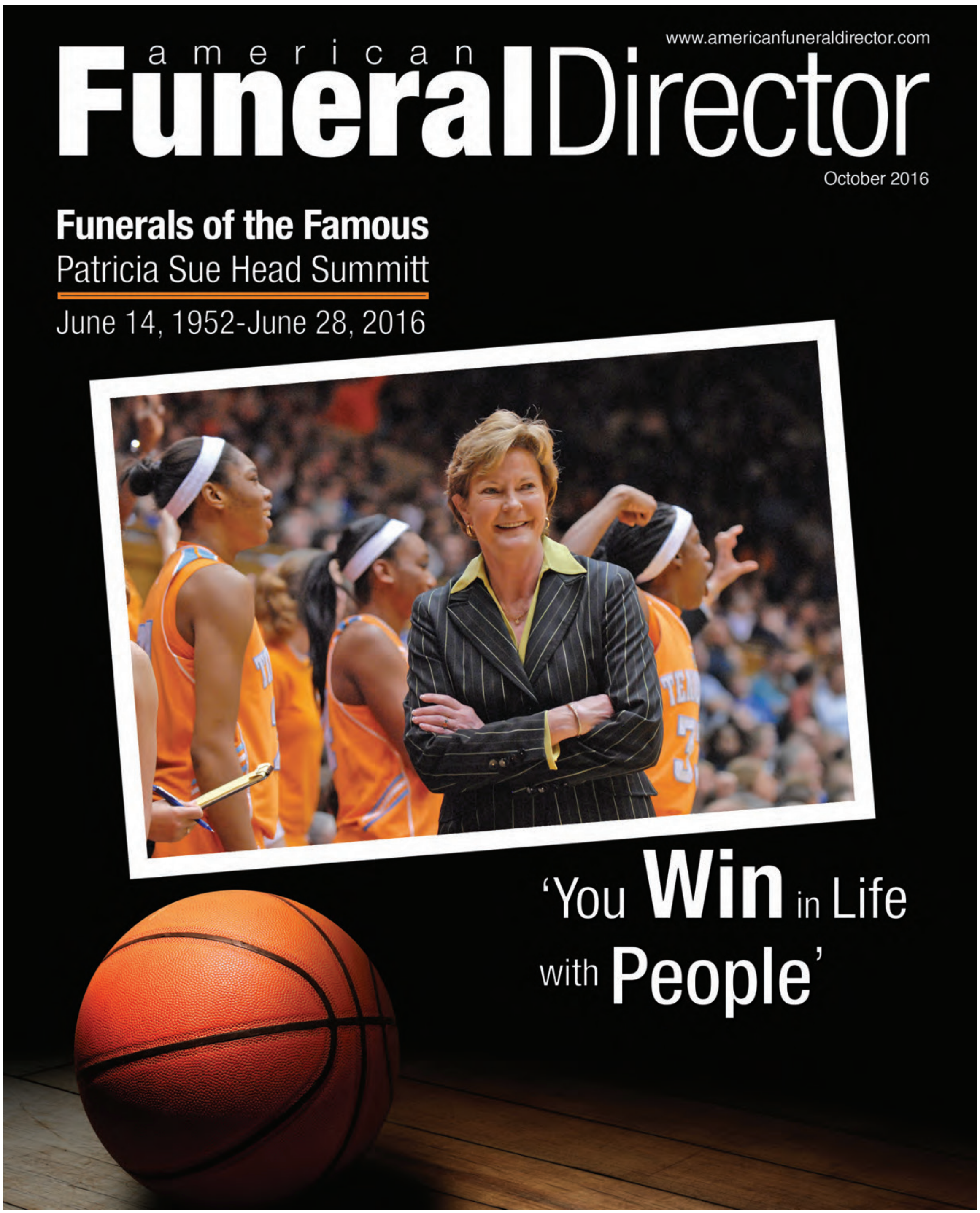

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Business

By Todd D. Mannix

How-to Re-evaluate Your Business During Difficult *(or Even Good)* Times

Financial measures are a tool almost any business uses to determine how well it is doing. Whether you are a manager responsible for a part or all of the bottom line, an entrepreneur who started a business or a multigenerational owner where the business has, or will be, passed off to you, you can use financial measures to understand how the business is doing.

