

Example Limited
Financial Performance Review
for the year ending 31 March 2010

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14 December 2010

Executive Overview

It is unfortunate, but true, that accounts prepared for tax or statutory purposes do not provide the information you need to properly manage your business.

To do that, you need to have management information systems in place that provide you with relevant information when you need it. And this *Financial Performance Review* is a great first step towards a management information system.

You'll find a great deal of information in this report. Information to help you make the right management decisions in your business.

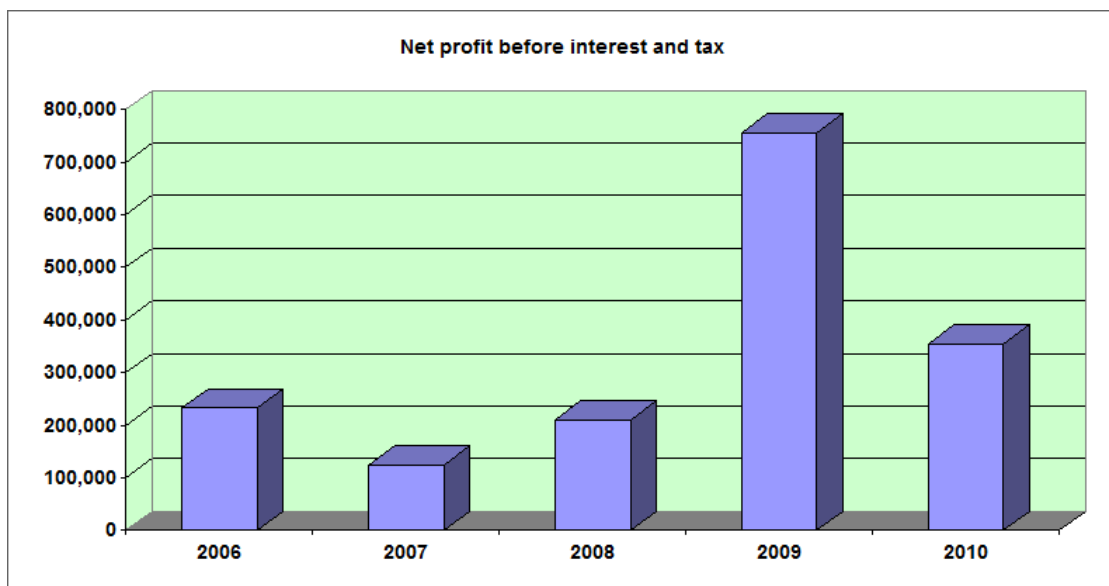
So read it carefully. And if there is anything you don't fully understand, please give me a call.

And let's start with a quick analysis of your performance in 3 key areas.

Clearly you would like your business to make money. And to do this you must increase each of your **net profit**, **return on investment** and **cash flow** at the same time.

Your **net profit** is what remains after deducting all the expenses you incur in running your business from the sales you make to your customers. You'll see later on in this review, you cannot manage net profit. But you can manage those elements that make up net profit. And you'll get a better understanding of how to do this in the section that covers your profitability.

But for now, the graph shows your net profit before interest and tax over the years.

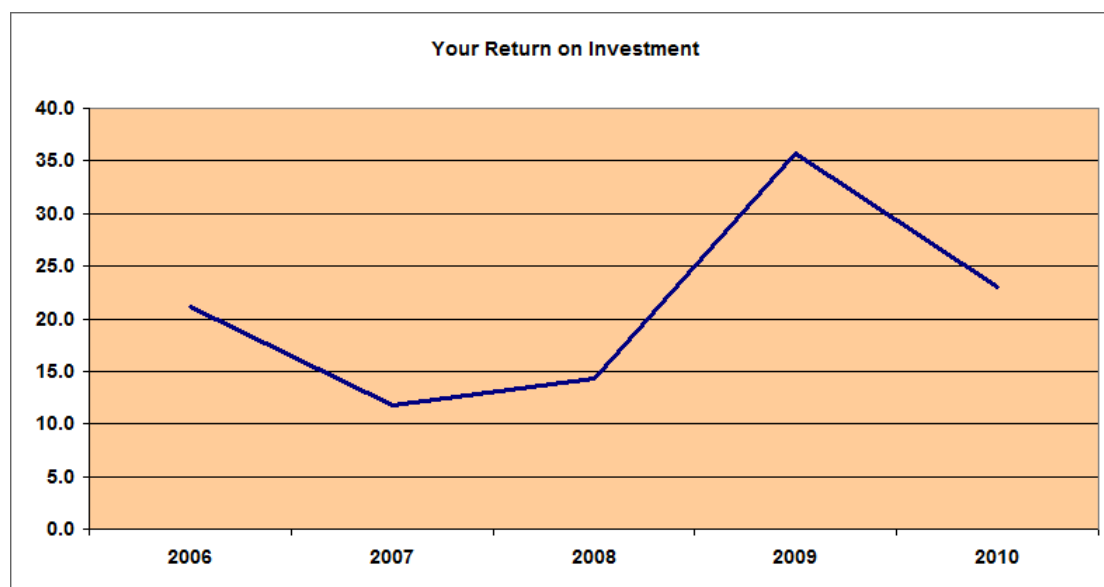


Your **return on investment** is the net profit return you receive expressed as a percentage of the assets you have tied up in your business. This is an extremely important measure; if the rate of increase in the assets is greater than the rate of growth in your net profit your business will eventually fail. This is regardless of the

amount of profit your business is generating.

And this is because the additional assets your business needs, over and above the net profit retained in your business, will need additional debt or capital.

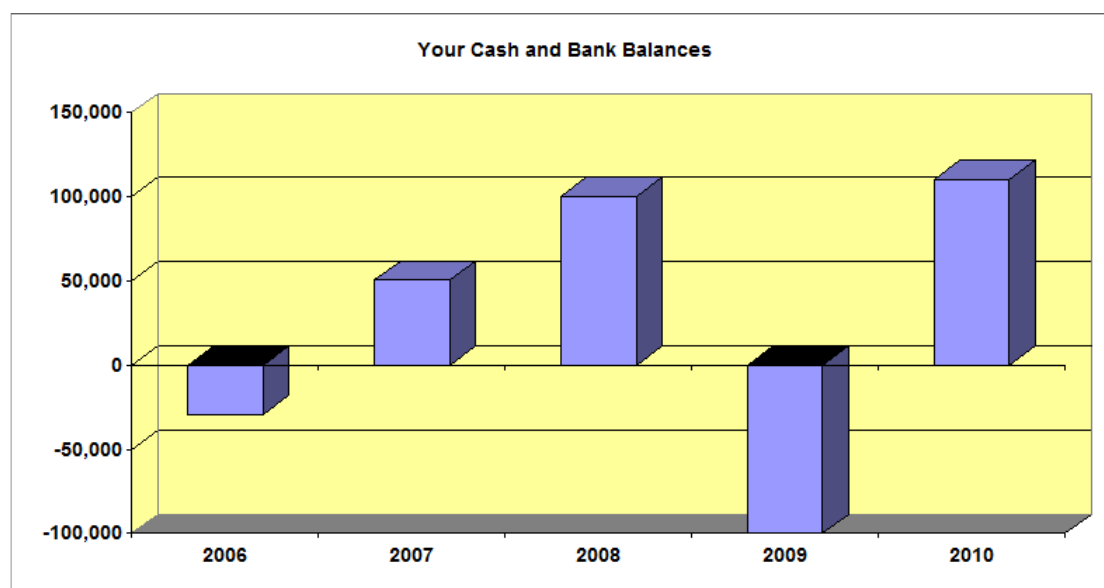
You'll discover why this is so important later on in this review. But for now, the graph shows your return on investment over the years.



And of course, your **cash flow** is the cash that flows into and out of your business. Cash flows into your business from, for example, cash sales, customers that owe you money, borrowings and the sale of equipment. Cash flows out of your business to pay for operating expenses, salaries, the purchase of equipment, repaying loans, tax and paying the business owners.

And it is vitally important to understand that cash flow and net profit don't necessarily go hand-in-hand. An unprofitable business can have good cash flow, but also a profitable business can have poor cash flow.

The following graph shows your cash and bank balances over the years.



So, for your business to be successful, you must get to grips with each of these 3 critical measures. You must work on improving all 3 simultaneously. And you must actively manage all three measures of your success.

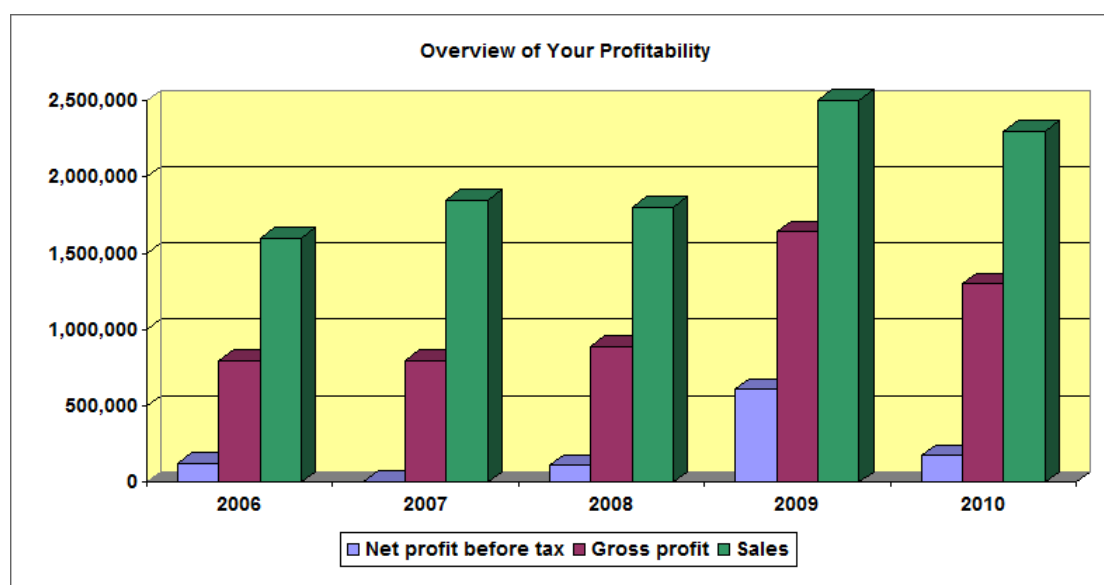
In this *financial performance review* we'll also look at both your income and your gross profit in much, much more detail.

Since your last accounts your sales have decreased by 8.0% to £2,300,000.

And your gross profit has decreased by 20.7% to £1,300,000.

After taking into account your overheads, financing costs and any other income you may have received, your net profit before tax (but this time, after interest) has decreased by 71.1% to £176,500.

The graph below summarises your performance in these 3 key areas over the years.



The pages that follow will look at your financial performance in much more detail.

You will discover the *Seven Key Growth Drivers* for growing your sales profitably.

You will get to grips with the different measures of profitability, how to analyse your costs in detail and how to manage your assets and working capital.

And you will discover why your return on investment can be a better measure of performance than simply profitability.

Throughout your *financial performance review* we will use ratio analysis to assess the performance of your business. We use ratio analysis because the size of a business is taken out of the analysis. And so it allows us to compare the performance of different sizes of business against each other. After all, we expect a larger business to make more profit than a smaller business. But it is much more important to understand how efficiently each business is using the assets each has available.

