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Where do you really make your money?

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In the current tough economic and capital markets environments, small to mid-sized business are looking for ways to enhance investors' value. That can be done by answering the classic question businesses large and small are asked by smart investors: Where do you really make your money?

While most private companies produce some form of financial statements, which are an invaluable check on the overall health of the business, much detail is hidden in the numbers. Doing the analyses to answer this question and then figure out how to increase stakeholders value doesn't have to be difficult. It can be done on a sampling basis and need not become a huge, time-consuming exercise tying up staff and resources. Here are some simple steps to achieve this:

Start at the top line Break sales down by type of product or service, whichever is meaningful for your business. Then, break sales down by customer if your accounting system allows. The result is the "top line" attractiveness of your customers and your products or services: In other words, how much in sales each generate.

If the list is long and complex, you can start with the largest in each category and work downward as time and cost allow. Again, the analysis need not be perfect, only sufficient to be meaningful and useful.

Next, fully load these sales with the attendant costs to generate them.

Direct-cost loading Next, analyze the specific cost of goods sold for each product and each customer – by production labour and materials. Your accounting system may generate this automatically, or you may be using a standard costing formula that blends costs across all categories. In the latter, you may need to manually estimate specific labour input and materials costs. This will give you the “direct cost” of each major product or service and each major customer.

Full-cost loading This step requires looking at key non-production personnel, in customer service and inside sales, business development and management personnel, along with any position unique to the business. Ask them to break down their average day – what they do and for whom. It can be a pretty informal estimation and still be meaningful.

Then, look at the capital cost (in plant and equipment) to provide these products or services. This is a bit more tricky. Look for simplifying rules of thumb, such as the square footage of plant space used, or percentage of a particularly expensive piece of equipment. Getting this even remotely right will make your analysis more relevant.

This exercise gives a sense of which products and services and which customers are “high maintenance” relative to others. Or which have comparatively complicated or cumbersome supply chains and service models.

A first peek For each product, service or customer category created, when you combine their “fully loaded cost” with the amount of sales generated, you will have a good sense of where you make your money. The exercise can also suggest how you can rebalance internal resources toward the largest and lowest maintenance customers or products/services.

Often, this is a preliminary step to indicate where your attention should be focused on more extensive analyses. It can be done relatively quickly, because there is no forecasting, deep conjecture or market analysis required. It is all based on fairly objective experience and data.

Business velocity The core goal here is to increase the “velocity” of your business by getting as much revenue through your infrastructure at as little cost as possible in a fixed period.

Pruning the bottom end or “lowest velocity” customers or products/services, or at least repricing or reconfiguring the delivery of this business, can enhance profitability, free up internal resources and create additional financial flexibility to pursue new growth initiatives. All without the complication of raising outside capital.

This is akin to the GE model under Jack Welch, its legendary chief executive of the 1980s and ’90s, whereby all the company’s vast array of businesses and employees were analyzed in-depth on a consistent basis and the bottom 10% of each was chopped.

For smaller businesses, the analysis can be done on an ad hoc basis. Annually, would be sufficient for most and it can be as informal or as exhaustive as you wish. Even if your business is profitable, this exercise can uncover ways to enhance performance with minimal risk.

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