Conducting a Business Check-Up

Published by: Cash Flow Engineering, LLC 9033 E. Easter Place, Suite 202, Centennial, CO 80112 303-221-0823

Contents

The Author

Cash Flow Engineering, LLC is a training and advisory company helping businesses develop and implement marketing, sales, operational and financial systems that generate consistent, predictable and sustainable cash flow.

Jeff Prager is the founder of Cash Flow Engineering, LLC and has been a CPA, business owner and entrepreneur for over 35 years. He has been a former CEO/CFO and owner of several successful multimillion-dollar companies. He was one of the founders of Ashworth Golf Clothing, the CFO/partner of a large land development company and the owner of Strauss Homes, which was once rated as the second largest privately owned home builder in Colorado and in the top 100 privately owned companies of Colorado (2003). During his career, he has helped companies raise over $1 billion (of which $200 million was for his own companies). Jeff also served as an instructor of managerial economics (applying economic theory to business decisions) at the University of Colorado at Denver. Jeff has spoken at the International Builders Show and is a frequent contributor to NAHB Biztools and other publications of NAHB. He was published in the 2012 Cost of Doing Business Study and is a contributor to that study.

He is also the author of two books published by Homestead Press:

- *Managing your Business with 7 Key Numbers*
- *Financial Forecasting in Microsoft Excel*

He also self published *The Peddler's Son*.

BUSINESS CHECKUP

Overview

They say the only constant in life is change. For those of us running businesses, this is painfully true. How often does your business perform exactly as you planned it, from lead generation, to your final payment from the client? If you said more than 5% of the time, you are lucky!

What does this mean for you…?

My goal in creating this course is to share my years of experience in guiding companies toward increased cash flow and distill it into a course that will help you develop the skills to conduct a Business Check-Up as a starting point to building a successful practice. The goal of this course is to impart to you the processes, methodologies and knowledge necessary to generate a complete Business Check-Up, discuss the results with your client and sell them additional services.

We use a tool called **Cash Flow Engineering®** which is a groundbreaking way of simplifying business processes to the point where they can not only be understood, but also easily acted upon to drive consistent, predictable and sustainable cash flow.

Through this course you will learn to master the Business Check-Up – a powerful engagement tool and the backbone of a strong consulting practice. You will also be introduced to two management devices that are at the foundation of Cash Flow Engineering®, the 7 Key Numbers® that drive a business, and the 8 Pillars of Success, or 8 Ps, that drive strategy. Combined, these present a simple, easy service plug-in for your consulting business to add new revenue quickly.

Also, there are 5 major tools we want to expose you to:

- The Customer Journey
- The 7 Key Numbers®
- The 8 Ps or Pillars
- The Sales Diamond
- The Wall Street Questions

Part 1: The Foundation. What is *Cash Flow Engineering*®?

Chapter 1: Your Business – Before we detail how you can help your clients, we need to look at how the Cash Flow Engineering process fits within and helps your business as a trusted advisor. You can use Cash Flow Engineering to grow your business, make more money for the same amount of work and/or to sustain your income while scaling back your hours. We'll look at the simple principle that allows that to happen then start to focus on specific steps you can take to be successful.

Chapter 2: Your clients' Businesses – To accountants, CPAs and financial planners, numbers are our friends. But to the typical business owner, these can be overwhelming and anything but friendly! First let's focus on the business environment and the problems most business owners of any size company face. We'll narrow the focus down to just 7 Key Numbers that drive all revenue and profits. Help your clients learn to manage these 7 Key Numbers and they'll be able to manage their sales, their growth… and their future! (And the same will be true for you too!) Also, consider what happens when they don't make their numbers. Change will be necessary and we'll direct that change through our 7 Key Numbers.

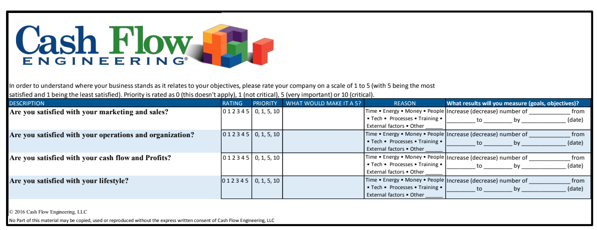
Key Points – Chapter 2

- The Business Owners Mindset
- The Objective of Cash Flow Engineering®
- The Derivation and Use of the 7 Key Numbers
- The Derivation and the Use of the 8 Ps

Part 2: Application of Cash Flow Engineering®

Chapter 3: Preparation for Meeting With client – The Business Check-Up is the fastest, most direct way to help your clients get a clear picture of the health of their business – where it is now, where they want it to be, and what needs to change for them to get there. It is imperative that they see the value in the information this service will reveal.

Introducing the process, describing the scope of work, and motivating your client to commit to the process is your first priority. An effective Engagement Letter will allow you to paint a clear and compelling picture of what is involved, set expectations that make your client more comfortable engaging your services and begin to develop the trust that your client must have in you to form a successful relationship. It will also outline the information you'll need from the client before you have the one-on-one meeting.


Cash Flow ENGINEERING®

In order to understand where your business stands as it relates to your objectives, please rate your company on a scale of 1 to 5 (with 5 being the most satisfied and 1 being the least satisfied). Priority is rated as 0 (this doesn't apply), 1 (not critical), 5 (very important) or 10 (critical).

DESCRIPTION	RATING	PRIORITY	WHAT WOULD MAKE IT A 5?	REASON	What results will you measure (goals, objectives)?
Are you satisfied with your marketing and sales?	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other ______	Increase (decrease) number of ____________ from _________ to _________ by ______________ (date)
Are you satisfied with your operations and organization?	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other ______	Increase (decrease) number of ____________ from _________ to _________ by ______________ (date)
Are you satisfied with your cash flow and Profits?	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other ______	Increase (decrease) number of ____________ from _________ to _________ by ______________ (date)
Are you satisfied with your lifestyle?	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other ______	Increase (decrease) number of ____________ from _________ to _________ by ______________ (date)

Chapter 4: Presentation of the Business Check-Up – This is where you get face-to-face with the client. In this section we'll teach you to ask direct questions that will reveal the actual state of the client's business in ways that balance sheets can't. You'll learn how to apply the "Sales Diamond" that quickly get the client to realize that *they need you* in order to fulfill their long-

term goals. In addition, you'll learn a highly effective and revealing technique using the ***Wall Street Questions***.

Specifically, you will learn to:

- Understand the questions you need to ask to understand your client's weaknesses (the Wall Street Questions)
- Show your client what they feel is lacking in their company, but can't put into words (The Sales Diamond)
- Identify the change that your clients need to make to accomplish their goals (The Delta)
- Demonstrate how your clients can accomplish their goals in easy steps (Back of the Napkin)

Chapter 5: Production of the Check-Up Summary – Here, we'll go over the report that you generate at the end of the engagement. It is a new twist on the SWOT analysis. In this section you'll learn how to present your findings in a way that virtually guarantees that your client will take action – and sets you up for the next engagement, as well as get you referrals.

		Strategies							
	3 key disciplines of a bus.	Marketing and Sales					Operations		Finance
	8 Pillars → 7 Key Numbers ↓	Purpose	Product	Promotion	Price	Place	Production	People	Profit
Goals	Number of leads								
	Conversion Rate			x		x			
	Average Price	x	x	x	x				
	Retention Rate								
	Average # of Transactions								
	Production Costs								
	Fixed Costs								

Chapter 6: Post-production – This is your follow-up. Your Business Check-Up will likely reveal some areas where your client needs to focus attention… and in most cases this is where they could really use some professional help. Understand that the Business Check-Up is just the first step in helping your clients reach their goals, how you follow up will be critical to strengthening long-term relationships, services and consulting.

In this section you'll see how to create an effective follow-up campaign that includes:

- Follow-up letters
- Phone scripts
- Email and direct mail campaigns
- Referral programs

Post script: Get Going. Know your plan and act on it. Assign target dates and responsibility. Also, no sale is ever complete. Make sure you work with your clients, follow up with them and your leads.

Our Case Study:
Introducing Vandelay Remodeling

Throughout this course, I've tried to create a unified example. The numbers have purposely been kept simple. However, in showing financial numbers, I took the liberty of using real numbers from Check-Ups I've actually performed.

We use an example company named Vandelay Remodeling. If you're a Seinfeld fan you may recognize the name. Although the name may bring back some humorous memories of the hit comedy show, the situation this company - Vandelay Remodeling - finds itself in is serious and all too real for many business owners. Vandelay Remodeling is a company that is having a difficult time achieving their objectives. As we learn more about the company, and look at ways we can help them, we will be presenting you with a mind-blowing framework to analyze your business.

So let me tell you a little bit about Vandelay Remodeling. It is a ten-year-old company in Arvada, Colorado founded by Art Vandelay. They're a mom and pop operation, with Art's wife Susan handling the books. Whoever answers the phone usually follows up with the lead. They have a couple of hourly employees and an administrator to keep track of all their jobs and projects and keep their vans rolling to the right locations. A couple of years ago, they specialized in basement remodels and their average sale was $10,000. As the economy worsened they made a decision to do handyman work in order to keep their crews working and their doors open.

Art was struggling but didn't know what to do. His accountant provided a balance sheet and income statement but Art really didn't understand his business nor what the financial statements were telling him. In short he didn't know the score.

Knowing he was in trouble, he hired me to help him.

This course, and the entire Cash Flow Engineering program itself, is based on what happened next. I am going to walk you through, in detail, the specific steps I took to help him understand his business, pull it out a tailspin, then grow Vandelay Remodeling to new heights.

The process I used with Vandelay and offer to you now is not a one-hit wonder. I have used the same process many, many times with similar results. If the definition of insanity is doing the same thing over and over again, but expecting different results, then it follows that the sane thing to do is expect the same results from doing the same thing. That's called a process. It works.

This course is designed to give you another service to offer your clients. If you are working directly for a company, you can use this as a guide to do a self-analysis.

Course Take Aways

- Understand the questions you need to ask to find the true problems in an organization (The Wall Street Questions)
- Identify their Delta – bridge the gap between where they are and where they want to be
- Identify what changes need to be made in order for them to achieve their goals
- Demonstrate how you can assist your clients in achieving their goals

Chapter 1: Understanding Your Business

Before we get into how Cash Flow Engineering can help your clients, we need to discuss and define *your* services. How does this training help *you!*?

Introduction to your "Number of Transactions per Customer"*
In the course of my life as a business owner, I've had dozens of people pass through my door. And in the course of my life as a homeowner, I've had dozens of contractors work on my house. And in 95% of the cases, each of these small business owners came in, did a job, and disappeared from my life.

Our one-time transaction earned them a few thousand bucks, but that was the extent of our relationship.

However let's not forget the other 5%. These are the consultants and contractors who made one job lead *organically* into the next. These business owners structured their businesses to create a lifetime relationship with me by leading me through their ideal *Customer Journey*.

* We'll discuss "Number of Transactions per Customer" in depth as part of the 7 Key Numbers.

Your Customer's Journey:

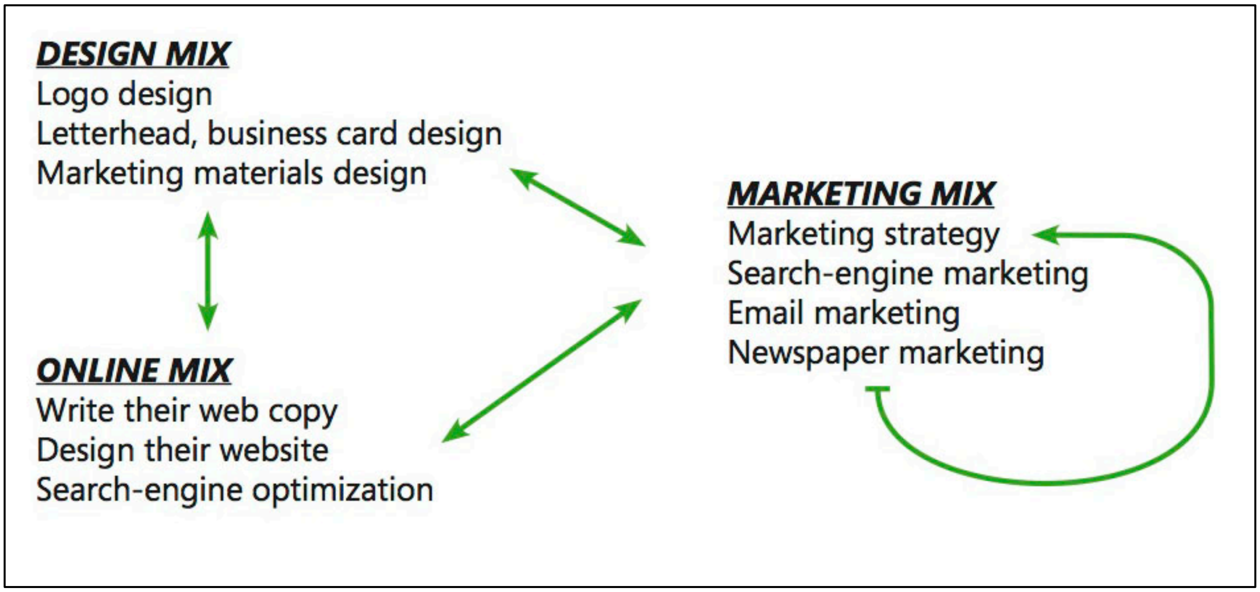
How to Structure Multiple Transactions

In the world of advertising, the "Customer Journey" is the term they use for moving a customer through a series of milestones until they reach a particular goal. And this concept is perfect for describing how to structure your company's activities to drive multiple transactions from every customer.