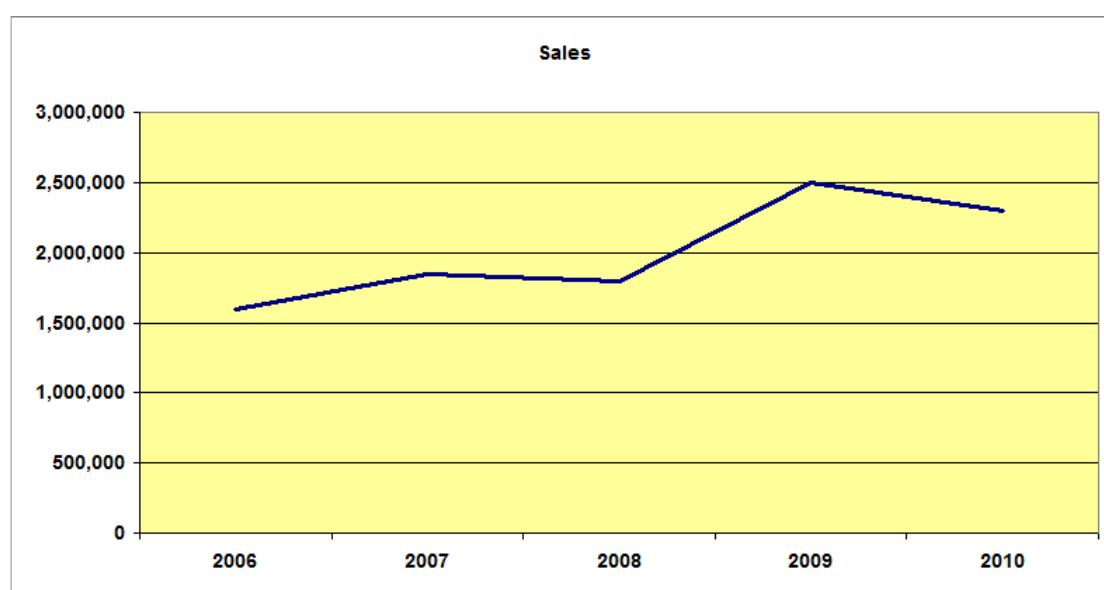
But an important note about ratio analysis. If you study ratio analysis you will see that there are subtle variations in the calculation of many ratios. And there are many ratios available that we won't cover here. In your *financial performance review* we have used the most common and useful ratios. And we have expressed them in their most common format. Of course, many of the subtle variations in the way they are calculated are equally valid. The important thing is that they are used consistently.

Your Sales

Since your last accounts your sales - sometimes referred to as *turnover* or *revenue* - have decreased by £200,000. This is a decline of 8.0% since last year.

For many businesses, growth is important. And sales growth is a great thing to aim for, provided it is profitable growth. But you may have heard the phrase, "*turnover is vanity, profit is sanity*". And so, if you want to grow your business we must get to the bottom of other key factors, such as profit margins and the impact that additional sales volume may have on your cost base.

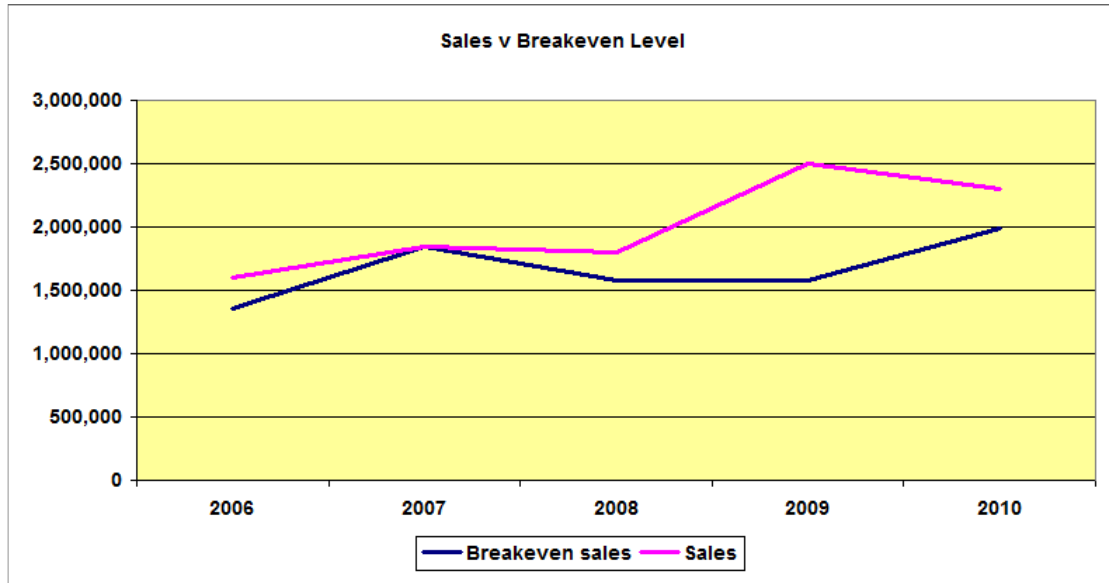
The graph below shows your sales over the years.



Breakeven Sales

Your breakeven level of sales is the level of sales you must achieve to show no profit or loss, i.e. the level of sales at which you will just break even. When you compare your breakeven level of sales with your actual sales it shows you the margin of safety you have. The bigger the gap between your sales and your breakeven point, the greater the level of safety there is within your business.

The graphical analysis below shows your sales against your breakeven sales over the years.



Key Growth Drivers

If you want to grow your business and you want to grow profitably, you must understand the underlying drivers of growth; called the *Seven Key Growth Drivers*. And these are...

- Pricing for maximum profit
- Getting more sales leads
- Converting your sales leads into paying customers
- Getting your customers to stay as customers for longer
- Getting your customers to spend more each time they buy from you
- Getting your customers to spend more often
- Increasing the effectiveness of your systems to make all these things happen consistently and effectively every single time

These *Seven Key Growth Drivers* are explored in much greater detail in our software tool, "*Simple Stuff That Works*". If you have not already seen this please give me a call. I know it will help you discover how to grow your business effectively.

The *Seven Key Growth Drivers* can be broadly categorised into 3 groups; the number of customers you have during the year, the number of times they buy from you on average during the year and the average amount they spend each time they do business with you.

By measuring each of these 3 components that make up your total sales, you will get a much, much better understanding of how you can improve your business.

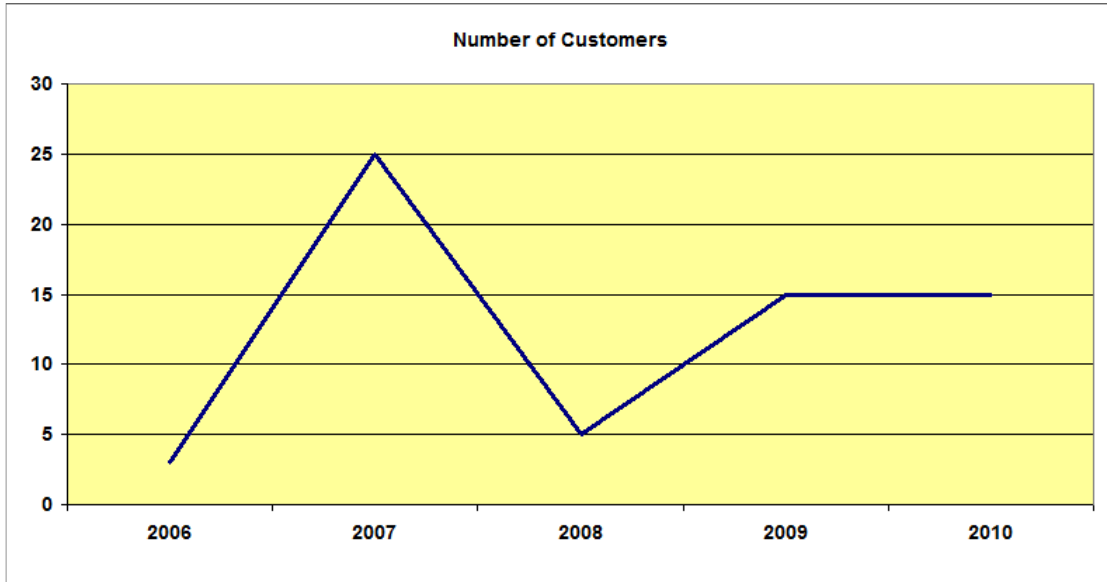
So let's look at each of these in turn.

Number of Customers

A change in the number of customers could reflect how well your marketing is working. It could also reflect your customer service levels. If your levels of customer service are falling, your defection rate will increase. In other words, customers will leave.

This year your customer base has decreased by 0.0% on last year.

If you want some great ideas for how to improve this area of your business please ask me about our "Simple Stuff That Works" software.

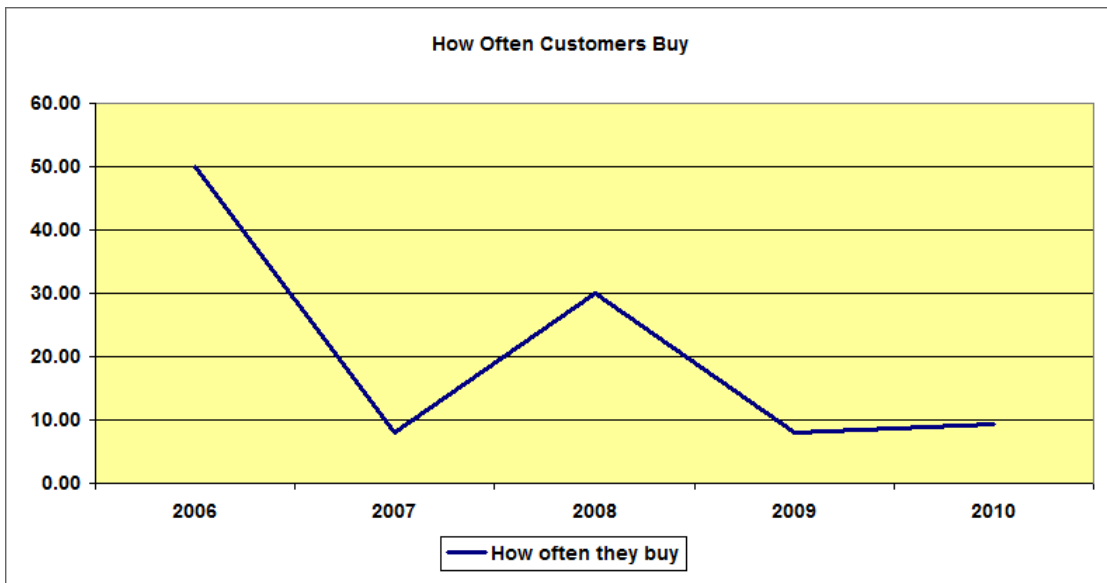


How Often They Buy

A change in the number of times your customers buy from you each year could reflect how well your customer contact program is working. It could also reflect your level of *perceived indifference* (i.e. the impression that you don't care). If customers feel that you don't care, they will buy from you less often.

This year the number of times that each of your customers buy from you on average has increased by 16.67% on last year.

If you want some great ideas for how to improve this area of your business please ask me about our "Simple Stuff That Works" software.

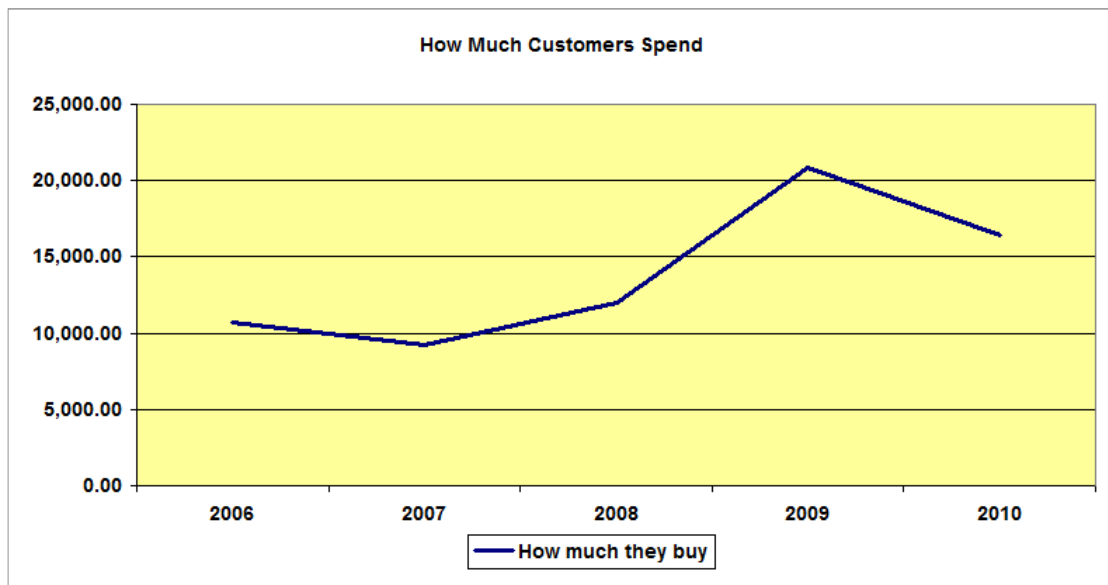


How Much They Spend

A change in the amount that each customer spends each time they do business with you could reflect a change in your pricing strategy. It could reflect the quality of customer you have. It could reflect the effectiveness with which your team are able to up-sell and cross-sell at the point of sale. And it could reflect a need for sales training for your team.