Many small businesses simply use a profit-and-loss sheet. At the end of every month, or perhaps every year at tax time, they put all their income in one column, and all the expenses in the other – and the result is the net income (or net loss). This is probably the easiest measure to understand, especially when things are going well or running along smoothly. You work hard and business comes through the door and it always seems to come out OK. But what happens if, all of the sudden, it isn't going so well? In reality, it is never "all of the sudden." In almost every case, when businesses start to realize they are struggling, there are measures that can be used to understand what the changes in the company are before they get to the point where your income statements really start to reflect it.

One of my favorite reads in business school was "The Goal: A Process of Ongoing Improvement," by Eliyahu M. Goldratt and Jeff Cox. I liked this book, first because it was an easy read as it was the rare business-school book that was in novel format, and second because it gave solid and specific examples of understanding processes and improvements that could be applied to any business.

Recently, a business associate shared this book with me as a gift, and I revisited the lessons I enjoyed learning many years prior. The premise, as the title might allude to, is to first understand the goal of your organization. In the book's example, the character Alex Rogo manages one of many manufacturing plants for a large organization. As with many organizations, performance measures are often put in place to justify large expenditures or investments. In Rogo's plant, the company had purchased a couple of new robotic machines to help make the process smoother, increase efficiency and increase throughput. To justify the cost of these machines to upper management, they needed to be running around the clock, and the number of parts processed using these machines needed to be business. Furthermore, if you dive into the details of what specifically has changed, year over year you will be better equipped to understand movement in the industry. The more data you have, the easier it will be to see trends. For example, if a funeral home looks at its purchases over the last 10 years, chances are it will see a trending decrease in the number of caskets it ordered. The increase in cremation is a clear trend that everyone is aware of, but the example can be used for any other line item. Are more or fewer people preplanning? Are more families using the facilities or coaches for longer? Are there new items that are popping up on your books for things you purchase for a funeral that can point you to a new trend as to where things are going and what the consumer is looking for?

Cost of Customer Acquisition

Another useful measure is the cost to acquire a new customer. This is a little less specific than the year-over-year trend analysis, but it may give a company insight as to the impact of its marketing and community investment and how it translates into new customers. It can give you an idea of where your dollars are best spent should you realize you are serving fewer customers and would like to increase sales. You can look back at years where you spent more money on marketing to see if there was an impact versus years where you cut back on marketing costs. You can also do this for specific items you advertise, display or suggest to your clients. The cost of acquiring a single customer can be calculated by dividing the money spent on marketing by the number of customers you acquired in a specific period.

Operating Expense Ratio

Another useful measure to look at is how efficiently a company is managing the day-to-day business in relation to the revenue coming in. How much are you spending on utilities, building maintenance, landscaping and car washes — and are there opportunities to cut some of these costs to be more efficient? To calculate this measure, take total operating expenses and divide it by total revenue in a specific period. The lower the ratio, the more efficient your company is in managing expenses to generate new revenue. The operating expense ratio allows a business manager to determine if there are costs that can be shaved without hurting the customer experience or the bottom line. Can you or one of your employees do some of the yard work yourselves? If electricity is a large burden, installing energy-efficient light bulbs or switches that turn themselves off if there is no movement in the room can assist in bringing costs down. Generally what people find who have not looked at this ratio before, is that the changes do not have to be huge swings in cost savings. Generally, a few dollars saved in a number of areas add up and increase efficiency.

These are just three examples of measures some businesses use to evaluate and understand what is impacting profitability. There are many other metrics and even variations of these metrics that companies can use to really understand what is impacting business the most. When determining what measure to use or how to make modifications to your business, it is important to stress that the goal should always be kept in mind. This is a service business, and it is a community business. You do not want to cut costs, for example, to the point where customers feel a negative change. You could be smart for today in saving a dollar, but if the customer has a negative experience, it will cost you more in the future. The goal of the organization, no matter what business you are in, is essential to keep in mind as companies use these and other metrics to really understand their business, perhaps in different terms from which they are accustomed. •