WHITE PAPER

5 STEPS TO CONTROLLING YOUR FINANCIALS AND GROWING YOUR BUSINESS

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Unless you have an accounting degree, you may spend more time running away from your financial data than analyzing it. High performers in the industry know better. They know financials are the Holy Grail of business. They know the ability to access this data in real time is the difference between feeling like they're always catching up to what's happened in their business and making sound, proactive decisions that increase cash flow and profitability.

This white paper will take you through the process of analyzing financial data to find opportunities for growth in your business. You will also gain insight into how industry benchmarks can help you set goals and create tangible action plans to increase efficiency and profitability.

The Right Mindset. The Right Data.

Analyzing financials is no walk in the park. It takes concentration and commitment. Consider this: The majority of owners and managers spend most of their time ensuring their compliance with fiduciary responsibility. You likely have stakeholders, family, employees whose livelihoods depend on your business decisions. You need to make ends meet and pay salaries to keep everyone happy. Where things get truly interesting, however, is when you get to wear the entrepreneur hat and, rather than asking yourself whether you're managing your business responsibly, you get to look at how to become more competitive and increase your bottom line.

The best performing retailers' rule of thumb is to demand the information they need from their accounting system or CPA. At the end of the day, you invest a significant amount of funds to keep all this information up to date and compliant, so don't be afraid to put it to work.

Here are three tips to get you started:

- As you gather information, remember also that a single snapshot will never be helpful. Historical data is critical in identifying trends.
- You need to be able to dig deeper. Get the right reports or find a system that will allow you to drill down. Endless columns of numbers don't mean anything unless you have access to detailed data and can see what's influencing your bottom line results.
- Question everything and manage by exception. Look at vendors, items, expenses, categories, locations side by side and find the outliers. If they're working better than others, find out why and see how you can apply what you learn to other underperforming areas. If they're under your store average, find out why and fix it.

Analyzing Data and Finding Opportunities

Once you know how and where to access your data, make time to learn it. There are multiple schools of thought and practices when it comes to analyzing financial data; however, an accounting degree isn't a requirement. At the end of the day, you know your business better than anyone else.

THE IMPORTANCE OF AN INTEGRATED SYSTEM

To dig deeper, you need information to be linked across your business. You can't get a holistic sense of what's going on when you have to check five different data sources to understand the full picture. Mixing and matching disparate data will likely lead you to find discrepancies that will prevent your business from getting reconciled.

As an owner or manager, you have very little time to spare. Demand the data you need to manage your business to success. Make sure your investment enables you to move things forward and avoid paying for busy work or creating busy work for yourself. There are systems out there that will automate accounting and generate the reports you need to make the right business decisions.

Contact info@profitsystems.com for more.

In the following sections, we'll take you through five easy steps including:

1. Define your objectives
2. Benchmark your business
3. Go into the data
4. Look for trends
5. Dig deeper and analyze

Let's dive in.

Step 1: Define Your Objectives

When you look at your financials as a whole, staring at hundreds of out-of-context numbers can be very overwhelming. Unless you know what you're looking for, you're just causing yourself a lot of unnecessary anxiety. Once you have a goal, however, you're able to better distinguish relevant data and start extracting the information you need to make decisions.

Before you jump into the data, define which Key Performance Indicators (KPIs) you'd like to look into, or at least have one area of your business that you want to improve in mind. For illustration purposes, in this paper, we will analyze four sample KPIs:

<table>
<tr><th>Occupancy Expense</th><th>Advertising Expense</th></tr>
<tr><td>Occupancy expenses are usually the most inflexible cost. They include items such as:
Store rent
Utilities
Maintenance
Because facility costs are so inflexible, the dollar amount of monthly rent directly determines the dollar amount of margin that the business must achieve to be profitable.</td><td>Advertising expenses include:
Traditional media
Digital media
Agency fees
Co-op received
Operations with low marketing costs typically have a very loyal customer base or a Triple-A location. Budgeting ad costs can be either variable or fixed. It is variable if the budget is strictly on a percent of sales and fixed if it is on a set spending amount. Variable spend means that if sales go up or down, so does the ad spend.</td></tr>
<tr><th>Selling Expense</th><th>Delivery Expense</th></tr>
<tr><td>Selling expenses include:
Commissions salaries of sales employees
Commissions and salaries of sales managers
Sales training
Sales tools
Selling vehicle expenses (if applicable).
Usually being dominated by commissions, this expense category is mostly a variable expense. So, unlike the fixed expenses of occupancy and administration, as sales grow, selling costs as a dollar amount increase. They should not fluctuate much as percent of sales, provided commissions are paid on a delivered basis.</td><td>Delivery expenses can be calculated as follows:

(All truck costs + All driver costs + All helper costs) - Delivery income

The delivery department is a big value added benefit of what retailers offer to their customers. Those operations that charge appropriately for their services and have efficient management of crews and routing can completely offset this department's expense with revenue. Good operators even add some of that revenue to their bottom line profitability.</td></tr>
</table>

The secret is to take one KPI or decision at a time, rather to try to conquer too much at once. Pick one piece, peel it off, and allow yourself to spend some time with it. In the process, keep asking yourself questions: Why am I looking into this data? What do I want to gain from this analysis? What am I trying to figure out specifically? What is the expected outcome of this exercise?

IMPORTANT! *Remember that "I just want to know" is not an objective. You need to look at your financials with a goal in mind to lower selling expenses or reevaluate your advertising for better ROI. And, most important, be committed to taking action.*

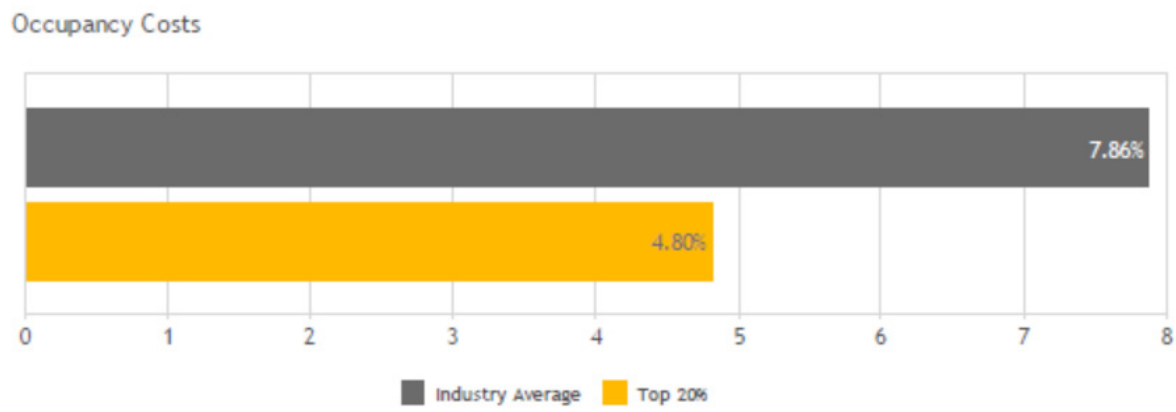
Step 2: Benchmark Your Business

Bench·mark; noun:"A standard or point of reference against which things may be compared or assessed."

Once you define your objectives, don't go rushing into the data just yet. How will you know whether where you stand is where you should be? You need a benchmark – whether you're using historical data from your own business or a tool such as the NAHFA Retail Performance Report.

Benchmarking helps you understand whether you're performing according to industry standards or consistently with your track record. A tool such as the NAHFA Retail Performance Report can also help you see how you compare to the top 20 percent highest performers. This information will help you decide whether you're above or below the norm, as well as define new objectives for your business to improve certain areas.

The Retail Performance Report is exactly that: an accumulation of financial information from hundreds of retailers both big and small. The purpose of this report is to portray what every retailer included in it is seeing in terms of overall cost in each area of their business. In this report you can find the industry averages for the KPIs mentioned above, allowing you to then understand where you are and where you should be relative to your peers.



Let's look at the averages for the industry, as well as the top performing retailers for each of our 4 KPIs according to the 2015 NAHFA Retail Performance Report[1] :

Occupancy Expense	**Advertising Expense**
Industry average: 7.86% of sales Top 20% of retailers: 4.8% of sales	Industry average: 5.77% of sales Top 20% of retailers: 3.65% of sales
Selling Expense	**Delivery Expense**
Industry average: 8.94% of sales Top 20% of retailers: 7.21% of sales	Industry average: 0.88% of sales Top 20% of retailers: 0.53% of sales

Looking at the chart above, the industry average for delivery expense is 0.88% of sales, and the top 20% of the highest performers have a cost of 0.53%. You need to know this before you look at your own numbers so that you know where you stand. If your delivery expense is 2.34% of sales, then you know there's opportunity for improvement. If it's 0.43%, then you don't need to focus on it because you're leaps and bounds above the average retailer.