This year the amount that each customer spends each time they do business with you has decreased by 21.14% on last year.

And once again, if you want some great ideas for how to improve this area of your business please ask me about our "*Simple Stuff That Works*" software.



Your Costs

We've already said that your net profit is equal to your sales less your costs. So it would be logical to conclude that one way to increase your net profit is to reduce costs.

But this is wrong.

We must first understand why a particular cost arises in the first place and whether that cost contributes to the goal of making money. And remember, to do that it must contribute to increasing net profit, return on investment or your cash flow. So if that cost does contribute to that goal, then reducing that cost may have a detrimental effect on your business.

A great example of that is marketing costs. In hard times many businesses cut back on their marketing spend. And yet this cost is vital for increasing sales (providing it is spent wisely).

There are 3 types of costs in any business:

- Direct costs
- Activity costs
- Fixed costs

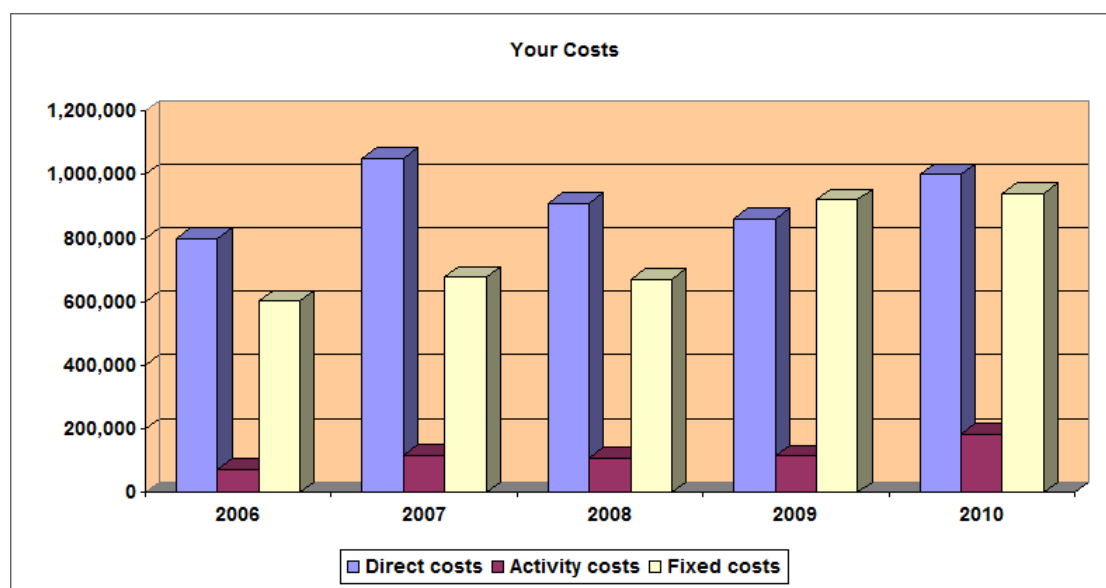
Direct costs are those costs that vary directly with sales (often referred to as *cost of sales* or *variable costs*). These include the *cost of goods sold* by a retailer and the *materials cost* of manufactured products. They will often be shown separately in your accounts.

But there is a second type of variable cost - known as **activity costs**. These costs - which are usually shown as overheads in your accounts - don't necessarily vary directly with sales. But they do vary with the level of *activity* that takes place within your business. These may include *telephone costs*, *motor expenses* and *bad debts*; since all of these may increase as the level of activity increases. Because they are often shown within overheads they are not easily identified without carrying out some further analysis.

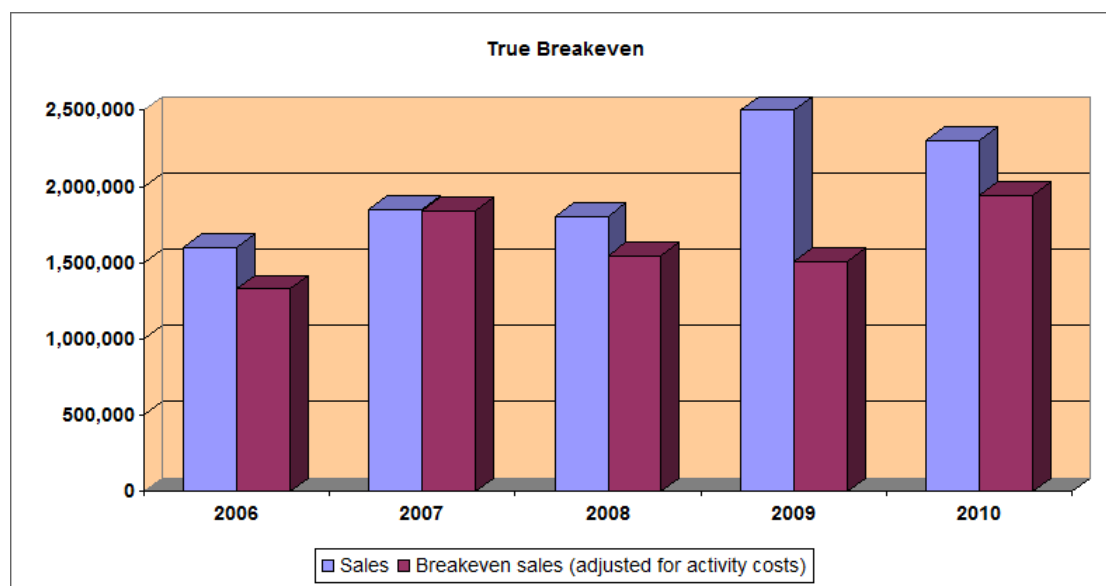
And finally, there are **fixed costs**. In the long run all expenses are really variable. In other words, as your business expands then all expenses will increase. But in the short term, there are many expenses that are fixed. For example, rent and rates are fixed in relation to your sales activity in the short term. But eventually, as your business grows, you will need larger premises, and so your rent and rates cost will increase as a result of an increase in your sales activity.

So we define a fixed cost as one that remains constant in the short term irrespective of the level of sales revenue or activity that is taking place in your business.

The graph below shows our best estimate of how your total costs for this year are split between the 3 types of cost.



Accounts that are produced for statutory and tax reasons don't break down your overheads between those that are fixed and those that vary with the level of activity (your *activity costs*). And yet for calculating a true breakeven level of sales and for performing accurate "what-if" analysis (which we'll cover later on in your *financial performance review*) it is essential to know what your total variable costs are. So for the purpose of this report, I have carried out a quick analysis for you based on my best judgement. However, I would recommend that we set up your accounting systems to report on this much more accurately.



Analysis of Total Costs

Since your last set of accounts your costs have changed as follows:

- Direct costs have increased by £140,000
- Activity costs have increased by £70,000

- Fixed costs have increased by £20,000

Your direct costs

If your *direct costs* are rising, that is not a cause for concern provided that your sales are rising at the same rate, or even faster. This is reflected in your gross profit margins, which is discussed in the section on your profitability.

But you can also measure the extent to which your direct costs are under control by looking at them as a percentage of your sales. And the lower the number the better.

Since your last set of accounts your *direct costs*, expressed as a percentage of your sales, have increased by 9.1% to 43.5%.

Your activity costs

As with your direct costs, if your *activity costs* are rising at the same, or even a slower rate, than your sales then that is not a cause for concern. You have these costs under control. We can measure this by looking at your variable costs as a percentage of your sales. And the lower the number the better.

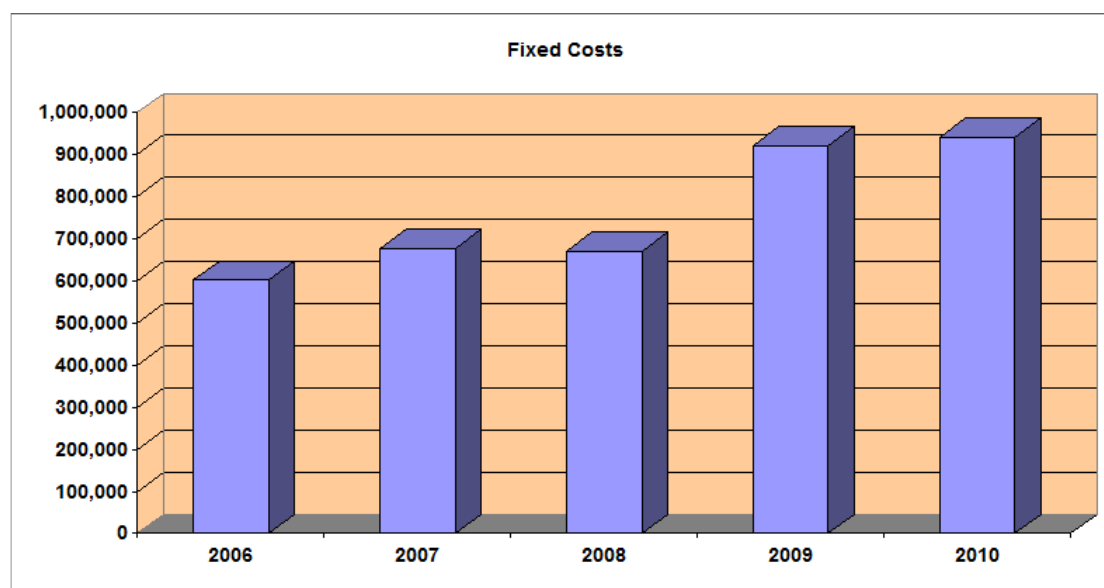
Since your last set of accounts your *activity costs*, expressed as a percentage of your sales, have increased by 3.44% to £185,000.

If either your *direct costs* or *activity costs* are rising at a rate that is greater than your sales, then these costs need to be investigated further to discover the underlying reasons.

Your fixed costs

And finally, if your *fixed costs* are rising, these need to be investigated in further detail to find out why. It may be simply an inflationary increase. It may be because you have expanded your operations. For example, moving into new premises. Or it may be that an element of those *fixed costs* are really *activity costs*. And if that is the case, it would be worth developing your management information systems to reflect this. This will help you with your forecasting.

The graphical analysis below shows the trend in fixed costs over the years.

