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Changing Needs In a Tough Economy

We are often asked to justify the investment in a Formal Accounting and Business Information System. One of the major justifications for moving up to a higher level of accounting system is that we need to "*do more with less*". This is important to a company that is experiencing growth or an economic downturn. In either case, they need to utilize their trained, experienced staff in the most productive and effective manor.

When we add new employees they need time to adapt to our company, learn our ways and gain experience in dealing with our customers. Not only does this take them time, but usually increases the burden on our experienced staff in training or mentoring these new employees. It is important, in times of growth, that we do not burden our best employees with unnecessary work or inaccurate information. **Our complete focus should be on providing service to the customer and any systems we implement in the company should enhance the client relationship rather than detract from it.**

The goals shift slightly in a tight economy, where, through no fault of our own, we are forced to make do with lower levels of revenue or margin. It is at these times that the only thing that we can accurately control is the "cost of doing business". Again, we have to make best use of our resources and need to be effective in our decisions to control costs. If we do not have accurate historical data or financial information on a timely basis, we are forced into the "hatchet cost cutting method", usually with extreme negative effects on our client service.

It is therefore the focus of the company at this time to make sure that everyone utilizes the system, trusts the data that is produced, and has access to big picture information on a daily, or weekly, basis so that actions can be taken while the events that cause them are fresh in our minds.

Data needs to be timely.

Our memory of events is excellent in the short term, but as the time increases from the event, our perception of the true timing; even if we remember the event itself, starts to become cloudy.

As a simple example, let us take our electricity bill. We receive this bill from the utility company on a monthly basis. This bill however, covers a period starting approximately 6 weeks before we receive the bill to a period ending about 2 weeks before we receive the bill. Upon receiving this bill we find that we used 20% more energy than the same time last year and we try to remember what might have caused this "cost overrun".

If this was a dramatic event such as installing a new piece of equipment, then this is not difficult to remember. If however, it was caused by a small operational change, this will often go undiagnosed.

In the same scenario with timely data; Monday morning a report is on your desk that said last week you used 20% more energy than the same week the year before. You can easily recall the events of last week and are much more likely to find a reason for this. Maybe you were open an extra day for inventory, or maybe a new employee started and did not follow the procedure for turning off systems at night.

The difference between these two scenarios is not the cost change but the fact that the information about that change in the second example was provided close to the event that caused the change.

In the case of the employee procedures, if we react to it the following week we will save 5 weeks of excess energy, because the issue causing the problem was addressed on a timely basis.

From a business standpoint, we often see systems in use where the data is not truly trusted due to lack of formal controls. The monthly financial information often has to go to an accountant who will review the information, make adjustments, and hopefully, within a few weeks give you an adjusted accurate statement of your financial position.

It is much better if the systems were in place to provide trusted, accurate data and present it in a weekly statistical way. This would allow you to rapidly see trends of sales and costs as they happen on a regular, timely basis.

<u>Managing Cash Flow</u>.

In an economy where the sales are reducing, cash management becomes far more important. You are selling less and your clients are often taking longer to pay.

Your own approach maybe to extend your own payables, however, this is often of limited value in terms of true cash management. Effective cash management really can be more effective when you can accurately analyze where cash is "tied up" in your business. In many businesses this is in the value of inventory. Many books have been written about effective inventory management in an effort to encourage businesses to understand the need to have effective inventory control policies.

Ideally, we should have just enough inventory in-house to cover the time it takes to replace that inventory from our vendors. This is a vast over simplification, but the concept has an important effect on the overall cash position and profitability of our business.

What does it actually cost us to hold inventory? There are numerous costs associated with having product in stock. Not only have we tied up working capital to obtain the inventory but we now have the cost of storage and staff to manage it. If the price of this inventory is volatile, we may be faced with a situation where the product we have in stock costs us more than its replacement.

There are many discussions on calculating costs, but a conservative estimate for the annual cost of carrying inventory is about 20%. In these difficult times, if you can reduce your inventory value by $100,000.00, this would equate to a least $20,000.00 a year to your bottom line.

<u>Where are the leaks?</u>

As I stated earlier, we have little control over our revenue at times where external factors, such as the economy have a greater effect than our own marketing efforts. In these times, it is vital to be able to control costs.

How can we control a cost if we do not know what it is?

No business is completely "leak proof". In times where business is excellent and work is coming in, we often ignore high levels of "cost leakage" due to the fact that the revenue stream and booming sales mean that we are still making an adequate or excellent profit margin. As revenue declines, these "leaks" become serious. We must attend to them or the business, like any vessel with leaks, will sink.

Before we can fix a leak we must find it.

It is the purpose of a good Formal Accounting System or Business Information System to allow management to rapidly identify specific leaks so that they can be repaired quickly and effectively.

Identification of these leaks is only the first step.

Your system must be able to put good controls in place to effectively stop the leaks, not just in the short term, but in applying policies for long term financial health.

Some examples we have experienced include effective communication between multiple locations. If location "A" is out of a product, without controls they may purchase a new batch from the vendor. With controls and an adequate information system they can rapidly cross check other company locations. An item that moves quickly in their location may exist in another location that barely moves. Transferring it within the company not only reduces inventory costs, but is far more profitable.

Another big area that has potential for lack of control is with product returns. If we return a product to a vendor for repair, exchange, or credit, it is still in our inventory until the transaction is completed. Without adequate controls, this "out of sight - out of mind" approach often results in missing product and subsequent losses.

Funding change:

Managing our cash in low business times is extremely important. An opportunity exists to "tighten the operations" while we are not busy rushing product out the door. **This is the best time to evaluate all systems for their effectiveness.**

Investing time and money in improving efficiency will pay dividends in the future. Leasing software and implementation solutions is becoming extremely cost effective as financial institutions look for other ways to invest in business. This allows us to improve our systems and cut costs today while deferring the cost over the next few years.

Taking the cost benefit of an effective implemented solution now while spreading the cost over the next few years is an excellent investment in your business future.

Summary:

The company that works hard to establish systems and improve productivity during a low revenue period, is ideally positioned to utilize their staff very effectively as the economy improves and the business picks up.

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