

Business Effectiveness Analysis Case Study #1

Aspire Business Development's Business Effectiveness Analysis provides “what if” scenarios to preview your businesses’ future financial performance and answer questions like these:

- Do we have enough cash flow for next year to **make my loan payments**?
- How do I **compare to others in my industry** on critical financial measures?
- How much will it improve my cash position to collect receivables faster?
- What would be the impact if I improved my **inventory turns by 10 days**?
- What changes could I make to increase profitability and growth?
- If I increase sales by 5%, what does this **mean to my bottom line**? Cash flow?

Here’s an example of how this analysis can have a significant impact on your business.

DesignCo Overview: DesignCo is a fairly successful engineering design company with 46 employees. Last year they had sales of \$5.4 Million with a net profit just over \$200,000. Using the Fintel Analysis tool to compare DesignCo to other Engineering Design companies of their size (over 1300 companies with their industry code in the medium size category are in the database), at first glance they appear to be in pretty good shape.

Here’s a look at where they compare to their industry average (for their size) on their income statement.

Income Statement	<u>Company</u>	<u>Industry</u>
Net Sales	\$5,403,625	\$5,403,625
Gross Profit	\$3,049,280	\$2,971,464
Operating Profit	\$404,637	\$217,058
Net Profit After Tax	\$209,381	\$132,171

DesignCo is a little more profitable than the average. However a look at the Balance Sheet comparison raises a bit more of a red flag:

Balance Sheet		
Cash	\$12,295	\$135,325
Accounts Receivable	\$1,596,436	\$875,464

They’re carrying a lot more Accounts Receivable and they’re low on cash. It’s not shown here, but the rest of the Balance Sheet indicates that DesignCo is also carrying more debt than the industry average resulting in a Net Worth of about half of the industry average for their size.

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Cash Flow Concerns?

The Fintel analysis process uses something called Net Balance Position (NBP) to reflect the projected health of cash flow for a company. Essentially NBP is the working capital available for the year less the working capital required; a negative number indicates you're likely to have a cash flow issue. One of the inherent assumptions is that you're projecting forward using the current year's financial statement, but unless you've made a significant change in how you do business, it's a reasonable planning approach.

Below is a view of DesignCo's Net Balance Position, which as you can see doesn't paint a very pretty picture. They're projected to be short on cash by \$580,000 and they are off the chart (on the negative side) compared to their industry peers.

Net Balance Position Indicators

Your cash Net Balance Position is composed as follows:

Working Capital Available \$957,277

Less:

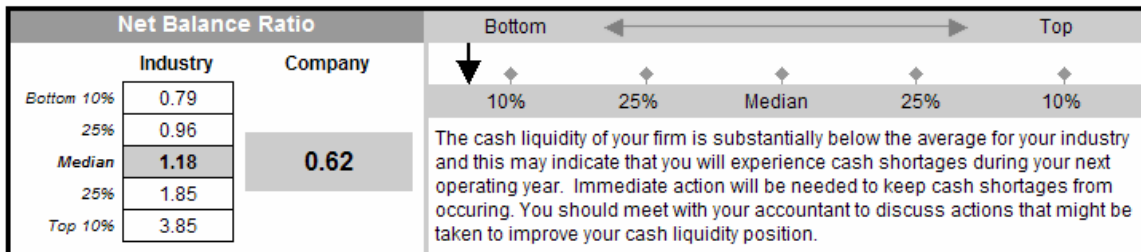
Working Capital Required \$1,540,238

Equals:

Net Balance Position (\$582,961)

Your cash liquidity position is negative for the next operating period. Corrective actions may be necessary or you risk being unable to meet short-term obligations. You should review the recommendations on the next two pages to help you develop a strategy to improve your cash liquidity position.

Taking the ratio of Working Capital Available to Working Capital Required, your Net Balance Position compares to that of your peers in the industry as follows:

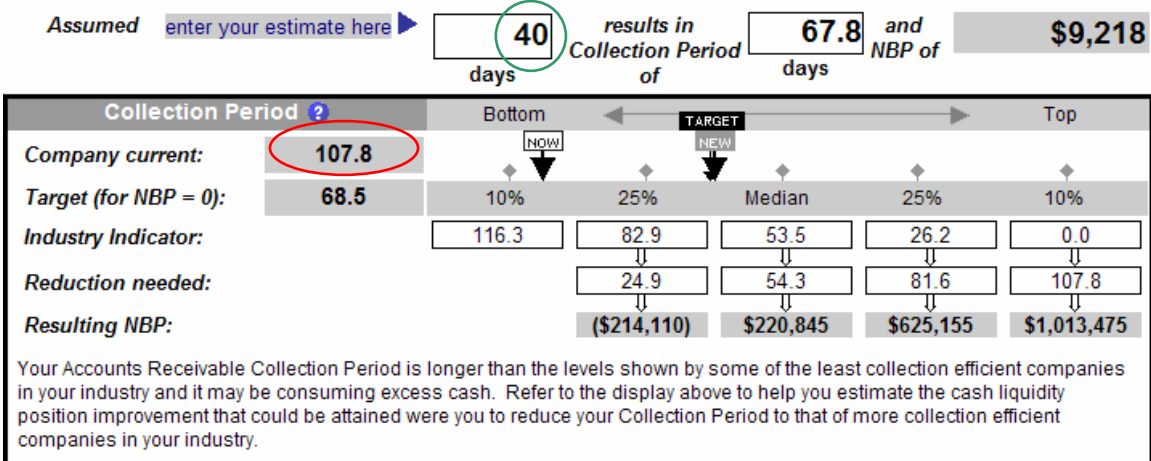


Identifying potential solutions for Cash Flow concerns:

Cash flow is primarily driven by how efficiently you manage your inventory, how quickly you get paid by your customers and how quickly you pay your vendors. For DesignCo, inventory doesn't apply, so the focus is really on the Accounts Receivable and Accounts Payable situations. Let's start out by seeing what reducing the A/R Collection period would do for the NBP of DesignCo.