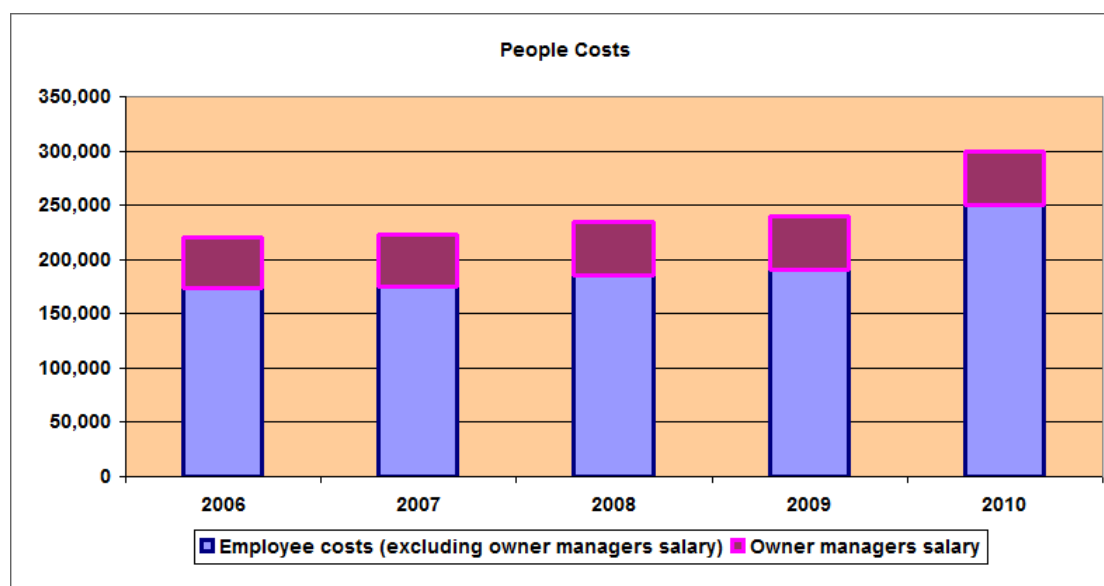


Your People Costs

For many businesses one of the most important costs and often the largest is the cost of the people that work in the business - both employees and owner-managers.

By owner-managers, we mean those directors in an incorporated business that are also shareholders. In an unincorporated business (sole traders and partnerships) the business owners do not draw a salary.

The following graph shows these costs over years.



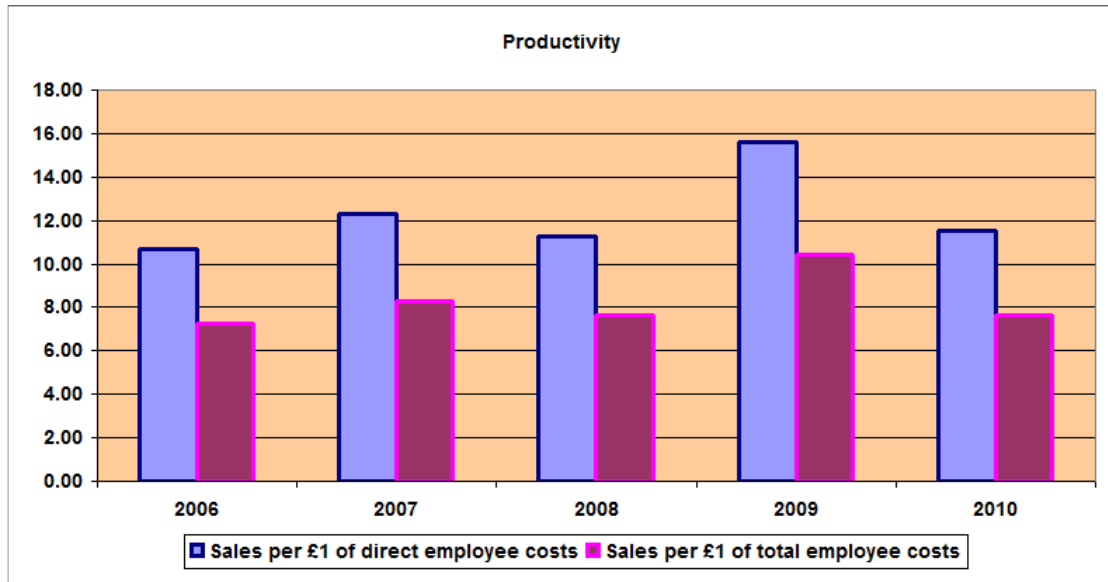
Productivity

We can measure the productivity of your team by analysing your sales for each £1 of direct employee wages. In other words, the productivity of those people who are directly involved with creating sales. And also your sales for each £1 of total employee wages.

These two ratios are a useful measure of productivity on your employee costs. A

decline may indicate that wages are increasing faster than sales. You may need to address sales productivity or your prices.

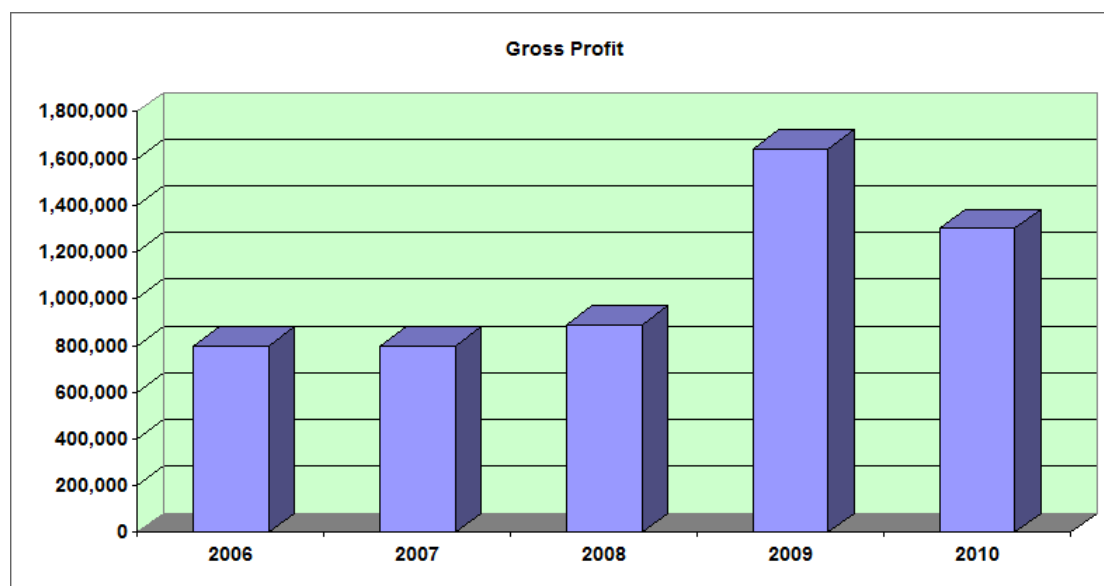
The following graph shows these two key ratios over the years.



Your Profitability

Gross Profit

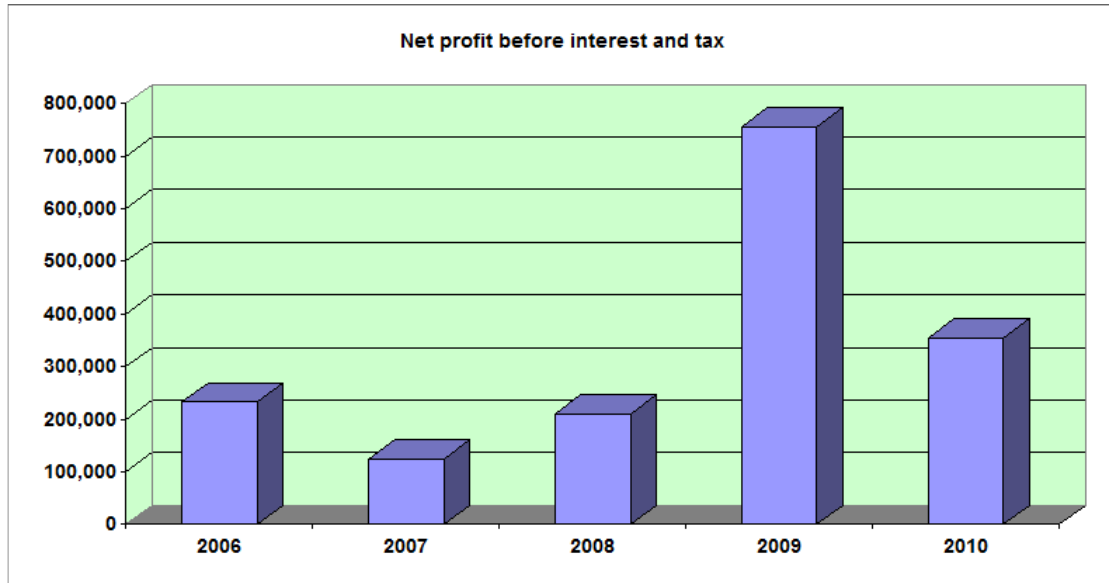
Since your last accounts your gross profit has changed from £1,640,000 to £1,300,000. Your gross profit is simply your sales less those costs that vary directly with your sales - often referred to as your *direct costs* or your *cost of sales*. In other words, your profit before deducting your fixed overheads and financing costs. And so your gross profit is what you have available to cover all the other costs you incur in running your business.



Net Profit

Since your last set of accounts your net profit - which is defined as your net operating profit before interest and tax - decreased by £400,000 from £755,000 to £355,000. Your net profit is simply the difference between your gross profit and your overheads, (after adjusting for other income).

Note: It is usual in ratio analysis to talk of net profit before interest. And so your financing costs - which may include bank interest, credit card interest, hire purchase interest and other loan interest - have not been taken into account in the graph below.



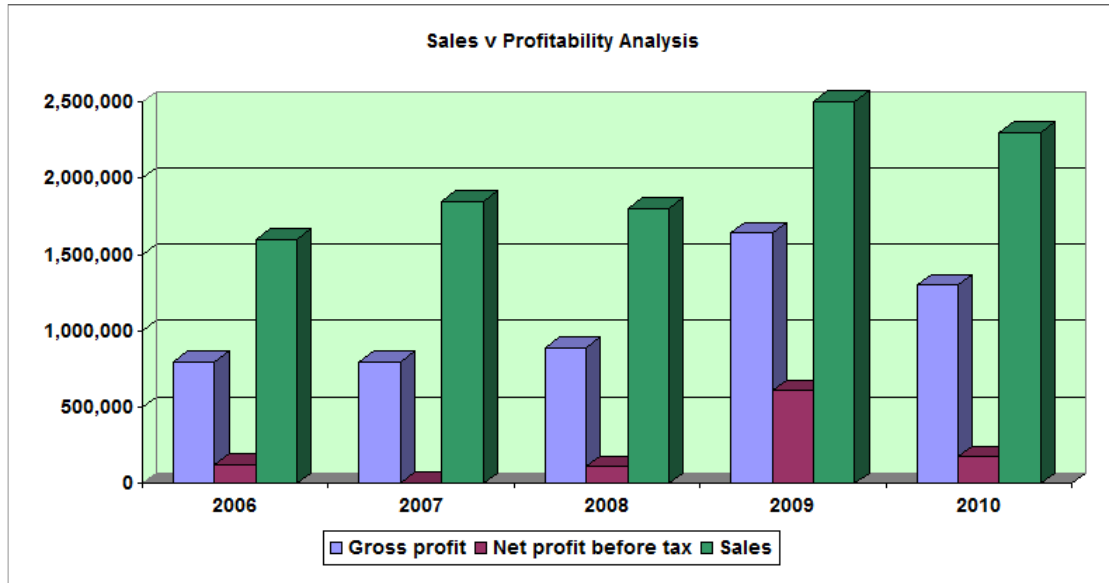
Remember, you **cannot** manage net profit. Net profit is simply what is left when you deduct your total costs from your income.

But what you **can** manage are the 5 elements that make up net profit. These are:

- The **price** you charge for the products and/or services you sell.
- The **quantity** (or volume) of products and/or services you sell - which depend on the other growth drivers we described earlier.
- The costs you incur directly in producing or buying the products and/or services you sell (your **direct costs**).
- Those overheads that vary with the levels of activity in your business (your **activity costs**).
- The costs you incur whether or not you make any sales (your **fixed costs** because they do not change with changes in sales volume... at least not on a day-to-day basis).

By understanding how the above factors interact with each other and putting appropriate strategies in place, it may be possible to significantly improve the profitability of your business.

The following graph shows your profitability over the years - both net profit before interest and tax and gross profit - against the level of sales you made.



Profit Ratios

Two important key ratios are your *gross margin* (often expressed as *gross profit %*) and your *net profit margin*.

Your *gross margin* is your gross profit expressed as a percentage of your sales. A declining margin can arise for several reasons. And since your last accounts your *gross margin* has decreased from 65.6% to 56.5%.