> **The Customer Journey:** "Matching your *sets of products* to your *sets of customers* to multiply your Number of Transactions per Customer."

The best customer journey we ever saw was built by a web designer we know. His customers hire him again and again NOT because he's so talented at sales, but because he charts out the journey he wants each customer to take and then focuses his customer retention efforts to move them along that path.

Here's how his offerings line up into a customer journey:



His customers initially hire him for web design or search-engine marketing. But rather than just hoping they call him back once the job is completed, he begins each relationship with a customer journey already mapped out. To complement or follow-up the first job, he first sells them on the complementary products in each mix. And then he moves them into one of his other mixes.

His most valuable mix is his online mix. That's because he designed it for repeat engagements over a 3-year cycle, as opposed to the 3-6 month cycle of his marketing mix. So even though his marketing mix generates more revenue per job, his online mix generates more revenue over the customer's lifetime. Which is why he pushes his customers into it.

While marketing and sales obviously contribute to their success, there's something more fundamental involved: they've actually structured their entire operation around a set of products and services that link together into a logical flow that creates his most desired result; *his* customer journey.

So, let's now focus on how to structure your offerings AND your customer base generate repeat business and maximize your Number of Transactions per Customer.

Step 1: Identify Your Products

The first step in building your customer journey is to identify all the products and services you offer or want to offer, and the best way to start is simply to get it all on paper. Here is an example for an accounting practice:

- Routine Services
    - Bookkeeping
    - Payroll
    - Taxes
    - Software

- Financial reviews
    - Ratio analysis
    - Status and interpretational reviews
    - Reviews of key management reports
    - Profitability by product line
    - Pricing reviews
    - Cost reviews
    - Financial report cards
- Planning
    - Business plans
    - 7 Key Number analysis
    - Design and implementation of management reports
    - Review of company purpose (vision, mission, core values, elevator speeches)
    - Marketing plans
    - Process and systems design
    - Tracking systems
    - Financial policies
    - Exit planning

What are you primary service categories?

____

____

____

What is your full menu of services your company offers?

____

____

____

What other services *could* you offer that would be *valuable* to your clients?

____

____

____

By the way, after reading Chapter 2, you may discover other needs your clients have that you can help address. Keep this in mind and be prepared to add more to this list of services.

Step 2: Promote the solution.

As you do a Check-Up, help you client shift their perspective from their need for your product or services to benefits your solution provides for them. NOTE: As you uncover problems in your clients' businesses, catalog the recurring problems you encounter and write definitions, possible solutions, and implications if corrective action is not taken for each. This will become your *"Custom Report Writing Manual"* we discuss in Chapter 6. The manual will contain a clear and concise definition of the problem, a statement of the solution and a list of the implications for their company if they don't solve the problem. These templates become your "Bible" allowing you to quickly create a new Business Check-Up Report tailored specifically for your client.

Here are examples of what I mean:

Situation – Current financial system is inadequate for proper management of the business.

> **Problem:** Financial management encompasses far more than bookkeeping and accounting. The current financial management process provides inadequate job cost reporting. This can result in cash flow challenges and ultimately inhibits the potential for growth and reduces overall enterprise value and profit.
>
> **Implications:** The level of detailed input required to effectively manage a construction company is only partially available and is often founded on intuition rather than facts. There is no detailed tracking by job (actual to planned), nor is coding done to track type of expenditure and compare it to their job budget. The current financial reports available are usable only as a look at what happened rather than a tool for management of the business. In addition, the current financial management system is basically structured to make sure the annual tax returns can be created. It is not designed as a tool for managing the company operations. Continuing in this fashion will restrict growth potential.
>
> **Solution:** Get a software package that has the flexibility to grow with you. Currently, your software is not providing the management numbers you need to control your costs, change orders and estimating as a unified system. Consider changing your accounting system.

Situation: Inadequate cash controls in place.

> **Problem:** *Cash flow controls your business activities.* When you let your cash take control of your fate, you find yourself delaying projects, canceling initiatives, or changing your company structure to accommodate the whims of your balance sheet. But if any aspect of your company should be completely under your control, it's your cash. So take charge of it.
>
> **Implications:** A company without cash cannot operate –it's as simple as that. Without adequate cash flow, you can't meet your financial obligations on time or you discover that you're spending money on unnecessary loans to fill the gap between your payday and everyone else's.

Solution: Use budgets to forecast how much cash you need, and then structure your income and expenses so you have the cash to do what you want when you need it. Read that again: *structure your income and expenses to generate the cash you need*. This is the power of measuring your business activities: you know what every activity costs (fixed and variable costs), and what every activity earns, which means you can take full control. You might also consider getting a system that has been designed for forecasting your cash needs – remember to focus on what you do best and outsource that which others do best.

Situation: Company has not determined safe level of debt.

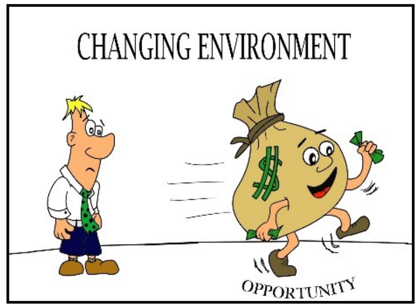
Problem: Debt can be an incredibly useful tool for growing your business. But it's also very dangerous if done wrong. Companies that use debt intelligently are more profitable and tend to stay around much longer than companies that borrow against their profits or borrow much more than they can repay.

Implications: If you don't know your safe level of debt, you might find that your company is leveraged beyond its operational capacity. You're paying a lot for this debt service and it's chewing into your cash flow and profits.

Solution: Borrow to invest in appreciating assets, not to pay for costs that revenue should be covering. Don't borrow more that you can repay. And make sure you're not fooling yourself by borrowing your profits. Instead, base your borrowing on your hard costs, and calculate your needs with a solid formula. Intelligent borrowing will impact your cash flow directly – don't let it get out of control. This affects your fixed costs.

At this point, you may be asking yourself, "How do I uncover these issues my client has?" or "How am I supposed to know the problem, let alone the solution?" We'll cover some of that in the next chapter then walk you through the steps in the following chapters. Like structural engineers, electrical engineers, civil engineers, etc., Cash Flow Engineers need to have at least a base line level of knowledge in their craft before they can apply their expertise and tools in the real world.

Chapter 2: Understanding The Business Owner



Every business owner has three resources: time, energy and money. In reality, they never have enough of any of these resources. A common characteristic of most entrepreneurs is that they are overworked, underpaid and constantly worried about making payroll and the future. Sound familiar?

In fact, most business owners are competing in industries characterized by many small operators and nearly all of them are struggling just to survive. The business environment is constantly changing, leaving owners with the perception that opportunity is slipping away. As a result, they feel like they are always chasing the next deal.

In most competitive situations companies are faced with high risk and an uncertain future. It all comes down to cash and ***driving consistent, predictable and sustainable cash flow***.

You've heard it before: *Cash is King*. The **number one problem** facing business owners is that they don't have enough cash to:

- Pay themselves, their vendors, their suppliers, and their employees
- Invest in marketing and sales, or
- Reinvest in their business in order to get it to the size and value they need to have the lifestyle they deserve.

So, how can we help you?

First, it is important to understand the most common reason for failure in business is the inability to maintain adequate cash on hand to meet the company's ever-changing requirements. This may be due to inadequate planning, budgeting or financial controls; a bad profit model; lack of leadership skills; inability to price correctly; and/or inability to get the message out. But our experience tells us that business owners who *follow their numbers* are much more successful than those that don't. So why don't more people look at their numbers? Most business owners either ignore their numbers or are scared of their numbers. We call this *Arithmophobia* (and yes, that's a real condition!). We'll describe this condition and suggest some treatments below.

What is the

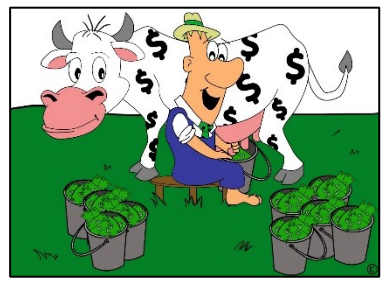
#1

objective of a business owner?

What is the number one objective of a business owner?

Most business owners want to turn their business into a cash cow. Our definition of a cash cow is a business that:

- Continues to not only make a profit, but generates consistent cash flow – day after day, month after month, and year after year
- Requires only minutes per day to manage
- Gives the owner the financial freedom, time and energy to enjoy to benefits of ownership and NOT be chained to it!



And, really, isn't that what every potential client got into business to achieve?

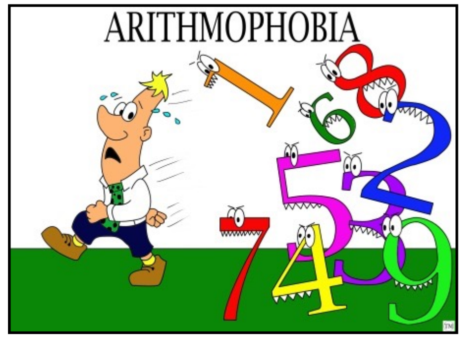
The harsh reality, though, is that 80% of new businesses will fail within the first five years, and of those that remain, 80% of them won't make it to their 10th anniversary. That means that there is less than a 4% chance that businesses will make it to their 10th year.

We can help our clients by introducing them to Cash Flow Engineering®. The objective is to help them drive their cash flow in a consistent, predictable and sustainable way. Our objective is to have the business owner view every dollar they spend as an investment in their company. Think about this… how many of you would invest $1 into the stock market if you would only get a return of 87₵. Hopefully, no one would. But, if you would get a return of $1.25 on that $1.00 invested, you would probably invest as much as you could.

The keys are being able to predict that return and having the cash flow to invest to generate even more cash.

These two keys are the core of Cash Flow Engineering®.

Arithmophobia



We often fear what we don't know or understand, and that's certainly true of the numbers that flow through a business. In reality, business owners simply don't know which numbers to watch, when to watch them, how to interpret them and what to do if they don't like the numbers they see. It can be terrifying! And that's where you come in.

As business coaches, advisors, and consultants, we are looked to as the experts that teach individuals to <u>see through the cascade of numbers and distill that information into something that is useful and actionable</u>. During this course, we will introduce you to the 7 Key Numbers that drive cash flow through a business and increase the sales and growth that will secure a business's future.

> **Note for Advisors:** The following sections are pulled directly from the course we provide business owners. Any client who completes the Cash Flow Engineering course will thus be familiar with the 7 Key Numbers and likely be much better informed and prepared to work with you.

The 7 Key Numbers and the 8 Pillars

The table below is a matrix that presents the "7 Key Numbers" against the "8 Pillars."

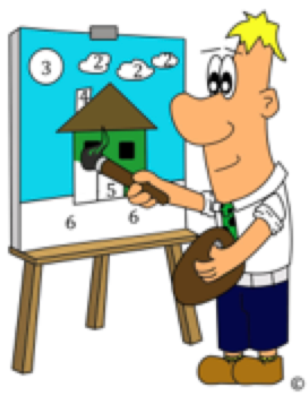
This table may not make sense to you right now—but believe it or not, this table actually offers strategic guidance to solving nearly any problem that a business will face across the three core disciplines of finance, operations, and marketing & sales.