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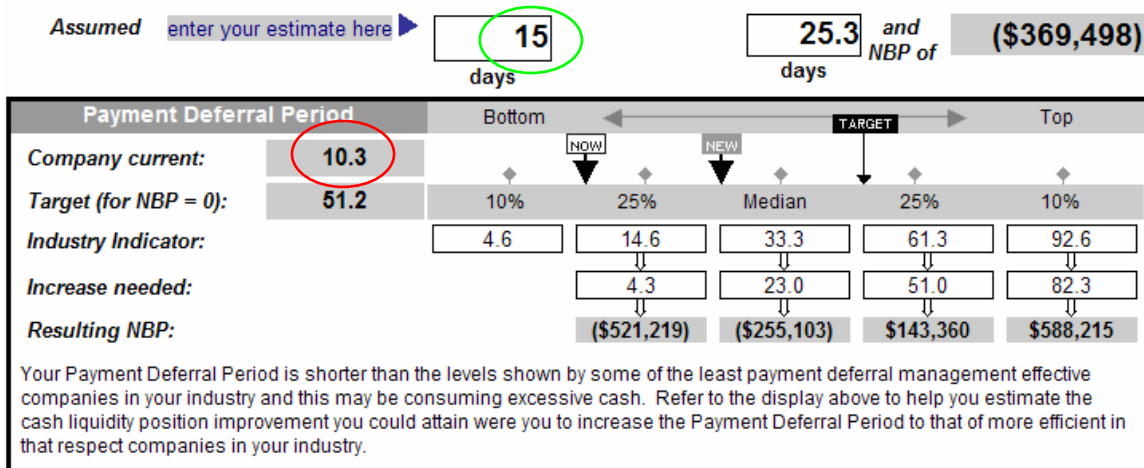
Method 2 Collection Period Reduction



The current collection period for DesignCo is at **107.8** days (top left of previous chart)! That's more than double the median collection period and obviously a big driver behind the cash flow issue. If we could reduce the collection period by just **40** days to 67.8 days (which is still worse than the median of 53.5) than the NBP goes from **(\$582,000)** to \$9,000 – a positive swing of almost \$600,000!!!

Using a similar approach with Payment Deferral (how quickly DesignCo pays their vendors), we can also see some room for improvement.

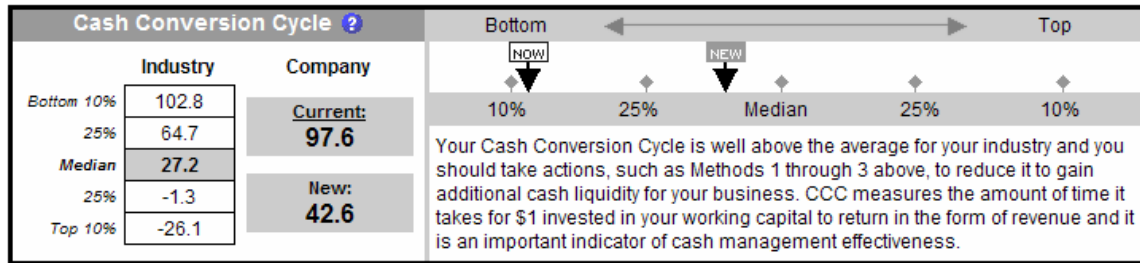
Method 3 Payment Deferral Period Increase



DesignCo had been paying their vendors in **10.3** days, well below the industry median of 33.3 days. Improving that number by **15** days to get us to 25.3, drops the NBP from **(\$582,000)** to **(\$369,000)** for an improvement of \$213,000, not quite as good as the collections fix, but still well worthwhile. Doing both of them together results in the following – still not quite at the median, but a much more tenable position.

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The following display shows your company's current position in Cash Conversion Cycle (CCC) in relation to your reference industry resulting from your performance in the above indicators and the new position that your company could attain, provided all three of the above methods are implemented at the rates specified.



Overall Effect

The results of the methods of NBP correction shown above are based on the assumption that each of them is applied separately, whereas a combination of them could be both more realistic and effective. If you find it possible to implement all of the above methods at the rates specified, the overall effect of that will be as follows:

Resulting NBP

\$222,680

That's interesting, but now what do we do?

Now the fun part starts: the Business Effectiveness Analysis will help you identify key areas that are impacting the future opportunities of your business. Using that data we will work with you to brainstorm ideas and identify a high level plan on ways to address the biggest problem areas. For DesignCo, the priorities are fairly obvious, but developing a plan to address those priorities likely isn't obvious (or it would have been done before).

Also, a plan by itself isn't going to solve anything, you actually have to implement change, which requires consistent action and follow-through. You can certainly make those changes on your own...or you could hire **Aspire Business Development** to give you the support and guidance you need to make difficult changes and reach the next level of success. Our 1 on 1 coaching/consulting service is designed for exactly this kind of situation. **Call us to see how we can help you implement your solutions.**

*Check out how **your** company performs against others in your industry!*

Contact us about a Business Effectiveness Analysis for you, this service provides you with the ability to **check your company's performance against its peers**. The information in Fintel's database contains **five years worth of financial information for over 900,000 privately held companies across 900 different industries...** yours included! Unlike other industry benchmarking information this database is largest of all private firm databases and updated annually.

Arrange for **Aspire** to create a custom report for you and to discuss analysis implications and impacts on your business. All for just \$495!



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