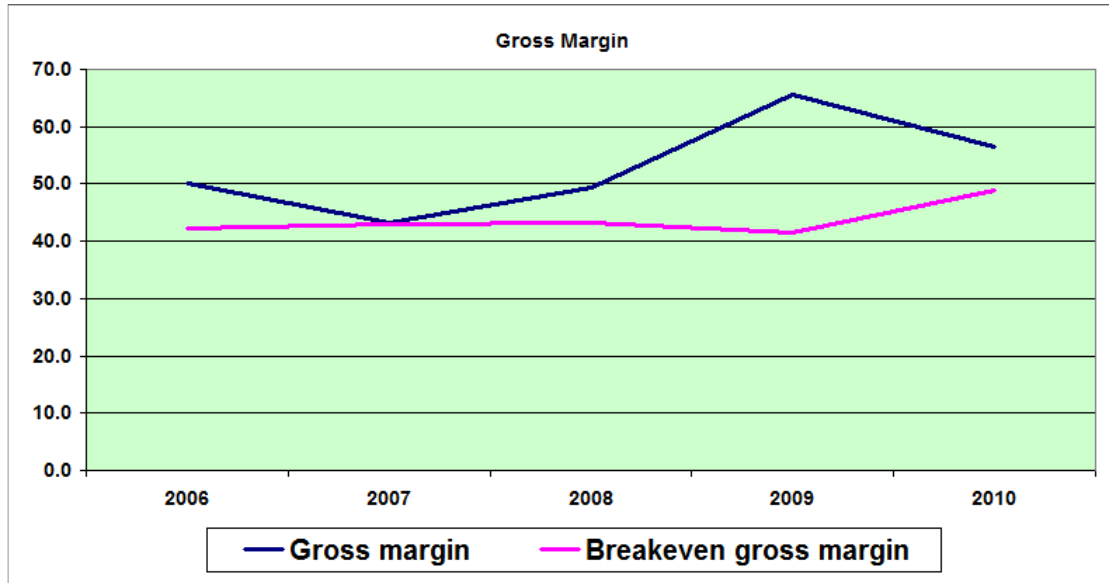
Your *gross margin* is an extremely important measure. In fact so important that we would recommend that you measure it by different product groups and even different customer groups. Because you need to know which of your products or services are the most profitable and which of your customers are the most profitable to deal with. And if you would like me to help you with this please give me a call.

If your margins fall then, unless you can improve them, you have to increase your volume of sales in order to maintain profitability. But this will put pressure on your business in other areas, particularly your cash flow.

Margins can fall for 3 reasons:

- You have reduced your prices without a corresponding reduction in your direct costs,
- Your direct costs are increasing faster than you are increasing your prices, or
- Your sales mix has changed as you switch the emphasis to lower margin products or lower margin customers. And this is why I suggest you measure your margins across different product or customer groups.

Another useful measure is your *breakeven gross margin*. And just like your breakeven sales, this measure will show you your margin of safety. The following graph shows both your *gross margin* and *breakeven gross margin* over the years. The bigger the gap between the two the greater your margin of safety.

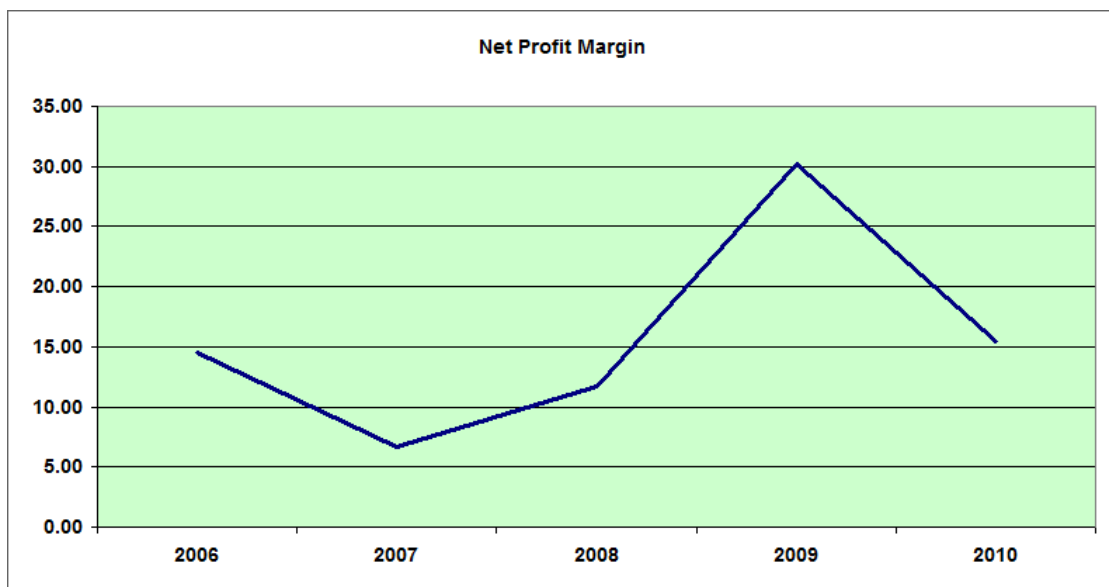


Your *net profit margin* is your net operating profit before interest and tax expressed as a percentage of your sales. It shows the proportion of your sales that is profit. And it reflects the efficiency of your business processes in terms of their revenue-generating outcomes.

But, as discussed above, you can't manage net profit. In fact profitability ratios tend to be less diagnostic because they only show the overall performance of your business. The other ratios that we will explore will look at the individual elements of your businesses activities.

However, your *net profit margin* is a good benchmark to evaluate your overall performance. Particularly when you benchmark yourself against other businesses in your sector.

The graphical analysis below shows your *net profit margin* over the years.



Your Cash

Liquidity Ratios

You've heard the expression "cash is king". Well it certainly is. Many profitable businesses have gone out of business simply because they did not manage cash very well. And the only way you can increase your cash flow is to control your working capital.

We use the term *liquidity* to mean the availability of cash. A liquid company has cash available. There are a number of key ratios that indicate your liquidity. The two key ratios that best show you how liquid your business is are the *current ratio* and the *quick ratio*. Both ratios compare your current assets and your current liabilities.

By current assets we mean those assets that can be turned into cash relatively easily; and they usually include your cash and bank balances, the amount of money you are owed by your debtors and any stock and work in progress. Your current liabilities are those amounts you owe (and which are payable within a year). For example, bank borrowings, trade creditors, tax liabilities and loan repayments due within the next year.

And the greater your current assets compared to your current liabilities, the safer your business should be. If on the other hand, your current liabilities are greater than your current assets your creditors (including lenders such as your bank) may lose confidence in your ability to continue to trade. They may ask for their money back more quickly. And to do that you would have to liquidate your current assets quickly. That may involve reducing your prices to sell off your stock and accepting discounts so that you are paid more quickly by your debtors.

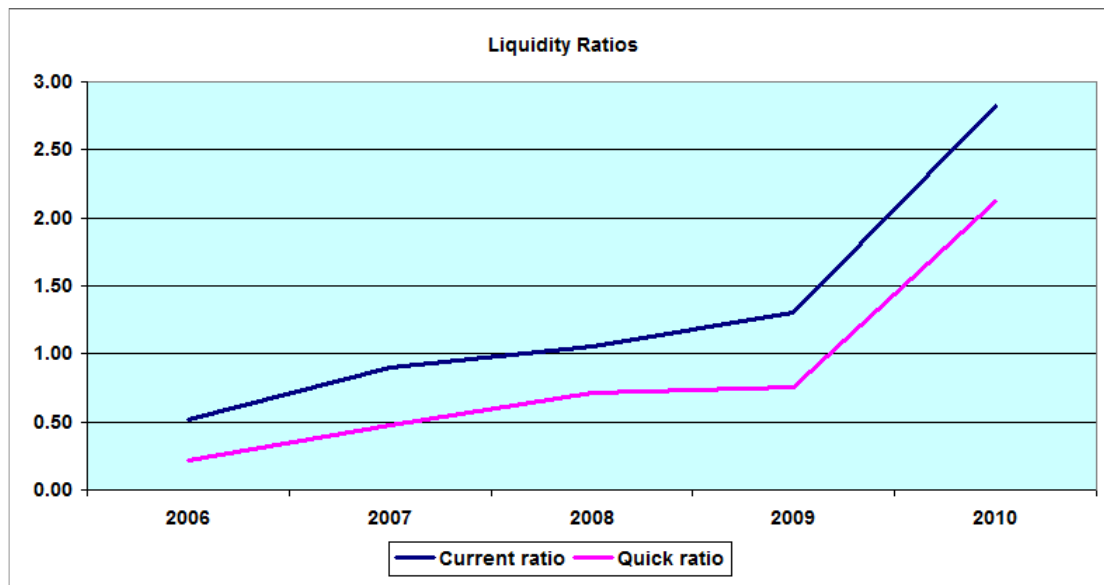
The *current ratio* shows the extent to which amounts that are due and payable within 12 months are covered by amounts, which are receivable within the same time. It gives a measure of short-term safety for your business. The higher the figure the better as it shows increased cash availability.

The *quick ratio* - which is often referred to as the *acid-test ratio* - is similar to the current ratio, but stock and work in progress (WIP) is excluded. And this is because it is much harder to turn stock into cash; particularly WIP. WIP must be turned into product first. Then it must be sold. And then the money must be collected. Therefore - by excluding stock and WIP - this ratio is much more closely cash related.

These two ratios are likely to be of very real significance to owner-managed businesses because the availability of credit could well depend on having current and quick ratios that are acceptable to lenders, such as banks.

And for both, a "good" ratio to strive for would be greater than 1.0.

These ratios for your business are shown on the graph below.