		Strategies							
	3 key disciplines of a bus.	Marketing and Sales					Operations		Finance
	8 Pillars → 7 Key Numbers ↓	Purpose	Product	Promotion	Price	Place	Production	People	Profit
Goals	Number of leads	x		x		x			x
	Conversion Rate	x		x		x			x
	Average Price	x	x	x	x		x		x
	Retention Rate	x		x					x
	Average # of Transactions	x	x	x	x				x
	Production Costs	x	x				x		x
	Fixed Costs	x						x	x

To begin, I'll introduce you to these two concepts: the *7 **Key Numbers*** and the ***8 Pillars***. By the time you reach the end of this section, you'll understand how the relationship between these two concepts offers an incredible wealth of strategies and tactics for solving fundamental business challenges.

Here's a reality, the skills that got you into business may not be the skills you need to run your business. ***Running a business is a learned skill*** and very few of us are naturals at it.

However, this section is intended to give you a paint-by-the-numbers overview of how to analyze a business.



Derivation of the 7 Key Numbers

The 7 Key Numbers are a convenient way to diagnose a company from lead generation and sales conversion to operations and financial management. The main take-away is that these 7 Key **Numbers create an interaction that traces the cascade effect of managerial decisions.** The following discussion details the derivation of the 7 Key Numbers.

Let's start with the basics. Revenue is based on quantity times price. Price can be further explained by average price per transaction. In the restaurant business, they think in terms of average price per ticket, e.g. "how much can I get you to spend each time you come to our place of business?"

But you can't charge anybody anything until you get the customer. So sales are a function of the number of leads you generate times a conversion rate. That gives us the number of new customers. Then we look at the customer journey (how we move them from one purchase to another) to generate a frequency of purchase (i.e. milk may be purchased once a week, whereas a home is purchased once every 4 years) and we want to generate repeat business from each customer. The chart below shows the process.

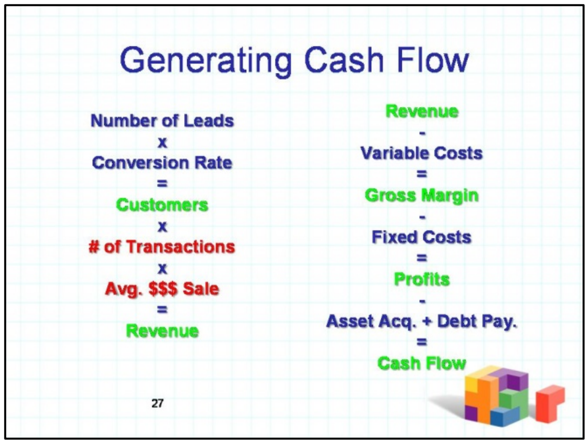
Number of Leads
x
Conversion Rate
+
Retained Customers
=
Customers
x
# of Transactions
x
Avg. $$$ Sale
=
Revenue

Once we generate revenues, it is our obligation to control costs. But, don't think like an accountant! Costs are all cash outflows: variable cost, fixed costs and other obligations (such as debt payments and asset purchases). Expanding from above, we can generate the following:

Revenue
-
Variable Costs
=
Gross Margin
-
Fixed Costs
=
Profits
-
Asset Acq. + Debt Pay.
=
Cash Flow

Can you see how this is transformational? Your accounting information may not present this is in a clear fashion. So, when budgeting, I use a totally different format to determine the achievability and reality of the budgeted numbers. I want to know how companies generate their revenue in order to determine their return on investment in various functions of their organization. Specifically, I relate their budget to marketing and sales, operations and financial management.

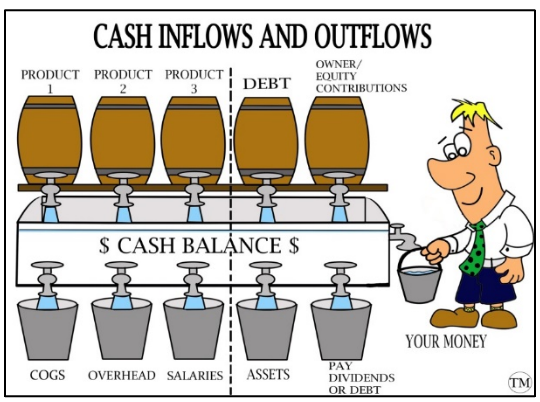
Together it looks like this:



The left side represents the marketing component of a company and the right side represents the production, delivery and fulfillment side of a business. The key to generating long-term success is to generate positive cash flow at all times.

The Bucket Theory

Most business owners focus on profits, but when you focus on broader **cash flow** instead of profit alone, you're on the way to building a company with CONSISTENT VALUE — and in the long run, that's what REALLY pays off.



This little illustration shows you how a business breathes. Instead of breathing air, it breathes money. Money comes in and money goes out. Money (credit) comes from various sources such as sales from product and services (your normal operations), loans, owner contributions and interest income, among other things.

The flow of cash (the water) makes its way into a general "trough." Along the way, money goes out to support operations and expenses. Until the money starts coming in faster than it is going out and you create a "waterline" that is high enough, there is no cash available to pay *you*.

You must monitor your cash at every point because the only time that you can really take money out of your business without killing it is when the money is coming in faster than it is going out.

Now, here is the disconnect between accountants and business owners. Business owners think in terms of cash flow coming in and going out. However, accountants look at everything to the left of the dotted line as the income statement. This includes some of the money coming in and some of the money going out. On the right side is the balance sheet. Again, it reflects some, but not all, of the money coming in and going out. Cash flow and profits are not the same thing.

Corporate America vs Main Street America

Most small businesses work by the traditional formula: Revenue minus cost equals profit. That means they make money and they spend money, and they either owe or pocket the difference. This is reactive and doesn't let you control the business.

But the big companies work off a different equation: "Revenue minus profit equals cost." Expenses are the leftovers, not profits. Do you see the difference? Wall Street reverses the formula. This says that whatever is left after you make money can be allocated to run the company. They start with a profit goal and make the adjustments necessary in their budget to achieve it. Very proactive. See the difference? Pay yourself *first* not last.

Take lessons from Corporate America. This is how they survive in bad economies and thrive in good times. And there's a lesson in language here that makes all the difference: "budgeting" is just a formal way of saying that you structure every one of your jobs based on what you *intend* to make, not what you *hope* to make. **This is the difference between Wall Street and Main Street.**

The 7 Key Numbers

The role of the leader in any organization or company is to develop a vision and the strategies to accomplish that vision. We will develop that vision in a minute, but first I'd like to introduce you to the seven numbers every leader should understand and monitor.

Think about the business process: you generate leads; you close those leads. Then, your goal is to drive more transactions per customer at the highest average price possible. You'll increase volume and revenue subject to the capacity of your company as determined by your operational and production structure. So, here are the 7 Key Numbers® that drive business success. These numbers work for small and large companies:

These 7 Key Numbers will tell the whole story of how your business is doing… and where it's headed.

The first number is the **Number of Leads** coming into your funnel. Since all income comes from customers, you need a consistent, healthy stream of new prospects entering your pipeline. The Number of Leads measures this stream and will tell you how effective your marketing is. The better you are at getting new leads, the faster your business can grow and the healthier you'll be.

The second number you must watch is your **Sales Conversion Rate** – the number of leads that actually become customers. This number will tell you how effective your sales process is. This is a critical part of your income stream. Since most of us love to do what we started our business to do – but hate to sell, this is a number we tend to overlook. Don't make that mistake! Too many businesses are great at marketing and poor at sales. Remember this: no sales, no money.

Number 3 is your **Customer Retention Rate** – how many current customers will continue to do business with you after the first transaction. The more customers you keep, the less new customers you need to get. That could lower your costs per transaction. When you form a relationship with a customer, are they a 'customer for life?' Or do you think of it as a more short-term relationship? Even high-ticket buyers, like homebuyers, should be looked at as long-term repeat buyers. After all, you want your business to be around for the long haul, don't you?

Number 4 measures how many times during a given period of time will a customer do business with you, or the average **Number of Transactions** per customer. Again, too often we think in terms of one big transaction. Think of your local auto dealership, though. They sell a car for a large dollar amount, but they offer parts and service that keeps buyers coming back on a regular basis. In fact, that dealership makes more on the subsequent transactions than they do on the sale of the vehicle! Homebuyers purchase a home, but then often there is remodeling, additions or even routine maintenance that can add to your bottom line.

Number 5 measures your **Average Price or Ticket per Transaction.** In any given visit, how much will each customer spend on your goods or services? If you measure that, you can begin to answer the next question, "What can I do to make that number bigger?" Is it by raising your prices or selling more goods and services every time you work with that customer?

So, numbers 3 through 5 tell you the lifetime value of a customer. If you're not totally in tune with that, then you're really not thinking long term. Measure and manage your lifetime value of a customer and you'll see your business steadily grow.

But, there are two more numbers you need to consider:

Numbers 6 and 7 have to do with how efficient you are at doing business. **Number 6 is your Variable Costs**. While the first five numbers address the money that comes into your business, number 6 measures how effectively you use your resources in purchasing, producing and fulfilling your customer's purchase. And frankly, failing to monitor this number can sink a business fast! But fortunately, I've learned some business-saving ways to control variable costs that can work for any business, and I'll be sharing these as part of this program.

The final critical number is Number 7, your Fixed Costs – your general business overhead and expenses. Finding the right balance between location and rent or mortgage, for example, can be tough. Do you base your decisions on past business or potential business? How to do you know when it's time to increase your investment or to cut back on overhead? Those are important questions, and fortunately the formulas I'll share with you can help you get and keep control of your overhead and expenses, and help you make the right decisions time after time.

Proactive vs Reactive

Now, here's how successful businesses use the 7 Key Numbers. **They start with the end in mind.** In other words, they turn these numbers upside down and start with a cash goal. Just like big companies, as I discussed earlier.

Working Your 7 Key Numbers

Tip - Take your 7 Key Numbers and turn them upside down. The first number you set should be your cash. In other words, pick your cash flow! Once you have determined what the cash flow will be, let that drive all the other numbers. Use your 7 Key Numbers to develop reasonable projections. If you don't know your numbers then guess! Over time you will triangulate to the correct numbers. You'll find that you're much better at protecting your cash flow when you know what it is from the start.

1. **CASH:** *This is a dollar figure.* How much free cash flow would you like to earn as a result of your hard work and the risk you take (this is AFTER your salary)? $______________.

   You should budget a profit goal to compensate you for the risk, the sweat, and the stress you endure as a business owner.

2. **Fixed costs:** *This is a dollar figure.* What are your annual costs for rent, leases, salaries, insurance, etc.? $______________.

   The key to fixed costs: You should budget your fixed costs to include a yearly salary that, at a minimum, would equal the amount you'd receive doing the same work for someone else. Again, these numbers should include how much you, as the owner, will earn AND should be part of your *planned* fixed costs, not something you *may* get if you're lucky.

3. **Variable costs:** *This is a percentage of revenue (or 1 – Gross Margin).* What percent of your revenue goes right back out the door to cover costs of goods sold, labor costs, shipping costs, sales costs, etc.? ____%

   This will drive your REVENUE goal. But, revenue is a function of five other numbers.

4. **Average price per transaction:** *This is a dollar figure.* What is the average price per transaction? $___________.

   If you divide the Revenue by the average price per transaction, you'll determine the number of sales you need.

5. **Number of transactions per customer:** *This is a number greater than or equal to one.* On average, how many times do your customers buy from you (in discrete transactions)? If they sign up for recurring monthly service or annual subscriptions, count that as 12.

   ____

   Dividing the number of sales you need by the average number of transactions per customer determines how many customers you need. But you may have some customers already.

6. **Customer retention rate:** *This is a percentage as well.* How many of your customers that buy once buy again? _________%

   By creating a customer retention program, we can keep some of the customers we have coming back. It is well-known that keeping customers is much cheaper than generating new customers. This drives a concept called lifetime value of a customer.

   So if we subtract the number of customers we already have from the number of customers we need, we define the marketing and sales effort needed.

7. **Sales conversion rate:** *This is a percentage.* How many of the leads (Number 1) convert to actual paying customers? ___________%

   Once we know our ratio of prospects to closings, we can then derive the number of leads our marketing effort needs to drive.

8. **Number of leads:** *This is a whole number.* How many new leads does your marketing generate for your company per month? ____

   Divide this number by 12 to get your monthly number of leads:___

Also, you (as their coach) should begin to think about strategies to achieve these numbers.

Understand the 7 Key Numbers that drive a business. You need to understand the interrelationships between revenues and expenses and what you need to do to get the results you want. If you want to plan backwards from goals to operations, you need to have predictable costs and revenues. Not just how much you expect to make or lose, but how each activity affects every other activity. How much will your costs have to increase, for example, in order to generate 50% more leads every month?