As you may have guessed, benchmarking helps you identify real areas of concern, as well as where opportunity lies. When you know where you stand against your peers, it is easier to come up with a tangible goal for improvement.

Step 3: Go into the Data

Now that you know what you're looking for and how you will measure where you stand against industry averages, it's time to start looking at data. When you hold a financial statement in your hand, make sure you focus on three things:

- What are the final bottom line numbers impacting the KPI at hand?
- Where do those numbers come from? What makes up the final number?
- Is every line that impacts that number allocated correctly?

The first question will help you get the big picture. If you're analyzing your occupancy expense, you'll likely find a line in your P&L that summarizes that number for you. The second question will help you drill down and identify why that number is what it is. When you break it down, you'll see how much of that is rent vs. utilities, for example. Finally, as you look into the details, make sure all the right expenses are being allocated appropriately. You wouldn't want non-occupancy expenses allocated to that bucket because they may skew your numbers. At the same time, you want to make sure your cost of insurance, for example, isn't allocated to the selling expenses account.

Once you understand where you stand, have a good grasp on what factors are impacting your numbers, and know everything is being allocated correctly, you can look for opportunities for improvement. Below are some examples of things you may want to look into for the KPIs we're analyzing here.

[1] North American Home Furnishings Association, Retailer Performance Report (2015)

Occupancy Expense	Advertising Expense
What you need to look at: ▪ Rate ▪ Utilities and where costs could be cut ▪ Possibility of recycling ▪ Cost of insurance	What you need to look at: ▪ All types of media both traditional and digital ▪ Agency fees
Delivery Expense	**Selling Expense**
What you need to look at: ▪ All truck costs ▪ All driver costs ▪ All helper costs	What you need to look at: ▪ Commission and salaries ▪ Smaller expenses such as sales training, tools, vehicle expenses etc.,

In order to understand why it's so important to be vigilant regarding financial data and expense allocation, let's take a look at the P&L statement below from Lee's Furniture and Welding, focusing specifically on the line for "Administrative Expense".

LEE'S FURNITURE AND WELDING

Profit & Loss Statement

PROFIT CENTER: ALL
PERIOD: 07/01/2015 TO 07/31/2015 AMOUNTS ARE RECALCULATED

	CURRENT-PERIOD AMOUNT	RATIO	YEAR-TO-DATE AMOUNT	RATIO	SAME-PERIOD-LAST-YR AMOUNT	RATIO	YEAR-TO-DATE-LAST-YR AMOUNT	RATIO
Retail Sales	$ 228,345.49	87.86	$ 1,283,464.02	88.91	$ 159,194.14	89.70	$ 1,206,472.58	89.32
Labor Sales	31,536.55	12.13	160,038.41	11.08	18,278.12	10.29	143,787.56	10.64
Retail Discounts Allowed	.00	.00	.00	.00	.00	.00	350.00	.02
Net Retail Sales	$ 259,882.04	100.00	$ 1,443,502.43	100.00	$ 177,472.26	100.00	$ 1,350,610.14	100.00
Less Cost of Retail Sales	$ (125,940.84)	48.46-	$ (723,885.94)	50.14-	$ (90,339.54)	50.90-	$ (696,321.45)	51.55-
Direct Supplies	(2,517.62)	.96-	(9,636.03)	.66-	(3,431.92)	1.93-	(25,440.76)	1.88-
Gross Margin	$ 131,423.58	50.57	$ 709,980.46	49.18	$ 83,700.80	47.16	$ 628,847.93	46.56
Cash Discounts Earned	$ 1,418.59	.54	$ 14,591.94	1.01	$ 2,029.14	1.14	$ 11,848.55	.87
Gross Operating Margin	$ 132,842.17	51.11	$ 724,572.40	50.19	$ 85,729.94	48.30	$ 640,696.48	47.43
Operating Expenses: *								
Administrative Expense	$ 64,317.56	24.74	$ 397,816.33	27.55	$ 47,885.23	26.98	$ 375,828.36	27.82
Occupancy Expense	4,673.15	1.79	36,159.29	2.50	(125,793.47)	70.88-	40,254.26	2.98
Advertising Expense	8,213.64	3.16	56,836.85	3.93	2,447.49	1.37	48,011.87	3.55
Customer Service Expense	.00	.00	(35.00)	.00-	.00	.00	(244.00)	.01-
Delivery Expense	(1,590.62)	.61-	17,482.76	1.21	3,005.04	1.69	17,570.53	1.30
Warehouse Expense	30.00	.01	485.00	.03	30.00	.01	210.00	.01
Less Total Operating Expenses	$ 75,643.73	29.10	$ 508,745.23	35.24	$ (72,425.71)	40.80-	$ 481,631.02	35.66
Net Mdse Income or (Loss)	$ 57,198.44	22.00	$ 215,827.17	14.95	$ 158,155.65	89.11	$ 159,065.46	11.77
Net Credit Income or (Loss)	$ (6,093.66)	2.34-	$ (11,001.21)	.76-	$ (247.34)	.13-	$ 96.33	.00
Net Income Before Income Tax	$ 51,104.78	19.66	$ 204,825.96	14.18	$ 157,908.31	88.97	$ 159,161.79	11.78
Total Net Income Or (Loss)	$ 51,104.78	19.66	$ 204,825.96	14.18	$ 157,908.31	88.97	$ 159,161.79	11.78