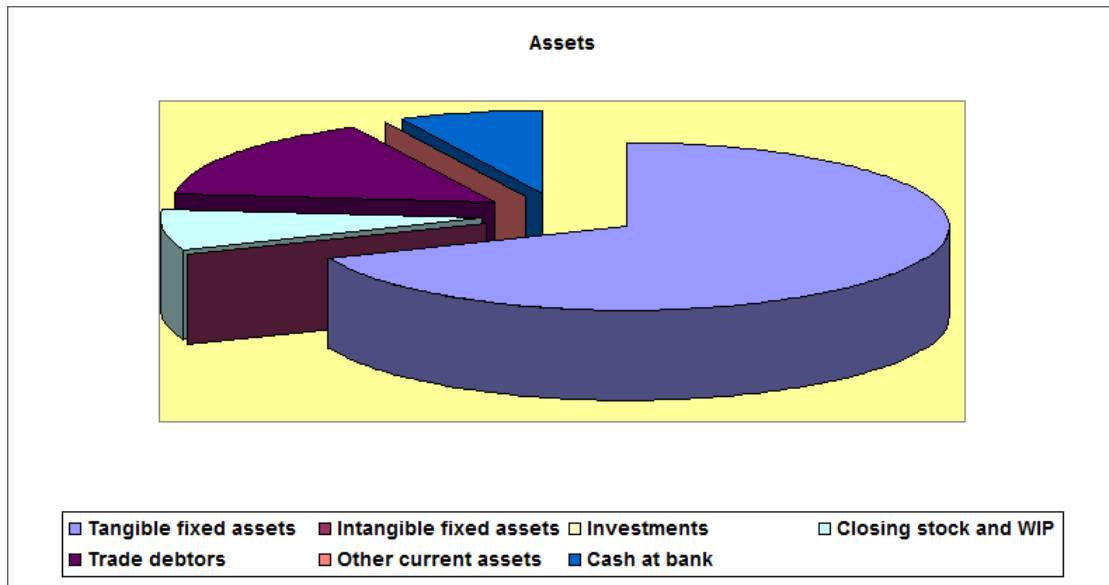


Your Assets and Liabilities

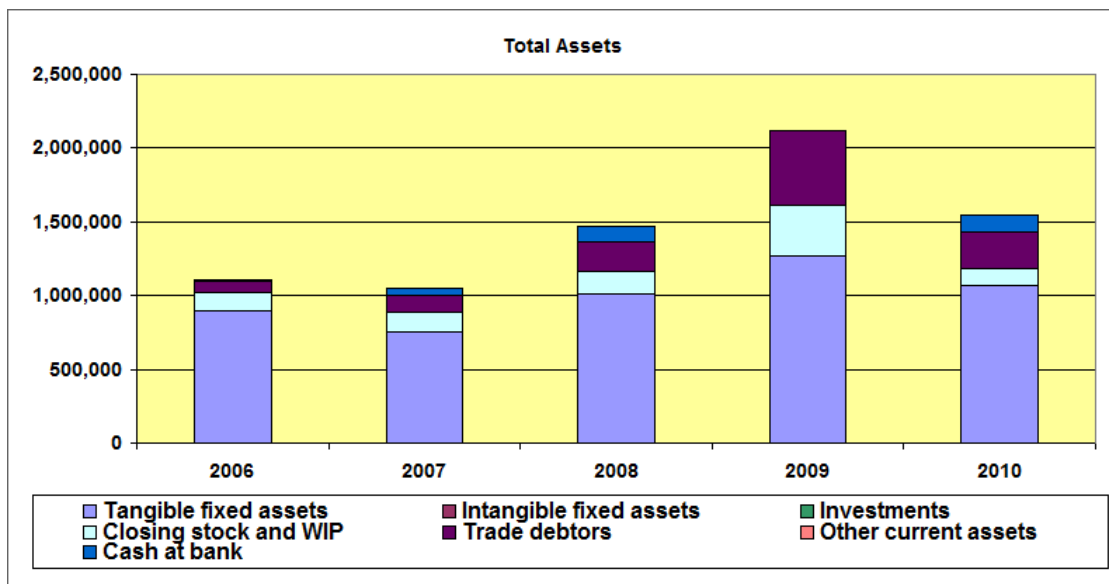
Your Assets

Your assets are made up of tangible fixed assets (e.g. equipment), intangible fixed assets (e.g. goodwill), investments, stock, trade debtors, other current assets (e.g. prepaid expenses), and cash and bank balances. The graph below shows the relative values of each of these as shown in your balance sheet.

Note that these values may differ from market values. This is often the case with land and buildings.



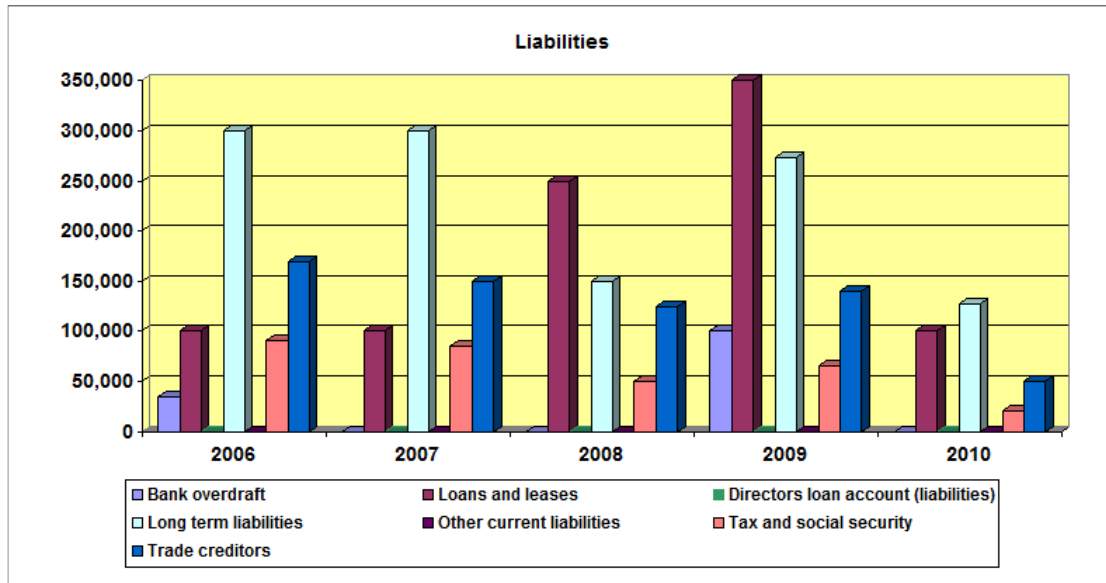
The graphical analysis below goes further and shows how your total assets are made up in each of the years.



Your Liabilities

Your liabilities are made up of bank loans and overdrafts, other loans (e.g. hire purchase agreements), trade creditors, tax and social security, other current liabilities

(e.g. accrued expenses), provisions and equity (which is shown on the bottom half of your balance sheet). The graph below shows the relative values of each of these as shown in your balance sheet.



Stock Turnover

It is important for your cash flow to turn stock and work in progress (WIP) into sales as quickly as possible. And so you need to manage the turnover of your stock and work in progress.

You can measure your effectiveness in this area of working capital management using the *stock turnover* activity ratio.

Stock turnover is the average number of days taken to turn your stock and WIP into cash. A higher rate of stock turnover (i.e. fewer days) will improve liquidity and is a sign that you are managing your stock efficiently.

However, a high stock turnover ratio implies a low level of stocks and this increases the possibility of running out of stock. This means that sales may be lost as a result. So although as a general rule of thumb you want to show the fewest number of days taken to turn your stock and WIP into sales, be wary of losing sales by running out of stock.

In fact, the optimal level of stock is the quantity you need to meet market demand (although in reality this is difficult to quantify).

And of course there may be some advantages in ordering larger quantities - such as lower prices and shipping costs - which may improve your profitability. Also it is often better to deal with 'quality' suppliers, which will deliver the right goods to you at the right time.

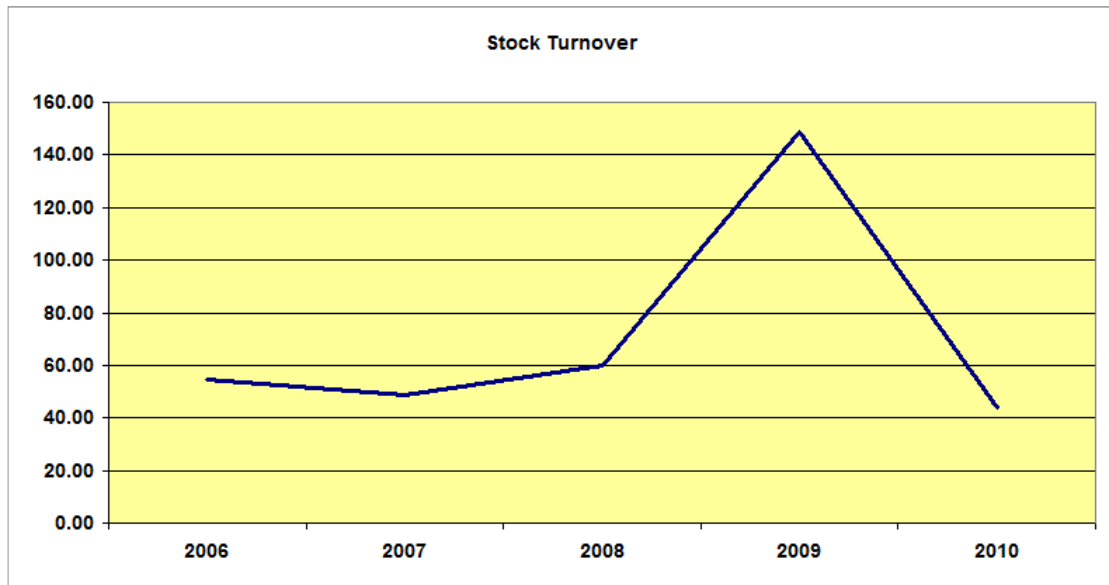
So for effective stock management you need to know the profitability and return on investment from each of your products or product groups. And you need information about the lead time and likely market demand. And it is a good idea to calculate the stock turnover for each of your products or product groups so you can see where your

cash is tied up.

If the average number of days is increasing, look for slow moving jobs and products and review your billing procedures to ensure that invoices are sent as soon as possible.

And a final note. I have used your closing stock and WIP as shown in your accounts in calculating this ratio. But strictly we should use your average stock level during the year. And so if the amount of stock you held at the year-end is not representative of the year as a whole - perhaps you ordered a large quantity at the year-end - then this will distort the ratio.

The following graph shows how this key activity ratio has varied over the years.



Debtor Days

It is important for your cash flow to turn the amount of money you are owed into cash as quickly as possible. And so you need to manage your debt collection policies and procedures.

You can measure your effectiveness in this area of working capital management using the *debtor days* activity ratio.

Debtor days - which is sometimes referred to as the debtor collection period - is the average number of days that your debtors take to pay. It reflects how effective your credit control policy is. Your liquidity will improve the lesser the number of days.

However, you may need to consider other factors; factors that may impact on your net profit.

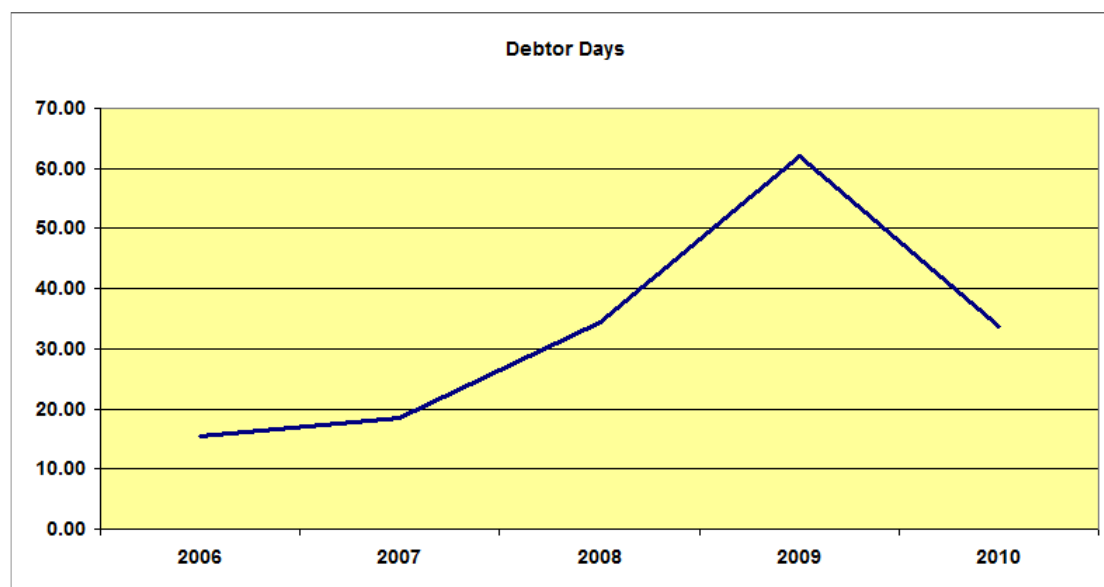
For example, if you offer better credit terms than your competitors you may attract more customers. And you may be able to charge higher prices as a result, which will improve your profitability. But on the other hand, you may attract customers that are unable to obtain credit terms elsewhere. And this may result in bad debts.

So you must consider the trade-off between risk and return. The more generous your

credit terms are the higher the level of sales you may be able to achieve but your business will be exposed to much, much greater risk.

I have taken your total sales for the year in calculating this ratio. But if sales are made up of both credit and cash sales, it would be more accurate to calculate the ratio based on credit sales only. Your *management information system* should be set up to do this for you automatically.

The following graph shows how this key activity ratio has varied over the years.