Example: Suppose you have a consulting practice and decide that you want a return on investment (cash) of $30,000. Your fixed costs are $250,000 per year and that includes your salary. Your costs of sales are 40% (which covers your target staffing levels and other miscellaneous costs). Then your sales goal must be approximately $467,000. At a blended rate of $200 per hour that would mean you need to generate 2,333 billable hours. If each client takes approximately 12 hours per engagement then you will need 194 clients. Looking at your existing clients, you will note that historically you keep 80% of them year after year. That means that you will need 34 new customers. If you close one out of every 4 qualified prospects, that means your marketing program that generates 138 qualified leads.

Line	Key Number	Plan
1.	Cash *goal*	$30,000
2.	**7. Fixed costs**	$250,000

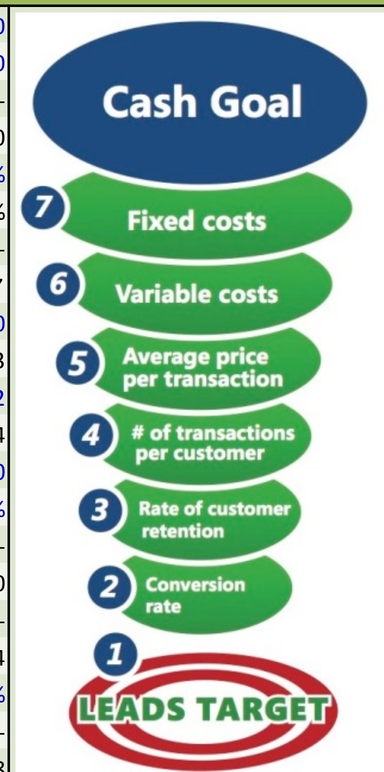
3.	*Total Costs to Cover (Line 1 + Line 2)*	$280,000
4.	**6. Variable costs**	40%
5.	*Gross Profit Margin (1- line 4)*	60%

6.	*Revenue goal (Line 3 ÷ Line 5)*	*$466,667*
7.	**5. Average price per transaction**	$200
8.	*Total units sales goal (line 6 ÷ line 7)*	2,333
9.	**4. Number of transactions per customer**	12
10.	*Number of Customers Needed (Line 8 ÷ Line 9)*	194
11.	*Number of existing customers*	200
12.	**3. Rate of customer retention**	80%

13.	*Number of retained customers (line 11 x line 12)*	160

14.	*Number of new customers needed (line 10 - line 13)*	34
15.	**2. Conversion rate**	25%

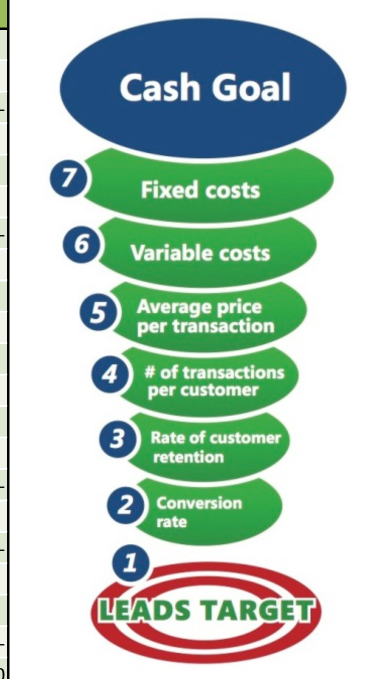
16.	**1. Leads target**	138



© 2016, Cash Flow Engineering, LLC

Now it's your turn!

Your 7 Key Numbers! Modeling from your Profit Goal			
Line	Key Number	Sample Plan	Your Plan
1.	*Cash goal*	$30,000	
2.	**7. Fixed costs**	$120,000	
		--------	--------
3.	*Total Costs to Cover (Line 1 + Line 2)*	$150,000	
4.	**6. Variable costs**	75%	
5.	*Gross Profit Margin (1- line 4)*	25%	
		--------	--------
6.	*Revenue goal (Line 3 ÷ Line 5)*	*$600,000*	
7.	**5. Average price per transaction**	$600	
8.	*Total units sales goal (line 6 ÷ line 7)*	1,000	
9.	**4. Number of transactions per customer**	4	
10.	*Number of Customers Needed (Line 8 ÷ Line 9)*	250	
11.	*Number of existing customers*	100	
12.	**3. Rate of customer retention**	50%	
		--------	--------
13.	*Number of retained customers (line 11 x line 12)*	50	
		--------	--------
14.	*Number of new customers needed (line 10 - line 13)*	200	
15.	**2. Conversion rate**	25%	
		--------	--------
16.	**1. Leads target**	800	0
© 2016, Cash Flow Engineering, LLC			



One method you have for predicting future results is extrapolating from the past. You can do this manually, of course: you can scour your bills and invoices and expenses and build formulas for figuring this out. But the better way is to use a system that does this all automatically: you just focus on running your business, knowing that your system is automatically measuring and analyzing and preparing the reports you need to make planning decisions.

Understand the **cascade effect** of your numbers. This interrelationship of numbers drives cash flow. But, in order to plan for the future, start with your cash goal and work backwards for determining how hard you will work. This will help you design all facets of your business.

But what happens when you aren't meeting your numbers? If we aren't meeting our expectations, there are 8 areas of your business that are the levers for change. We call these 8 levers the 8 Pillars of the 8 Ps.

The 8 Pillars (aka the 8 Ps)

The 8 Pillars infuse power into the 7 Key Numbers and give you the control to accelerate your business growth and profitability.

The 8 Pillars help determine what needs to change in your business to get you where you want to go. Together they provide a framework that allows for better, faster management decisions. They provide the foundation for a business owner to maintain full control of their business and to achieve the benefits of ownership commensurate with the risk.

For a business to grow stably and profitably it has to be well-defined and well-positioned. We use the 8 Pillars, to describe a business, both externally and internally. These 8 Pillars for Success are critical metrics that apply to virtually any business.

The first requirement to generate both short and long term cash flow is to have a **Purpose**. A purpose is defined by your vision.

However, the basic key to business survival is to generate both short and long-term cash flow. **Notice that I did not say "profit".** Most of us realize that the fundamental process in long-term survival is to <u>generate cash (hopefully profit) by charging more for your products</u> than it costs to produce them.

The success of the enterprise is determined by the "profit" it makes. By the way, we are going use profit as a synonym for cash flow AND financial management because we aren't using the accounting definition of profit (see next section).

From an economic standpoint our next goal is to generate **Profit** which is defined as revenues less costs. Note that we now have 2 Ps (Purpose and Profit).

Cash Flow = Revenue (and receipts) – Costs (and other expenditures)

This is a fairly simply concept. However, we need to break down these items into subcomponents so that we can plan and operate our business. Revenue is the quantity of your goods or services that you sell times the **Price** you charge (Q x P). So, restating the above formula (using algebraic substitution):

Cash Flow = Quantity x Price - Costs

The quantity you sell is a function of your **Product** mix, the **Place** you offer your products, and your **Promotional** efforts. (You may recognize the 4 Ps of marketing: Product, Place, Price and Promotion.) Now, let's continue to breakdown the cost side of the equation.

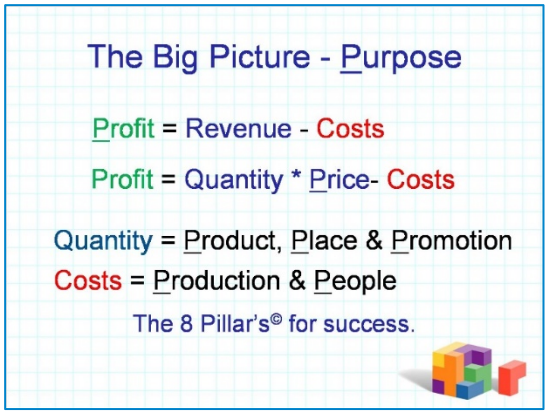
Costs = Variable costs + Fixed costs

On the cost side, costs depend on both your **Production** processes (variable costs and expenditures) and the **People** you employ and the costs associated with keeping your doors open (fixed costs and expenditures). People also include the concept of management. Management's purpose is to plan, organize, direct and monitor.

Again, by substitution our formulas is:

Cash Flow = Quantity x Price - (Variable + Fixed Costs)

If you have been counting, there are eight elements of a business that all business owners must pay attention to in order to be successful:



Executing on all 8 Pillars of business demands that you develop systems that work well. Recall that there are three major areas of a business:

- Marketing and Sales
- Operations and management
- Financial management

These three areas are all related and it is imperative that all three are fully integrated to have a fully operational business. **In other words, focus on the whole business not just the parts**. For example, think of a car's engine. For the engine to work properly, all the components of the engine must work properly. If the fuel pump isn't working up to specs, then the whole engine suffers.

This simultaneous attention to both the big picture and the details ensures that your company will acquire new customers and retain existing ones.

So, let's recap and expand our definition. The 8 Pillars of every business are:

- **Purpose**: Mission, vision, core values, and strategic objectives.
- **Product**: Characteristics of your product, your market, competition and the industry in which you operate
- **Place**: Dimensions of the business (brick and mortar, virtual, etc.)
- **Promotion**: Business development which is usually segmented as advertising, promotion, merchandising (point of purchase) and selling
- **Price**: Pricing policies & terms
- **Production**: Operations, fulfillment, delivery and post-sales support
- **People**: Management, employees, culture & organization
- **Profit**: Fiscal & Financial Management

And by manipulating any of these levers, we can drive change.

Using the 8 Pillars

As I said previously, the 8 Pillars help determine what needs to change in your business to get you where you want to go. Together they provide a framework that allows you to make better, faster management decisions. They provide the foundation for you to drive your business rather than just create a job for yourself.

So, let’s expand the 8 P’s even further:

Pillar #1: Purpose

- Why are you in business?
- What do you want to achieve? What do you want your business to become?
- Who do you serve and what benefits do you bring them?
- Are you running the company with a clear vision and sharp focus?

Too many business owners lose sight of why they began their business in the first place. Lose sight of that purpose and you run the risk of becoming confused and getting off track. Answering these questions helps you maintain a growth- and purpose-oriented focus.

Pillar #2: Product

- What are you selling?
- Is what you’re offering in line with what people are buying?
- Have you done your market research? Have you identified current and coming trends?
- Have you developed the right mix of products for your target market?

Making sure your products meet the needs and demands of the market – consistently and over time – is critical to your stability and profits. Keeping in tune with your buyers will ensure your longevity and growth.

Pillar #3: Place

- Where are you conducting business?
- How do your customers interact with you?
- Do you need to open a new office? Sell online? Rent a stall at the flea market?

The old adage: ‘Location, location, location’ still holds true. Today, though, location can mean online – or even a website optimized for mobile consumption. The easier you make it for your customers to do business with you, the more sales you’ll make.

Pillar #4: Price

- How are you pricing your product?
- Are your products priced correctly for the value you offer?
- What would happen if you were to raise the price?
- What would happen if you lowered it?

All products and markets are price-sensitive, but price is rarely the determining factor in a purchase. And the lowest-priced product is usually the first one out of business! Do you think Starbucks is trying to compete with McDonalds in the way they price a cup of coffee? Of course not! Instead, their price is determined by the value of the experience they offer their customers.

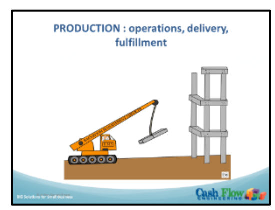
Studies show that most companies with viable products could raise their prices by as much as 30% and still retain 95% of their customers!

Pillar #5: Promotion

- How are you telling people about what you sell?
- Do you have a strategic marketing plan AND a sales plan?
- Have you defined your target audience?
- How are you communicating your competitive advantage?

How you promote your products and services has to align with what your buyers are looking for and how they shop. And it's usually not just a product that they're shopping for – it's a solution. It's been said that nobody needs a drill; what they need is a hole. Identify and promote your solutions and benefits in the right way and you'll never lack for customers.

Pillar #6: Production



- How are you producing your product?
- Is your production process both efficient and effective?

Your market won't tolerate inefficiency. While buyers will consistently choose value over price, they won't overpay for your inefficiencies, either. If you're a builder that might mean exploring materials and methods that deliver high value and efficiency. If you provide a service, are you delivering meaningful solutions on time and within budget? Constantly look for ways to make your production processes lean and competitive.

Pillar #7: People

- Who is involved with your company?
- Do you have the right people?
- Are they in the right places?
- Are all your employees and vendors your advocates as well as assets?
- Could your business survive losing you?