If you're looking for anomalies and managing by exception, then this item warrants a red flag as administrative expenses typically aren't so high. However, you'll also notice that this report does not show a sales expense line item. This is an example of how many retailers become frustrated trying to figure out the mass of data, and why it's important to go into your financial reports and understand what exactly is impacting every number. The administrative expense being too high is a clear indication that something is awry, and given the missing sales expense, you can guess that it's probably an allocation issue. Somehow, two different expenses got lumped together, and without digging into your data to figure that out beforehand, you may become confused.

You need your financials to reflect what's really going on in your business, and the only way to accomplish that is by exhibiting hyper-vigilance and working with the appropriate people in your firm (your CPA and the like). Doing so will allow you to have clear and accurate financial statements, and it is only then that you can do a meaningful analysis of the data for growth.

Step 4: Look for Trends

Data analysis is the process of interpreting the meaning of data, which requires that you look for patterns - similarities, disparities, trends, and other relationships – and think about what these patterns might mean. A snapshot does not tell a full story. For example, you cannot judge your patio furniture sales based on what happened in November through February. If you analyze a full year, you may also see trends in accessory sales with perhaps a spike closer to the holidays. Looking at trends can help you understand seasonality and even predict sales or how much staff you really need to cover Thanksgiving week vs. your Memorial Day sale.

Don't forget to look around; data in isolation means nothing.

Step 5: Dig Deeper and Analyze

When you analyze financial statements, it's important to remember that the information that's laid out in front of you is a summary of what's going on within your business. You've analyzed and strategized, but this step is about looking at everything from a 10,000 foot perspective.

Once you look for trends and analyze their meaning, you need to lay out a detailed plan for next steps. Which areas of your business are experiencing issues? How will you solve these issues? What are the steps? Having a sound strategy is the key to rectifying any situation that you find to be less than ideal.

Once you dig into your data, you may find that some areas of your operation are far above industry averages. While realizing that you're doing better than your competition is a wonderful thing, those performing areas aren't as worth looking into. You want to improve the areas of your business that aren't performing which means acting on the issues and figuring out why they're occurring.

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To illustrate why digging deeper is so important, let's take a look at the same P&L statement above from Lee's Furniture & Welding, focusing on the line items "Net Retail Sales" and "Delivery Expense".

From 2014 to 2015, net retail sales jumped roughly $100,000 from $1,350,610 to $1,443,502, while delivery costs lessened about $100. Knowing these two bits of data alone, however, won't help you. You need to connect the dots in a meaningful context by comparing them side-by-side and thinking critically.

If you're increasing sales volume, it would be intuitive to assume that the cost of delivering those goods would also increase – the more you sell, the more you have to deliver. According to this P&L, however, this business significantly increased their sales while decreasing their delivery costs, and that's definitely something which warrants further investigation.

Really getting into the nitty-gritty of your data allows you to spot abnormalities and then manage by exception. Always dig deeper and think critically.

Rinse and Repeat

The "bonus" sixth step is to "rinse and repeat". Once you become more familiar with your data, you can regularly tackle a new goal. The most successful retailers seek continuous process improvement and never stop looking for ways to increase their efficiency and bottom line.

Pick the next category and repeat the process. Tear into it, analyze it, compare it to industry averages, figure out what you're doing right and wrong, and then make the necessary changes to grow your business. The goal is to get all of your KPIs as close as possible (and higher) than industry averages; however, remember that any improvement over your current state is a win and will impact your bottom line.

Final Thoughts

The key to business growth is to never allow yourself to become complacent. Gaining control over your financials and understanding them will help you consciously select a growth strategy and capitalize on the data that is already available to you.

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