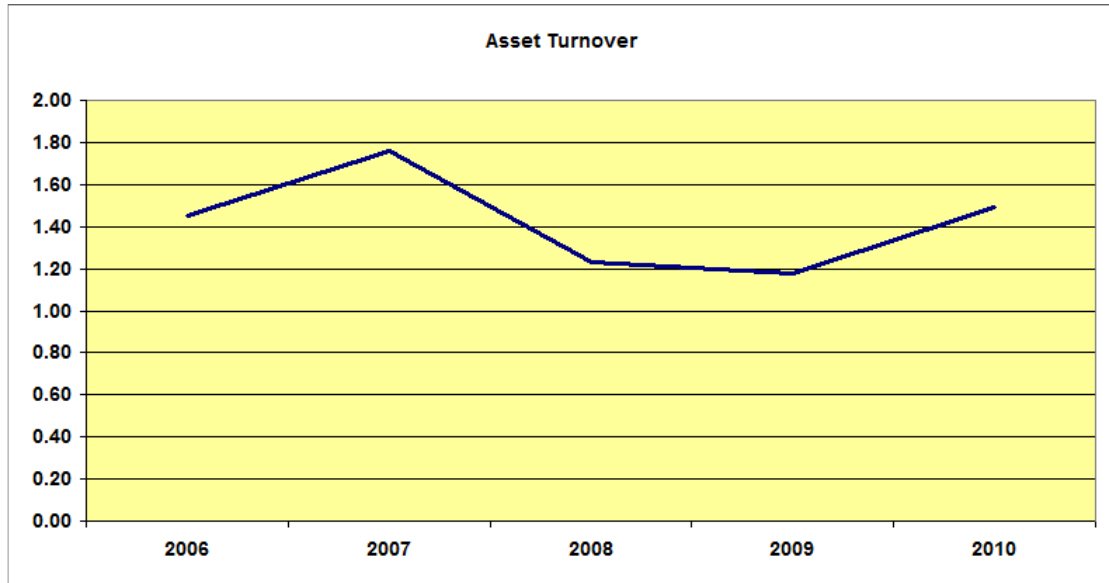


Use of Assets

The *asset turnover* ratio is used for measuring the efficiency with which your assets are used. The higher the level of sales generated for each £1 of assets the more efficient your business is performing. So it represents how effectively you are using your assets to create sales.

But you need to apply a little care when interpreting this ratio. The ratio is based upon your fixed and current assets. And so it depends very much on the valuation of your fixed assets in the balance sheet; particularly with respect to land and buildings where the value in the balance sheet may be very different to the current value.

As you'll soon see, this is a vital component to your *return on investment*.



Gearing

The money used to finance a business comes from 2 sources:

- Capital provided by the shareholders or business owners (which includes capital introduced and profit that is retained in the business). This is referred to as *equity*.
- Money borrowed from those lending money to the business in the form of credit (which includes loans from banks and finance companies, credit given by suppliers and hire purchase arrangements). This is referred to as *debt*.

Gearing ratios show the relative amounts of equity and debt.

A business with a high gearing ratio is one that has a high level of debt and a relatively low level of equity. In fact it is possible for a business to be financed totally by means of debt.

However, this is very risky because if interest rates rise or profits fall the business might not generate sufficient cash to meet its interest payments.

Conversely, a low gearing ratio means there is a relatively high level of equity. In fact it is possible for a business to be financed totally by equity.

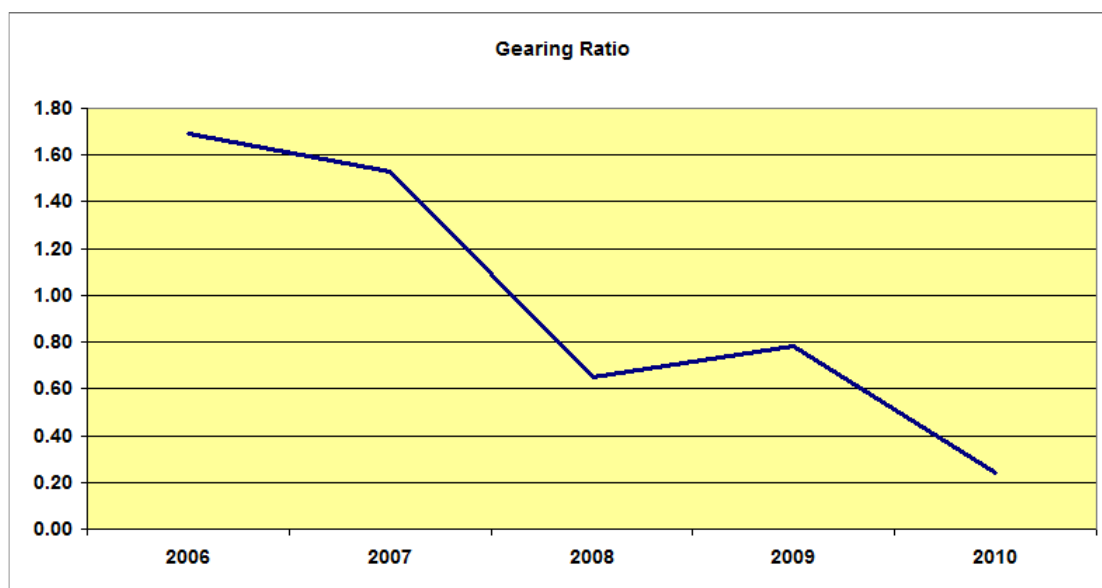
While this eliminates the financial risk, it also reduces the return that the owners of the business receive from their investment. And debt is usually cheaper than equity. So it may be profitable to have some debt within a business. And so businesses with a low gearing ratio could mean that it is paying too much for the money it is raising to finance its assets.

Provided that the return on investment is greater than the net cost of debt then the owners' return on equity will increase with higher levels of debt.

So once again, there is a trade-off between risk and return; and your role is to achieve the appropriate balance for your business.

There are a number of ratios for measuring gearing, including *debt to equity* ratio,

debt ratio and *interest cover*. For the purpose of this analysis I will use the *debt to equity* ratio and I will define debt as current liabilities and long-term debt. Although it is possible to use just long-term debt.



Return On Investment

Return on Investment (often shown as simply **ROI**) - sometimes referred to as *Return on Total Assets* - is your net operating profit before interest and tax divided by your total assets employed. It gives the net return on your assets employed and reflects the overall profitability of the assets used in the business.

It can also be calculated by multiplying your *net profit margin* by your *asset turnover*.

And so this ratio reflects the effectiveness of resource utilisation by bringing together the efficiency of your business processes (reflected by your *net profit margin*) and the efficiency of asset utilisation (reflected by your *asset turnover*). And so it is a critically important indicator of how well your business is performing.

By looking at these two components of your return on investment you can see whether attention is needed to focus on margin (which reflects the value created for your customers relative to the cost of resources used) or asset productivity (which reflects the efficiency with which your assets are used).

Good strategy is about creating competitive advantage. And a business that has a relative advantage compared to its competitors will achieve a higher ROI. So in essence relative ROI defines strategic advantage.

But if ROI is falling then that suggests that the annual increase in your assets is greater than the annual increase in your net profit. And eventually your business would fail. To illustrate this, consider the following simple scenario.

If your net profit is £10,000 and is increasing each year by 10%, and your total assets are £100,000 and is increasing each year by 12% then ROI is 10%. But even though net profit is increasing each year, the business is doomed to failure.

Why is this?

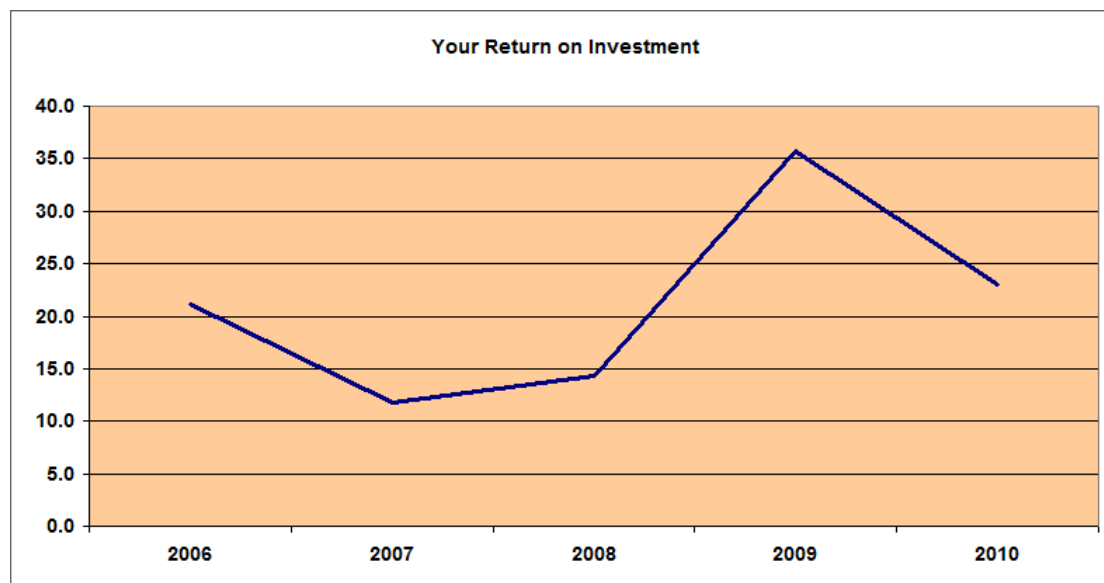
In year 2, net profit would increase by 10% to £11,000. And the total assets would increase by 12% to £112,000. This is a ROI of 9.8%. But to achieve this result the business needs additional assets of £12,000. And if all of the £11,000 profit is retained in the business then a further £1,000 of additional debt - or your money - is needed. Since for every £1 of extra assets that your business needs you will need an extra £1 of debt or your own money to finance it.

In year 3, you would need a further £1,340 to finance this business. So can you see that if the business needs money every year to finance it, then eventually - even though it is profitable - it will go out of business?

Since this is critically important why don't you do the calculations for year 3 to prove to yourself that this business would need a further £1,340 to finance it? And what is the ROI in year 3?

Bear in mind that this ratio can be distorted by two common factors; an artificially high or low level of remuneration for the owner manager (which we will look at

shortly) and where the market value of assets is significantly different to the balance sheet valuation (which is often the case with land and buildings).



Return On Capital Employed

Return on Capital Employed (often referred to as simply **ROCE**) is a slight variation on ROI.

Rather than using total assets in the calculation, it uses equity and long-term debt.

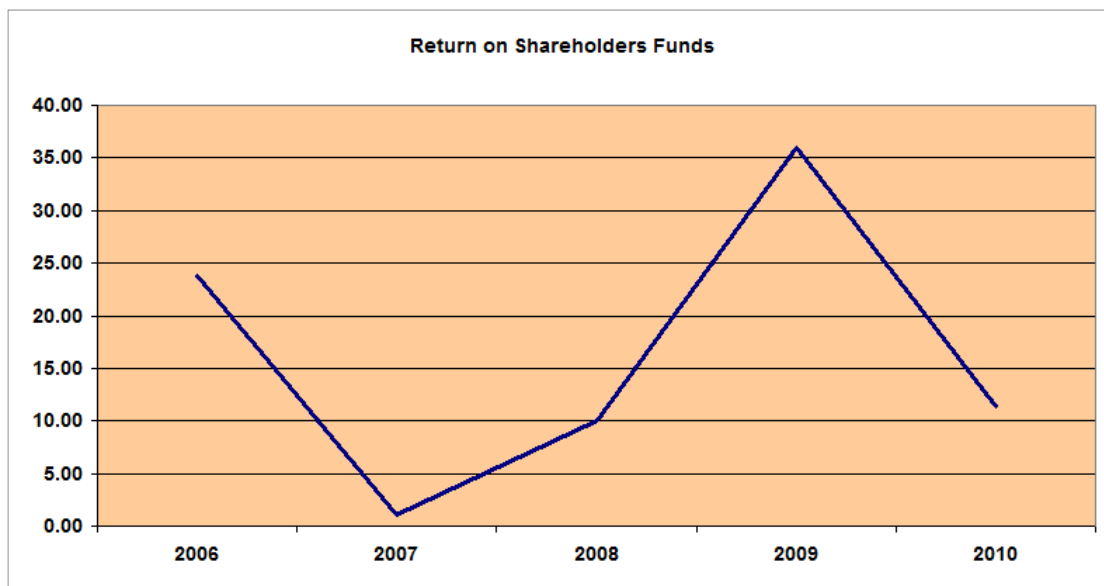


Return On Shareholders Funds

Return on Shareholders' Fund - sometimes referred to as *Return on Equity* - looks at the performance of your business purely from the owners' point of view.