Your company is the people that compose it. Most entrepreneurs have a real problem hiring people that can grow the business – and delegating to them. They assume the "If I want it done right I need to do it myself" attitude. If you want the real freedom that your business can offer you, then hire the right people – and get out of their way!

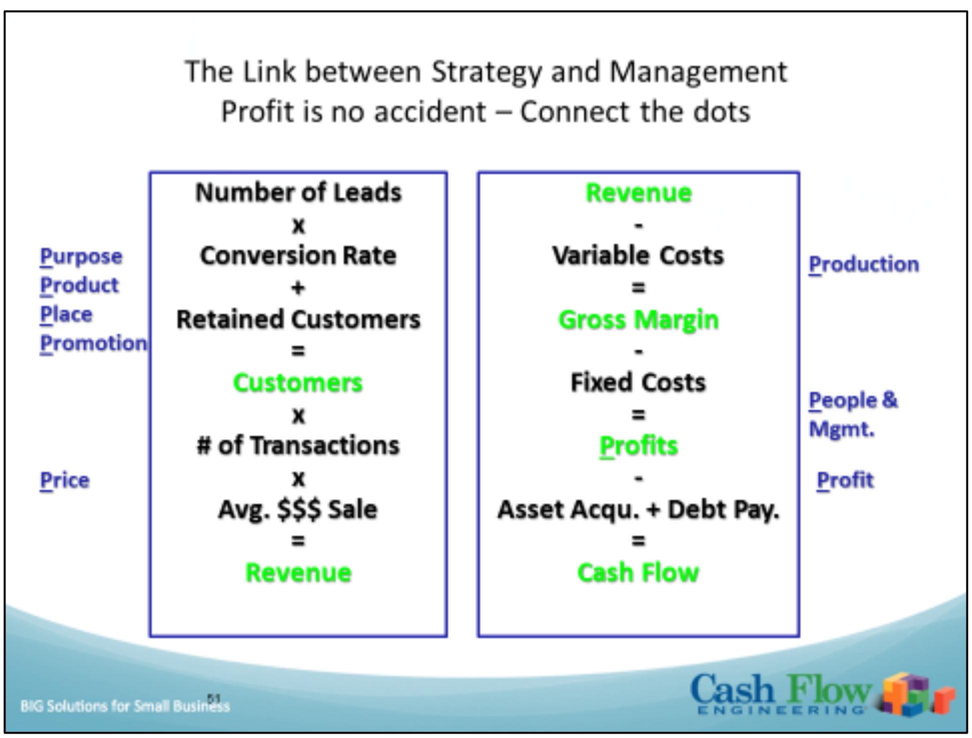
Pillar #8: Profit

- Are you generating cash flow and profit?
- How are your revenues, costs, and balances stacking up against your benchmarks?

Here's something that might surprise you: You can stay in business for years without making a profit. But, you will not be able to last one day without cash. Cash flow is the lifeblood of your company. Take a look at some of the biggest companies – LevelOne, Amazon, and Apple. Initially, none of them made a profit. However, they generated cash from investors and debt. But, over the long term, your business has to be profitable to survive. Positive cash flow is your overriding objective, but long term profit is a close second.

Watching the 7 Key Numbers will allow you to stay both competitive and profitable. And of the 8 Pillars that we just discussed, the first 7 Pillars will provide the framework that will make the 8th Pillar, Profit, a natural result. In fact, using these two management and planning tools – the 7 Key Numbers and the 8 Pillars – will make it almost impossible to fail, no matter the economy or market.

The Strategic Matrix for driving change



Strategies answer the question of "how are we going to accomplish the objective or drive the change?" In order to drive change, first determine which numbers you need or want to change. Then simply determine which levers you want to pull to drive improvement in those numbers.

		Strategies							
	3 Key Disciplines	**Marketing and Sales**					**Operations**		**Finance**
	8 Pillars → / **7 Key Numbers ↓**	**Purpose**	**Product**	**Promotion**	**Price**	**Place**	**Production**	**People**	**Profit**
Goals	1 Number of Leads	x		x		x			x
	2 Conversion Rate	x		x		x			x
	3 Average Price	x	x	x	x		x		x
	4 Retention Rate	x		x					x
	5 Avg. # of Transactions	x	x	x	x				x
	6 Production Costs	x	x				x		x
	7 Fixed Costs	x						x	x

As an example:

First, isolate the numbers we want to change. What if we could (goal setting):

- Increase the conversion rate from 25% to 35%
- Increase the average price per transaction from $500 to $750?

Then isolate the levers that will create that change (Strategies):

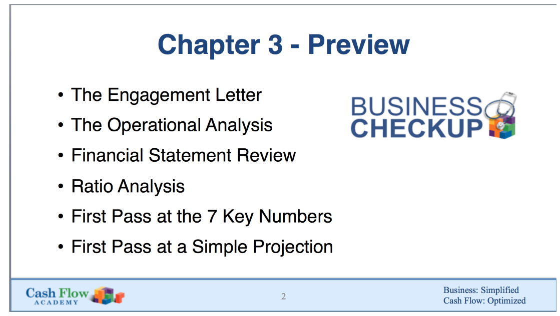
- Promotion: Increase conversion rate by letting Art handle all sales, using a customer qualifying sheet, and training staff in proper phone technique.
- Price: Increase the average price by sending smaller jobs to our competitors, using better time management, and employing better qualifying practices.

It's as simple as that.

Chapter 3: Preparation

Introduction

So we now know what is going through the minds of our clients, we understand the objective of a business is to drive cash flow and we know a major stumbling block for clients may be Arithmophobia. In this section, we will talk about the engagement letter and start to apply what you've learned about the 7 Key Numbers and the 8 Pillars.



The Engagement Letter

Let me preface this section by saying there is no substitute for having a lawyer review your documents. This section is merely an overview of the engagement letter and is not to be construed as legal advice. In fact, you will need to format your document to comply with requirements as a CPA. Here are some of the provisions that I use (again, seek your own legal counsel and make sure you comply with all applicable rules).

<u>The Parties</u>: This should outline the parties to the agreement (usually your firm and the firm to which you are offering your services).

<u>The Preamble</u>: The Preamble (also called recitals) might start by thanking them for their confidence in selecting your firm to provide a Business Check-Up. Also, state that pursuant to their request you are providing the agreement as "a definitive, full expression of our mutual understanding and agreement." Finally, include agreement text such as, "You agree that you have had adequate opportunity to review and negotiate this Agreement with counsel of your choosing and therefore the terms shall be interpreted as though written by both parties."

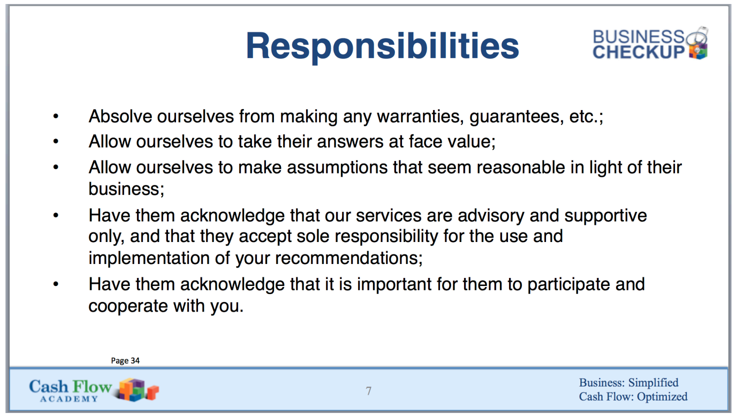
A typical Engagement Letter might include the following elements:

<u>Scope of Work and Price</u>
In this section we tell them:

- Our price - as well as how we will get paid (i.e. down payment, progress payments, final payment, etc.)
- What this includes (e.g. "This will include a one-day session with the client …")
- What is required of the client:
    - Operational Analysis Form (to be provided)
    - 3 years of tax returns
    - Profit and Loss Statement (Income Statement) and Balance Sheet for the 3 years (if available)

- What you will do (e.g. “We will evaluate your action plan for achieving your cash flow, revenue, profit and long-term growth goals and do the following…”)
- What they will get: (e.g. At the end of the engagement we will give you a summary of our findings”)

Responsibilities
In essence we want to:



- Absolve ourselves from making any warranties, guarantees, etc.
- Allow ourselves to take their answers at face value
- Allow ourselves to make assumptions that seem reasonable in light of their business
- Have them acknowledge that our services are advisory and supportive only, and that they accept sole responsibility for the use and implementation of your recommendations
- Have them acknowledge that it is important for them to participate and cooperate with you

Acceptance: Upon acceptance of this agreement, state what the client will pay you and how it is to be paid. For instance: “If paid by credit card, you authorize us to charge your credit card.”

Termination of Agreement: In the event materials mentioned above are not received or you don’t get along, you should have a provision to terminate the agreement. This should be mutual between you and the client.

Indemnity: Have your attorney put in an indemnity clause and if there is a suit, where the jurisdiction shall be.

Signatures to the agreement: Have signature blocks with dates and titles of people involved.

Welcome letter

Once they sign the engagement letter, send them a follow-up email and/or letter. I use the following:

> Dear _______,
>
> Congratulations! You’ve just taken an important step towards improving your business.
>
> More than any seminar, course or business class you may have taken, Backroom’s Business Check-Up will deliver insights into your business that will help you plug leaks,

increase efficiencies and generate consistent and predictable cash flow – from now on! We're excited to be working with you, and eager to get started.

In order for us to deliver the greatest benefit to you, there are some things that we'll need before we begin:

- The Operational Analysis form (attached). Please fill it out and send it in before our meeting. Don't spend a lot of time answering the questions. Short answers, incomplete sentences – even one or two word answers are acceptable. This is for information purposes only. In all, you should not spend more than 1 minute on each answer; most should take only a few seconds.
- 3 years of tax returns (if you file a schedule C, we do not need your whole return).
- Your Profit and Loss Statement (Income Statement) and Balance Sheet for the 3 years (if available) from your accounting system, and your most current P&L and Balance sheet. If you haven't been in business for 3 years, please give us what you have.
- Your most current aged receivables and payables.
- A copy of a job costing and tracking report for at least one home.

Please make sure that we have these a few days before our meeting as I'll need some time to analyze the information before we meet.

Thanks again for the opportunity and I look forward to our next meeting.

Sincerely,

[sig]

The Operational Analysis

The operational questionnaire for our fictitious company, Vandelay, is shown below. The first part is divided into categories that represent the 8 Pillars. I developed the 8 Pillars when I created a course on how to write business plans (many years ago). It works for virtually any company. Caveat: If you work with specialized industries, tailor this form to make it applicable.

Some clients handwrite their answers; others type them in. Just make sure you get their gut reaction (which is why I tell them not to spend more than one minute on any given question). During the interview (next chapter), you might find that their real answers differ significantly from what they wrote down.

Take a few minutes to look at the answers and make comments on the form as appropriate. This will create a foundation for the actual Business Check-Up. In each section, there will be an editorial part in normal print.

Basically, every time there is a no answer, an incomplete answer or a question mark, it opens up an opportunity for you to do additional consulting.

> Note: In the following example, you'll see the questions I asked and the answers Art Vandelay provided either highlighted or in italics and underlined. We use these responses for the rest of the analysis and Business Check-Up.