It is calculated from your net profit after interest and tax (i.e. the profit available for distribution to the shareholders) divided by shareholders' equity.

It is an important measure for anyone looking to invest in a business.



Owners Salary Adjustment

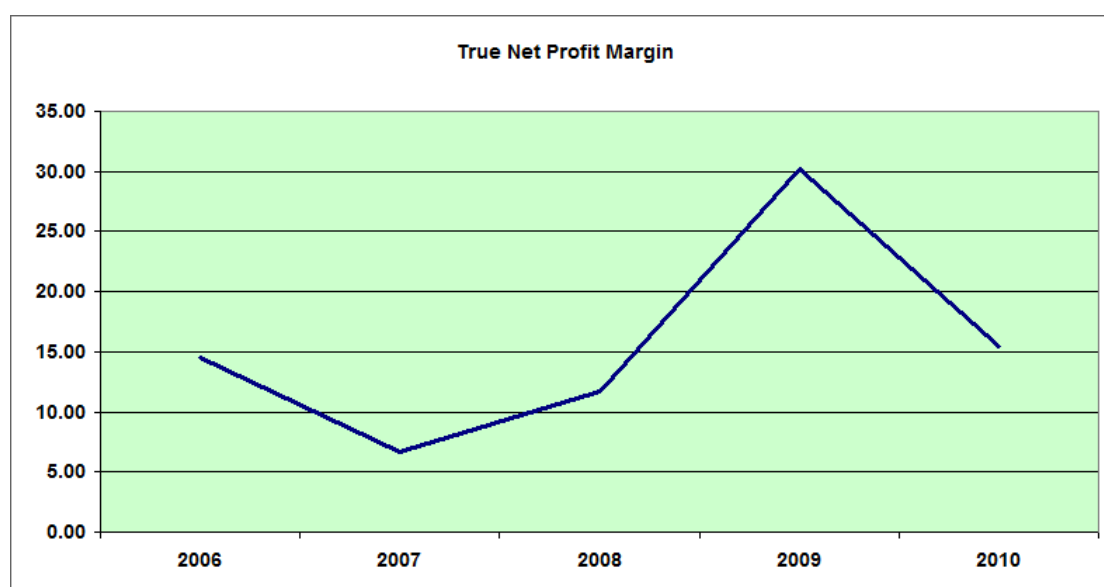
Like many businesses, your accounts probably haven't been charged with full commercial salaries for the owners - perhaps because of reinvestment or tax planning.

So, to calculate your "true" profits, we need to adjust the profits shown in your accounts for the difference between the owners managers' salaries that ARE shown in the accounts (referred to as *directors' remuneration*) and how much salary the owner managers' would expect if they were employees instead (in other words, to reflect what you are worth in the marketplace).

I have entered an estimated adjustment of £0 to give you a feel of what the "true" profits of your business look like. But you may feel you are worth even more than that!

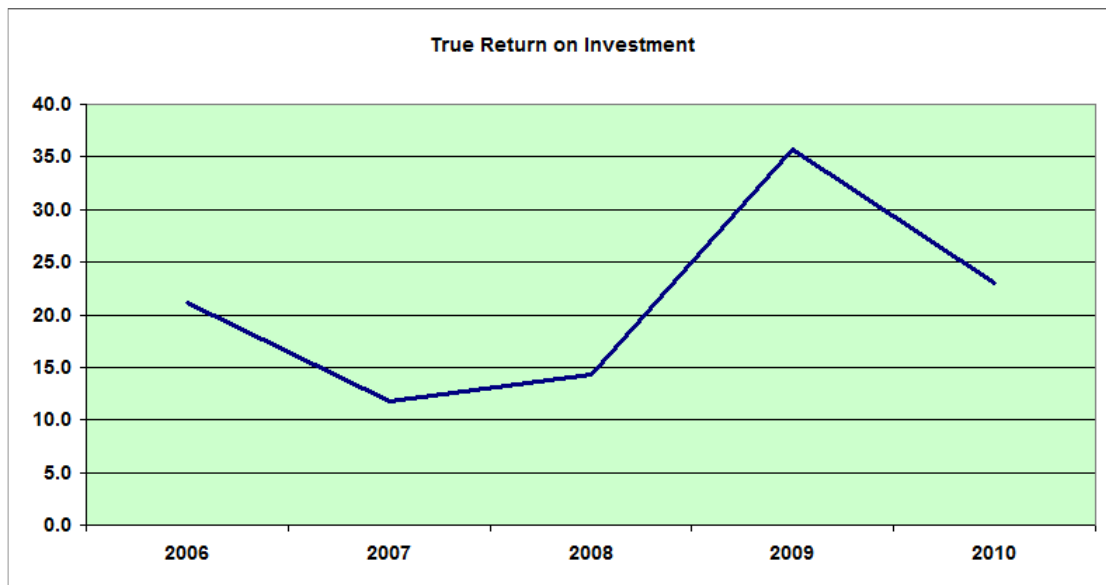
The graph below shows both the level of owners' salary before AND after this adjustment.

When we take this into account your "true" *net profit margin* will really be as shown in the following graph. And if you want to compare how your business has performed against other businesses in the same business sector as you then you should really use this measure.



And of course, since your *net profit margin* is a key component in your *return on investment* then we must really restate this ratio to give a more accurate picture for your business.

And this is shown below.



Looking to the future

Of course, what we have done here is to look at how your business has performed in the past. But it is even more important to look to the future. So let's look at that now.

What-if analysis allows you to project your results into the future based on changing a few variables. So although this year your profits are £176,500, the really important question is...

How much higher could they be?

Well if you can change ...		Scenario 1	Scenario 2	Scenario 3
The quantity you sell by ...		2%	5%	10%
The average you sell it for by ...		2%	5%	10%
And cut your costs by ...		2%	5%	10%
Your Profit will change ...	From	To	Or	Or Even
	£	£	£	£
Sales	2,300,000	2,392,920	2,535,750	2,783,000
Costs that vary with how much you sell	(1,185,000)	(1,184,526)	(1,182,038)	(1,173,150)
Costs that don't vary with how much you sell	(940,000)	(921,200)	(893,000)	(846,000)
Other income	1,500	1,500	1,500	1,500
Profits shown in accounts	176,500	288,694	462,213	765,350
Owners salary adjustment (See Note Below)	0	0	0	0
'True' Profit	£176,500	£288,694	£462,213	£765,350
Which is an improvement of ..		63.6%	161.9%	333.6%

Note	Like many businesses, your accounts haven't been charged with full commercial salaries for the owners. So, to arrive at the true profits we need to adjust the profits shown in the accounts for the difference between the salaries that are included in the accounts for the owners, and how much the owners' time is actually worth. An estimated adjustment of £0 is included above to give you a feel of what the true profits of your business look like.
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How can you make those sorts of improvements happen?

The simple answer is to ask us about the profit improvement tools we've been developing in conjunction with some of the country's leading business thinkers, including a former UK entrepreneur of the year.

Tools that have been specifically designed to help businesses like yours become much more successful. These tools can make a massive difference to your prospects and your profits.

Next Steps

How to Monitor Your Performance

Remember that, if you want to make money, you must simultaneously increase your net profit, return on investment and cash flow. So these would be good things to start measuring.

But you need to measure much, much more than that.

What you should measure depends upon your strategy

And your strategy needs to be designed based upon what's important to your customers so that your strategy meets their needs.

Simply keeping records of your financial transactions will not provide you with sufficient information to properly manage your business. It will tell you how well you are doing, but it won't tell you why.

And this is all vitally important because the quality of every decision you make depends upon the quality of the information available to you.

So if you want to make the best possible decisions, you must have the best possible (accurate and relevant) information.

So what else should you measure?

There are many things that every business should measure.

For example, if you want to grow your business you need to measure and work on the seven standard *Key Growth Drivers* and how to use them simultaneously. (NB: By doing that you'll also benefit from something called *Synergistic Impact* - which can add £000s more to your bottom line).

You should also identify and systematically measure those things that are critical to the success of your business - in other words, your specific *Key Success Drivers*.

Your Key Success Drivers

It is important to understand what are the key drivers to your success. And it is equally important to measure these on a regular basis (sometimes you will see them referred to a *Key Performance Indicators* or **KPIs**).

For example, in a retail business, a Key Success Driver could be the volume of sales for each square foot of retail space. Without a full understanding of its Key Success Drivers, a retailer might be tempted to move away from the city centre where costs per square foot are double those in the suburbs. But armed with the Key Success Driver information that the city centre location generates more than double the sales per square foot compared to the suburbs, it would be able to make the right decision (ie to stay in the City Centre where its profits per square foot will be higher).

As part of our *Management Reporting* services and our ***Making It Happen***

programme we will help you to identify the Key Success Drivers for your business. And then help you to set up a measurement system so that you can easily track these critical measures.

It is probably fair to say that the majority of business people do not yet systematically measure this sort of detailed information. But it is vital information for fine-tuning a business and ensuring long-term success.

And since we are committed to your success, we strongly recommend that you measure:

- The seven standard Key Growth Drivers, and
- All the other specific Key Success Drivers for your business

Your Next Steps

So what should you do next?

Here is my recommended list of *Next Steps*:

- Put a *management information system* in place that will provide you with the information you need to make the right decisions for your business - including the seven standard Key Growth Drivers and the all the Key Success Drivers for your business. And if you'd like me to help you with that please give me a call.
- If growing your business profitably is important to you then give me a call to arrange a ***Business Potential Review***. Although we normally charge £250 for this service, I would be happy to carry this out as part of your investment in this *Financial Performance Review*. We will need approximately one hour - so please give me a call to arrange a time that works well for you.
- Alternatively, give me a call to find out about our "*Simple Stuff That Works*" software. This is a very, very powerful suite of software that will guide you through each of the Seven Key Growth Drivers and show you exactly how you can grow your business in an effective and systematic way.
- If keeping control of your costs is important to you then I suggest that you invest in regular *management accounts and reports*. I can provide you with these on a monthly or quarterly basis. So please give me a call for further information.
- If you feel that you are not getting 100% out of your team, then this will have an impact on their productivity and the results your business is achieving. The key to this is an understanding of how to manage and motivate your team. And this is a key element of our ***Making It Happen*** programme. So if you would like me to help you get the most out of your team, then please give me a call.
- If you want to improve your *gross margins*, then it is important to carry out a detailed analysis of how your gross margins are made up - in particular by different products or services and by different customer groups. In the case of different customer groups, you should also have a crystal clear understanding of who your '*ideal customers*' are. And once again, please call me if you want any

help with this.

- Cash flow is the lifeblood of any business. And many profitable businesses have failed because they ran out of cash. So it is important that you carry out regular cash flow forecasting.
- You must control your working capital if you want to improve your cash flow. And an important element of working capital management is credit control. If you want help with improving your credit control then please ask me. And if your debtor days ratio is increasing then I think it is important that you give me a call.
- If you are considering selling all, or part, of your business then the *return on investment* and *return on equity* ratios will give you a good idea of how attractive your business may be to a potential buyer. If you would like me to carry out a detailed *Business Valuation* to give you an idea of how much your business is worth then please call me.
- Conversely, if you are considering buying another business, then the ratios for your target business are well worth investigating. And if you have a business in mind, please ask me about doing a detailed *business valuation* for that business.
- This *financial performance review* is a great way to benchmark your business against itself in previous years. However, you may also want to find out how you have performed compared with other similar business in your business sector.

And If You Only Had Time For One Thing...

So if you were only to do *OneThing*TM then I recommend that you spend an hour with me to go through a ***Business Potential Review***. (Remember, although a Business Potential Review normally costs £250, I would like to give it to you as a gift as part of my commitment to your success).

In our hour together, we'll use our *Business Potential* software to look at your key challenges in business, explore the potential within your business to become even more successful and brainstorm some strategies that will become your first steps for getting from where you are now to where you want to be.

The future success and profitability of your business has to be worth at least an hour, doesn't it?