Business Overview (Purpose):

- What is your business? *Remodeling and handyman work*
- Why did you start your business? *Enjoy project management and was tired of working for others*.
- Do you have a business and/or financial plan to develop this growth*? No mission statement. No financial plan!*
- What keeps you awake at night? *Getting new quality jobs and cash flow. Seems like every time I collect money from someone, there are bills to use up all the money.*
- How are you doing? *Seem to be working harder and getting nowhere*.
- On scale on 1-10 rate your marketing & sales? 1 3 5 7 9 10
    - Are you okay with that? *No, seem to always be using the next job to pay for the last.*
- On scale on 1-10 rate your Operations? 1 3 5 7 9 10
    - Are you okay with that? *Have a lot more jobs but nothing to show for it. Started doing more handyman work to get through the recession.*
- On scale on 1-10 rate your overall finances (cash flow and profit)? 1 3 5 7 9 10
    - Are you okay with that? *No, but I guess I can do everything myself and save lots of money.*
- On scale on 1-10 rate how would you rate your lifestyle? 1 3 5 7 9 10
    - Are you okay with that? *I can't figure out how I'm going to make real money. I seem to always be working.*
- Where do you want to be as a result of being a business owner? *Make a comfortable living.*
    - Lifestyle? *Be able to leave the office for 3 day weekends here or there.*
    - Financial goals? *Maybe $150,000 a year.*
    - Where do you see your business growing? *In this recession, I'm taking on smaller jobs. My people need raises, so I guess I'll work harder. Timeline? Don't know.*

Other questions you can ask:

____

____

____

____

Product:

- What are your products/services? *We started out by doing basements only but in order to keep our crews together, we are doing handyman work.*
- Do you know your profitability by product/service? *No, we don't know how much we are making on a job nor do we know how to calculate that.*
- How did you decide to sell this product/service? *Was working for someone else and got tired of taking orders and working for someone who didn't know what they were doing.*
- Why is your product/service better than competition? *Personal attention to details. Ability to deliver a quality product at a reasonable price.*
- Does your chart of accounts and books segregate sales by type of product/service? *Don't know.*
- What is unique about your product, your service, your delivery, your follow-up and/or you? *We have a warranty that goes until they sell their home.*

Other questions you can ask:

____

____

____

____

Price:

- How do you price your product? *We estimate our hard costs and then apply a factor to it.*
- What is your pricing strategy? *Beat the competition and do whatever we have to, to get the job.*
- How do you factor in your costs? Is it profitable? *Detailed estimate based on costs. I think it is profitable!*
- Does your price cover your costs to produce the product/service, warranty, overhead and do you know your breakeven volume? *Don't think we are covering our overhead and my salary.*
- What is the average price per transaction? $600

Other questions you can ask:

____

____

____

____

Place:

- How do you find your customers? *Word of mouth, flyers around jobs, ads in local paper*
- Where do you sell your products? (Retail, wholesale, public?) *Homeowners in the Arvada area.*
- Can you track sales by source, distribution channel, office, sales person, distribution channel? *Generally, we know where they come from, but we don't track.*
- Where is your geographic market? (Local, state, national, world? *Local, like we said, Arvada and surrounding areas*
- Do you sell through the internet? If so, how? *Not applicable*

Other questions you can ask:

____

____

____

Promotion:

- Who are your customers? Demographics of market? (Age, income, ethnicity)? *Usually something is changing in their lives, more children, aging in place, want change*
- How do you get your phone ringing? *Word of mouth, flyers, ads.*
- Do you have a sales force? Anyone who answers the phone. Website? *Yes, we do have a website with pictures of jobs we've completed.*
- Referral program? *Trying to set one up.*
- Are you tracking your leads? *Usually, no formal process*
- Do you have a process for following up with leads and prospects? *Yes, we set up an appointment and bring our notebook to show them our work. As the economy changed, we started getting small jobs, we drive over, give an estimate and try to close at that point.*
- Do you have a way to track the progress of a sale? *No*
- Do you have a client continuity (outreach) program? *No, working on it.*
- How many new prospects a year do you get? *500*
- What percent of those new prospects become clients? *25%*
- How many transactions per year do you have with your clients on average? *When we did basements, it was only one, but now that we are doing handyman work, we see our average client 4 times per year.*

Other questions you can ask:

____

____

____

Production:

- How do you make your product or provide your service? *Each job is different, so we have to determine the scope of the work, meet with clients frequently and then custom design a solution.*
- Are you dependent on any suppliers or vendors? *NO* How many? *No* How often? *NO*
- Do you have a scheduling system that tracks bottlenecks (either employee or vendor)? Areas that slow you down? *We are too small to have a scheduling system. However, a problem is getting vendors to show up on time. We are too small to get them to show up when we are ready.*
- Do you keep product on hand? How much? *N/A*
- Do you have a product or service that has a sequential order in their delivery (i.e. building a house)? If so, do you have a way of tracking jobs in both dollars and time? *There are similarities between each basement.*
- Do you have a system to track employee productivity? *We only have two hourly people on payroll and one administrator.*
- If you are a service-based business, can you top-grade your vendors, clients and employees? Top grade means give them an A, B, C or F grade. *We take whatever vendors we can get.*
- What are your variable costs as a percent of revenue? *75%*

Other questions you can ask:

____

____

____

____

____

____

____

____

People:

- Do you have an organization chart? (If so, please send us a copy of it.) *no*
- How many people do you employ? *3*
- Do you have enough staff? *yes*
- Do you have job descriptions for all the people in your organization? *No*
- Do you have insurance policies in place to protect your business? *G/L, car & truck, WC*
- Who are the key advisors you currently use? *Accountant does taxes*
- Do you have and use a system for successful hiring? *No*

- Do you conduct regular weekly staff meetings? *No*
- Are jobs produced at a cost that is within 2% of the estimated cost? Yes/No *Don't know*
- What are the key reports you use to monitor your business?
- What information do you desire and not receive? *Job Costs*
- Do you have a board of directors/advisors? *No*

Report	Why?	Who uses it?
N/A		

Other questions you can ask:

Profit and Cash Flow:

- Are you making the kind of money that you expected? *No* What are your expectations? *$30,000*
- Do you formally monitor cash flow? How? *Watch my checkbook and credit cards*
- How often do you review your financial statements? *Once a year with accountant, wife does books but I really don't pay attention to them.*
- How often do you budget? (Annual, semi-annual?) *Do job budgets, but never see how we actually did.*

- How closely do you stay within this budget? *Don't track*
- Do you monitor your key ratios? *?????*

Other questions you can ask:

____

____

____

____

As we said before, you only need to monitor seven key numbers to understand your full business funnel. Your balance sheet, income statement and statements of cash flow are important, but they don't tell the whole story. The 7 Key Numbers complete the tale by telling you clearly and concisely how every MAJOR aspect of your business is performing, and how they cascade down to profitability.

You can use the 7 Key Numbers to monitor your business activities to ensure you're on track to meet your goals. This is how we get to "Thumbs Up, Thumbs Down" management. You compare your actual results to your anticipated results and draw your own conclusion. Are your results as good or better than expected? Thumbs up! Are the results now what you wanted? Thumbs down.

____

Your 7 Key Numbers

Now, please do your best to estimate your 7 Key Numbers. If you don't know then guess!

1. **Number of leads:** *This is a whole number.* How many new leads does your marketing generate for your company per month? *45*
   Multiply this number by 12 to get your annual number of leads: *500*
2. **Sales conversion rate:** *This is a percentage.* How many of the leads (Number 1) convert to actual paying customers? *25%*
3. **Customer retention rate:** *This is a percentage as well.* How many of your customers that buy once buy again? *50%*
4. **Number of transactions per customer:** *This is a number greater than or equal to one.* On average, how many times do your customers buy from you (in discrete transactions)? If they sign up for recurring monthly service or annual subscriptions, count that as 12.
   They buy approximately four times a year.
5. **Average price per transaction:** *This is a dollar figure.* What is the average price per transaction? *$600.*

6. **Variable costs:** *This is a percentage of revenue (or 1 – Gross Margin).* What percent of your revenue goes right back out the door to cover costs of goods sold, labor costs, shipping costs, sales costs, etc.? *75%*
7. **Fixed costs:** *This is a dollar figure.* What are your annual costs for rent, leases, salaries, insurance, etc.? *$120,000.*

Thank you for answering these questions. Please forward them to us as soon as possible along with any other items we may have requested.

Analyzing the 7 Key Numbers – First Pass

Through the 7 Key Number framework, we can drive both **breakeven** and goal setting so that an owner gets both a salary and a return on their investment off time, energy and money.

At this time, we will do a preliminary 7 Key Number analysis to see the trajectory of the company as the owner just described it.

Vandelay Remodeling, LLC		
Your 7 Key Numbers! Modeling from Leads		
Line #	Key Number	First Pass
1.	**1. Number of leads generated**	*500*
2.	**2. Conversion rate**	25%

3.	*Number of new customers needed (line 1 x line 2)*	*125*
4.	*Number of existing customers*	*100*
5.	**3. Rate of customer retention**	50%

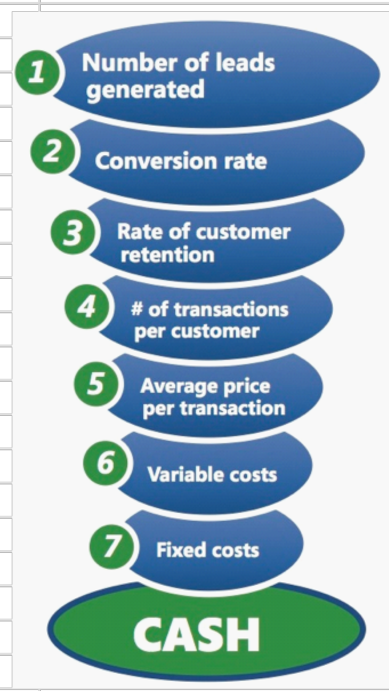
6.	*Number of retained customers (line 4 X line 5)*	*50*
7.	*Number of Customers Needed (Line 3 + Line 6)*	*175*
8.	**4. Number of transactions per customer**	4

9.	*Total units sales goal (line 7 x line 8)*	700
10.	**5. Average price per transaction**	$600
11.	*Revenue (Line 9 x line 10)*	*$420,000*
12.	**6. Variable costs**	75%

13.	*Total Variable Costs (line 11 x line 12)*	*$315,000*

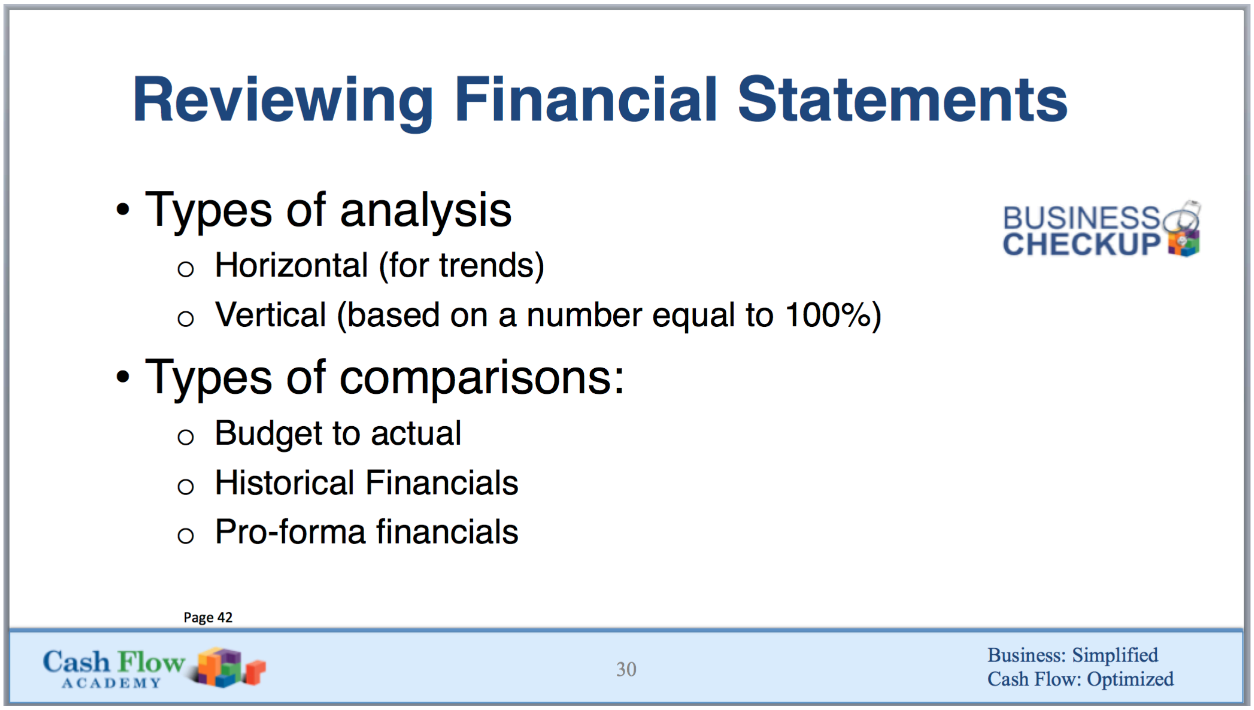
14.	*Total Gross Profit (line 11 - line 13)*	*$105,000*
15.	**7. Fixed costs**	$120,000

16	*Cash*	($15,000)
© 2015, Backroom Management Services, LLC		



Other questions you can ask:

Reviewing Their Financial Statements



Trend Analysis

"Trend analysis" involves analysis of the changes in an account balance or a ratio over a period of time. It is also used to compare historical operating levels with current operating levels.

The usual methods of comparing data are:

- Budget to actual comparisons (financial and operating data presentations)
- Comparisons to historical financials (compare financial and operating data)
- Incorporating expectations for key factors and assertions
- Comparisons to pro forma financials (historical statements recast to show the
- Effects of a transaction or event that did not occur in the historical period. (Answers the question, what if?)
- Comparison to prospective financial statements (either forecasts or projections)

To achieve the best results, you should have a summary of comparative statements, preferably for two to five years.

- Show dollar and percentage (%) figures.
- Show month-end and year-to-date figures.
- Consider showing the market value of property.

There are two types of trend analysis:

Horizontal analysis is used to evaluate the trend in the accounts over the years. The purpose of this analysis is to evaluate the dollar and percentage increases and decreases in various accounts. When an analysis covers a span of many years, comparative financial statements may become cumbersome, and therefore this analysis may more effectively showing trends relative to a base year.

In ***vertical analysis*,** a significant item on a financial statement is used as a base value, and all other items on the financial statement are compared to it. On the balance sheet, Total Assets is usually assigned a value of 100 percent. Each asset account is then expressed as a percentage of total assets. Total liabilities and stockholders' equity are also assigned 100 percent. Each liability and equity account is then expressed as a percentage of total liabilities and stockholders' equity. In the income statement, net sales are given the value of 100 percent, and all other accounts are evaluated in comparison to net sales. The resulting figures are then given in a common size statement.

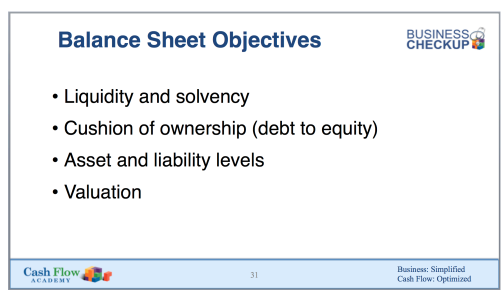
Vertical analysis of the income statement is used to indicate existing relationships between each income statement account and revenue. Vertical analysis of the balance sheet illustrates a mix of assets. Tying this mix of assets to the income statement is useful for analyzing the effectiveness of the asset mix. This helps identify underutilization of assets, unnecessary assets or the need to expand the asset base.

In addition, the results of vertical analysis can be used to further assess the firm's relative position in its industry.

When reviewing financial statements, there are certain objectives that you will want to analyze and concerns that you will want to address. In fact, knowing what to look for – what questions to ask – makes the statements more useful and easier to understand, even for business owners with Arithmophobia. Let's look at each of the common financial statements in turn, starting with the Balance Sheet.

The Balance Sheet

Balance Sheet Objectives – Evaluating the financial strength of an entity



The balance sheet basically presents the resources of an entity and the claims against those resources (secured creditors, unsecured creditors and owners). An auditor would be interested in the balances on the balance sheet in terms of management assertions (existence, completeness, rights and obligations, valuation, presentation and disclosure). Third parties would be interested in assets and liability levels and their impact on the profitability and return on investment.

- *Liquidity and solvency:* The Company's ability to meet its obligations on a timely basis and continue in existence. Liquidity measures the quality and adequacy of current assets to meet current obligations. Solvency is a long-term concept. This concept is also called alignment as it challenges the company's matching of debt to assets to determine if debt sources properly relate to the assets used as collateral.

- *Cushion of ownership:* The Company's relative size of ownership equity that is available to absorb possible losses from operations, decreases in asset values, and poor estimates of future cash flows.
- *Asset and liability levels:* This relates to the absolute amount in any given account. The actual level may be too high or low depending upon management.
- *Valuation:* Are values presented on the financial statements reasonable?

To interpret a balance sheet, the reader must ask five questions:

- Does the company have the proper level of fixed assets? Fixed assets should not be so excessive so as to reduce a company's ability to continue operating.
- Does the company have sufficient working capital to handle sales volume? In other words, does it have the liquid assets necessary to handle inventory and accounts receivable as it grows?
- Is the company solvent? There should be enough assets (at cost/at market value) to adequately cover all debt.
- Can the company pay its bills? There should be enough cash to cover all current expenses.
- Is the company building wealth? If the equity on the current balance sheet is compared to the equity on previous balance sheets, there should be an overall increase – thereby showing growth in wealth.

NOTES:

Sample Company
Statement of Financial Position
For the Year Ended December 31

	2014 $	% B/S	Days	2013 $	% B/S	Days	2012 $	% B/S	Days	2011 $	% B/S	Days	2010 $	% B/S
Assets														
Cash	24,296	1%		359,594	13%		529,708	21%		910,279	39%		1,193,003	44%
Accounts Receivable	1,008,333	32%	55	583,333	22%	50	406,250	16%	45	184,722	8%	40	315,000	12%
Inventory	561,000	18%	45	288,167	11%	38	202,222	8%	35	83,125	4%	30	131,250	5%
Prepaid Expenses	0	0%		0	0%		0	0%		5,000	0%		10,000	0%
Deposits	25,000	1%		25,000	1%		25,000	1%		25,000	1%		0	0%
Total Current Assets	1,618,629	51%		1,256,094	47%		1,163,180	47%		1,208,126	52%		1,649,253	60%
Fixed Assets														
Equipment	700,000	22%		600,000	22%		500,000	20%		400,000	17%		300,000	11%
Furniture	110,000	3%		90,000	3%		70,000	3%		50,000	2%		30,000	1%
Buildings	1,125,000	36%		1,025,000	38%		925,000	37%		750,000	32%		750,000	27%
Less Accum Depr	-408,500	-13%		-290,000	-11%		-186,833	-7%		-99,000	-4%		-29,000	-1%
Total Fixed Assets	1,526,500	48%		1,425,000	53%		1,308,167	52%		1,101,000	47%		1,051,000	38%
Other Assets														
Organizational Costs	1,000	0%		3,000	0%		5,000	0%		7,000	0%		9,000	0%
Loan Fees	13,750	0%		16,250	1%		18,750	1%		21,250	1%		23,750	1%
Total Other Assets	14,750	0%		19,250	1%		23,750	1%		28,250	1%		32,750	1%
Total Assets	3,159,879	100%		2,700,344	100%		2,495,097	100%		2,337,376	100%		2,733,003	100%
Liabilities														
Current Liabilities														
Accounts Payable	473,733	15%	38	257,833	10%	34	190,667	8%	33	83,125	4%	30	270,854	10%
Deposits Taken	0	0%		0	0%		0	0%		10,000	0%		0	0%
Credit Lines	600,000	19%		625,000	23%		650,000	26%		675,000	29%		700,000	26%
Current Maturity on LT Debt	109,388	3%		103,437	4%		97,997	4%		93,023	4%		88,475	3%
Total Current Liabilities	1,183,121	37%		986,270	37%		938,664	38%		861,148	37%		1,059,329	39%
Long Term Liabilities														
Long Term Debt	200,000	6%		240,000	9%		280,000	11%		320,000	14%		360,000	13%
Mortgage Payable	457,680	14%		527,068	20%		590,505	24%		648,502	28%		701,525	26%
Total Long Term Liabilities	657,680	21%		767,068	28%		870,505	35%		968,502	41%		1,061,525	39%
Total Liabilities	1,840,801	58%		1,753,338	65%		1,809,169	73%		1,829,650	78%		2,120,854	78%
Stockholders' Equity														
Common Stock	25,000	1%		25,000	1%		25,000	1%		25,000	1%		25,000	1%
Capital in Excess of Par	475,000	15%		475,000	18%		475,000	19%		475,000	20%		475,000	17%
Retained Earnings	819,078	26%		447,006	17%		185,928	7%		7,726	0%		112,149	4%
Total Stockholders'Equity	1,319,078	42%		947,006	35%		685,928	27%		507,726	22%		612,149	22%
Total Liabilities & Stockholders' Equity	3,159,879	100%		2,700,344	100%		2,495,097	100%		2,337,376	100%		2,733,003	100%

What trends do you see unfolding in the balance sheets?

____

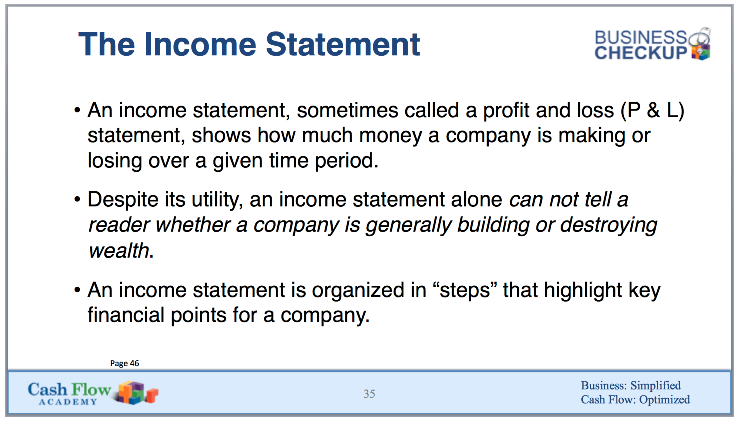
____

____

____

The Income Statement

Income Statement Objectives – Evaluating the profitability of an organization
The income statement presents an entity's ability to create profits and provide a return on assets. Third parties would be interested in the cushion of income and the ability of the entity to service debt. Management would be interested in the profit margins and return on investment. Investors would be concerned with profitability and market value.



- Cushion of income: The cushion of income is the ability to create a sales cushion in both dollars and units to enable a business to cover all anticipated costs and obligations without having to enter into a "retraction" and/or "debt" mode of operations. Creditors are interested in the "cushion of income" that exists to absorb economic downturns in the economy and/or the entity's industry.
- Fixed overhead: Does the overhead match the needs of the organization in terms of its sales, size, etc.? The key factor is to make sure that expenses are not too high or too low.
- Return on investment: Return on investment is best illustrated through the DuPont Model. The DuPont model makes it clear that the primary concerns from a management perspective is the amount of assets it takes to create a dollar of profit and the proper mix of debt and equity to create a favorable return on investment. We will discuss this subject later.
- Market value: Investors are concerned with market value ratios and the impact of these ratios on future return.

An income statement, like a balance sheet, can be compared to industry-wide averages for similar data, and serves multiple purposes. They can help an owner or manager answer these important questions:

- Are revenues where I want them?
- Am I controlling my variable costs?
- Am I pricing my products correctly (gross margin)?
- Am I selling the right products?
- Are my costs of running the business in line?
- Am I profitable?

Sample Company
Income Statement
For the Period Ended December 31

	2014		2013		2012		2011		2010	
Units Sold	120,000		80,000		65,000		35,000		28,000	
Average Price	55.00		52.50		50.00		47.50		45.00	
Income from Operations										
Sales Revenue										
Sales	6,600,000	100%	4,200,000	100%	3,250,000	100%	1,662,500	100%	1,260,000	100%
Credit Card Fees	-66,000	1%	-42,000	1%	-32,500	1%	-16,625	1%	-12,600	1%
Bad Debts	-132,000	2%	-84,000	2%	-65,000	2%	-33,250	2%	-25,200	2%
Returns	-66,000	1%	-42,000	1%	-32,500	1%	-16,625	1%	-12,600	1%
Net Revenue	6,336,000	96%	4,032,000	96%	3,120,000	96%	1,596,000	96%	1,209,600	96%
Cost of Goods Sold	4,488,000	68%	2,730,000	65%	2,080,000	64%	997,500	60%	756,000	60%
Gross Margin	1,848,000	28%	1,302,000	31%	1,040,000	32%	598,500	36%	453,600	36%
Operating Expenses										
Sales & Marketing	330,000	5.0%	210,000	5.0%	162,500	5.0%	83,125	5.0%	63,000	5.0%
Operations	264,000	4.0%	168,000	4.0%	130,000	4.0%	66,500	4.0%	50,400	4.0%
General & Administrative	396,000	6.0%	252,000	6.0%	195,000	6.0%	99,750	6.0%	75,600	6.0%
Depreciation	118,500	2.0%	103,167	2.5%	87,833	2.7%	70,000	4.2%	29,000	2.3%
Amortization	4,500	0.1%	4,500	0.1%	4,500	0.1%	4,500	0.3%	2,250	0.2%
Total Operating Expenses	1,113,000	17%	737,667	18%	579,833	18%	323,875	19%	220,250	17%
Earnings before Interest & Taxes	735,000	11%	564,333	13%	460,167	14%	274,625	17%	233,350	19%
Interest Income										
Interest on Credit Lines	-55,125	-1%	-57,375	-1%	-59,625	-2%	-61,875	-4%	-31,500	-3%
Interest on Long Term Debt	-21,600	0%	-25,200	-1%	-28,800	-1%	-32,400	-2%	-18,000	-1%
Interest Expense	-48,321	-1%	-53,762	-1%	-58,735	-2%	-63,283	-4%	0	0%
Pretax Income	609,954	9%	427,996	10%	313,007	10%	117,067	7%	183,850	15%
39% Taxes	237,882	4%	166,918	4%	122,073	4%	45,656	3%	71,702	6%
Earnings After Taxes	372,072	6%	261,078	6%	190,934	6%	71,411	4%	112,149	9%

What trends do you see unfolding in the income statement?

____

____

____

Statement of Cash Flow – Evaluating the lifeblood of an organization

Think of cash flow like you would blood flowing through the body. Without blood, the body would surely die. Without cash, an entity's ability to generate sufficient cash flows to meet the operating, financing and investing needs would diminish, and the entity would no longer be able to demonstrate any level of solvency. An auditor would be interested in the statement of cash flows in terms of management assertions. Third parties would be interested in the cash and debt cushions of the organization. Management would be interested in the sales cushion, sales leverage and asset turnover (operating cycles).

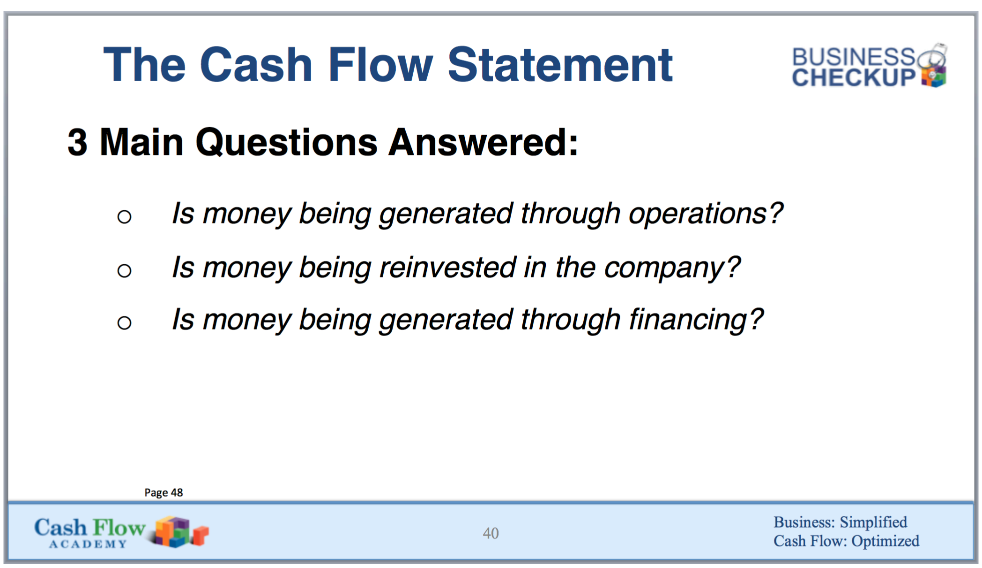
- *Cash cushion:* Creditors are interested (as management should be!) in knowing a company's "real" cash position. As a company's cash position approaches zero, there is a danger that the company's profits will be adversely impacted because of an accompanying reduction in the number of options available to management, such as taking advantage of early payment discounts, acquiring new equipment, etc.

- *Operating cycle or asset utilization:* Measures how fast assets are converted into cash. This indicates the effectiveness of distribution, sales and collection policies.
- *Debt Cushion:* Cash flow necessary to service interest expense, which is the primary measure of a firm's financial strength and stability. There are numerous relationships that are used to calculate the debt cushion.
- *Sales cushion:* The level of sales needed to cover all anticipated cash outflows.
- *Sales leverage:* The maximum amount of sales the equity of a business can "safely" sustain.

Management and stockholders may also be concerned with certain market value ratios. Think of this as a car. Your assets are the engine. If you go too slowly, it stalls (your overhead eats you up) and if you go too fast, you red line it (you blow up the car).

A cash flow statement should answer the following questions:

- *Is money being generated through operations?*
  Cash flow generated by operations should be positive – indicating that the company is fulfilling its mission.
- *Is money being reinvested in the company?*
  If investing cash flow is negative, it indicates that the company is buying assets faster than it is selling them. It is normal for start-ups and expanding companies to have a negative cash flow.
- *Is money being generated through financing?*
  The answer to this question can be interpreted in different ways. For instance, a large amount of money coming in through financing might be an indicator that the company is expanding. Conversely, it could indicate that the company is desperate for cash and financing everything in sight.



Sample Company
Statement of Cash Flows
For the Year Period December 31

	2014		2013		2012		2011		2010
Operating Activities									
Net Income (loss)	372,072		261,078		190,934		71,411		112,149
Adjustments to reconcile net income									
to net cash used by operating activities:									
Depreciation	118,500		103,167		87,833		70,000		29,000
Amortization	4,500		4,500		4,500		4,500		2,250
Changes in operating Assets & Liab									
Accounts Receivable	-425,000		-177,083		-221,528		130,278		-315,000
Inventory	-272,833		-85,944		-119,097		48,125		-131,250
Prepaid Expenses	0		0		5,000		5,000		-10,000
Deposits	0		0		0		-25,000		0
Accounts Payable	215,900		67,167		107,542		-187,729		270,854
Deposits Taken	0		0		-10,000		10,000		0
Accrued Expenses	0		0		0		0		0
Total Cash used in Operating Activities	13,139		172,883		45,184		126,585		-41,998
Investing Activities									
Purchase of Intangible Assets	0		0		0		0		-35,000
Purchase of PPE	-220,000		-220,000		-295,000		-120,000		-1,080,000
Sales of PPE									
Net Cash used in Operating Activities	-220,000		-220,000		-295,000		-120,000		-1,115,000
Financing Activities									
Proceeds from Secured Notes Payabl	0		0		0		0		790,000
Repayment of Debt	-63,437		-57,997		-53,023		-48,475		0
Proceeds from Intermediate Debt	0		0		0		0		360,000
Payments on Intermediate Debt	-40,000		-40,000		-40,000		-40,000		0
Proceeds from Credit Lines	0		0		0		0		700,000
Payment on Credit Lines	-25,000		-25,000		-25,000		-25,000		0
Proceeds from the Issuance of Stock	0		0		0		0		500,000
Dividends	0		0		0		0		0
Net Cash used in Financing Activities	-128,437		-122,997		-118,023		-113,475		2,350,000
Net Increase in Cash	-335,298		-170,114		-367,839		-106,890		1,193,003
Beginning Cash	359,594		529,708		910,279		1,193,003		0
Ending Cash	24,296		359,594		542,439		1,086,112		1,193,003
Minimum Cash Balance Required	500,000		500,000		500,000		500,000		500,000
Excess (deficiency) of Total Cash Neede	-475,704		-140,406		42,439		586,112		693,003
Borrowings Needed	0		0		0		0		0
Distributions	0	30%	0	30%	12,732	30%	175,834	30%	0
Ending Cash	24,296		359,594		529,708		910,279		1,193,003

What trends do you see unfolding in the cash flow statement?

Exercise:
Please analyze the financial statements above and summarize what you think may be areas to work on:

____

____

____

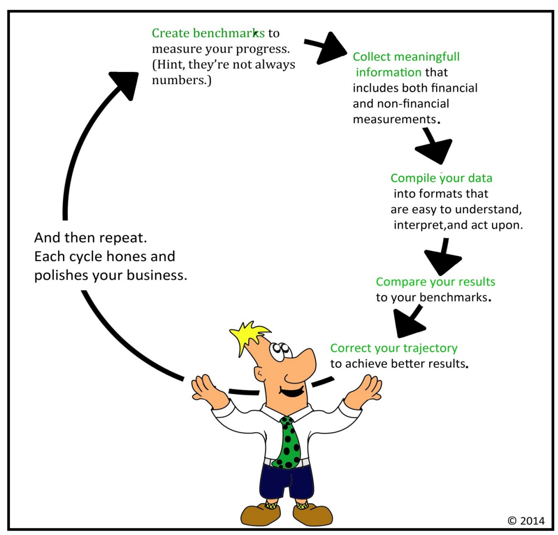
Ratio Analysis

The next step in your business Check-Up is to perform a *ratio analysis*. Remember that we asked for three years of returns and financial statements? Now, we input those numbers into a ratio analysis spreadsheet. Inputting these simple numbers will drive all our ratios and the DuPont analysis, which we will discuss shortly. Each of these indicators helps paint a picture of where the company is going in the long term. It also helps spot any problems that can become obstacles along the way.

What is ratio analysis?
Ratio analysis is the process of identifying certain numbers from your financial statements, making a mathematical calculation with them and then evaluating the results. These ratios serve as a benchmark for performance.

Ratio analysis compares relationships of financial and operational data to balances within the balance sheet or income statement. Used properly, they indicate possible strengths and weaknesses of the entity or indicate trends of improvement or deterioration.

Calculating a ratio is not an end in itself and, alone, is of no value to you.



As with everything financial or managerial, we **create** expectations for what are optimal ratios, we **collect** the data (hopefully, through our financial system), we **compile** it into useful financial information, and then we **compare** our results to our expectations and make **corrections** where necessary.

Ratio analysis provides a yardstick to measure performance, set future goals and identify patterns and problem areas. The best sources of comparative data include:

- Industry or trade association publications
- Banking and finance industry publications (which are available from your banker)
- General financial reference books (which are available from your library)

Are there more ratios we can use?
Yes, once we have the overall picture of the company, you may want to further break down these ratios into even more ratios to help us define our direction. We call these ratios ***performance ratios.***

Ratio analysis can be further characterized by objectives of the test. There are 5 major categories of ratios: Liquidity and solvency ratios, debt ratios, asset management (turnover) ratios, profitability ratios and value ratios.

1. <u>Liquidity and Solvency</u>: - The ability of the company to meet obligations on a timely basis and ability to stay in business
    a. Net working capital
    b. Current ratio
    c. Quick ratio
    d. Intermediate ratio
    e. Long term ratio

2. <u>Debt ratios</u>: – These ratios reflect capital structure or the cushion of ownership and measure the ability of the entity to absorb possible losses due to absorb losses from operations, decreases in asset values, and poor estimates of future cash flows
    a. Debt to equity
    b. Assets to equity
    c. Debt to assets

3. <u>Asset management, utilization or turnover ratios</u>: These ratios measure how quickly assets can be converted into cash (the operating cycle). They are very useful for industry comparisons. They also measure the effectiveness of distribution, sales and collection policies.
    a. A/R turnover
    b. Inventory turnover
    c. A/P turnover
    d. Asset turnover
    e. Sales to working capital

4. <u>Profitability or cushion of income ratios</u>: These ratios measure overall effectiveness of cost control, pricing policies and the ability cover all anticipated costs.
    a. Gross profit margin
    b. EBITDA
    c. Net profit

5. <u>Debt cushion</u>
    a. Times interest earned
    b. Earnings before interest and taxes

6. <u>Value ratios</u> – These ratios relate an entity's stock price or valuation to its earnings.

7. Break-even analysis (also called cost-volume-profit analysis) is an analysis of the level of sales needed to cover all costs. This is a useful tool for determining the sales cushion and cushion of income.

See Appendix 1 for a more detailed explanation of some of the usual ratios.

What is the purpose of these ratios?
Ratios act as "flags" or indicators of possible strengths and weaknesses. Ratios are not absolutes, i.e., we cannot absolutely say that a number is bad, but that the trend it reflects indicates improvement or deterioration over a period of time. (Ratios are only meaningful when compared to some standard such as industry norms, past trends, and stated management objectives.)

What is the methodology used to determine which ratios are applicable?
Methodology:

- Select the limited number of indicators that have significance to the problem of interest.
- Calculate these ratios for several past periods as well as the current period.
- Present results in a way that allows comparison to be made to applicable standards such as industry norms, requirements by lenders, etc.
- Focus on major variations from the standard and trends over time.
- Investigate causes of variations by crosschecking with other ratios and raw data.

Note: Sources of comparative ratios include Dun & Bradstreet, Robert Morris Associates, Prentice Hall's Almanac of Business and Industrial Ratios, Standard & Poor's Industry Surveys – as well as trade associations.

What are the limitations of ratio analysis?
Limitations:

- Ratios based on current and past period date are only useful to the extent that they can reasonably be considered to forecast the future.
- In large firms that cover a number of different industries, it is difficult to make comparisons to an industry standard.
- In making comparisons, the fact that the industry average is used may cause some concern, particularly if there is significant variation within the industry.
- Ratios can be distorted by the fact that they are based on data that takes a picture of the firm at "a point in time".
- The effects of different accounting methods (e.g., LIFO vs FIFO inventory) may make comparisons difficult. As a result, ratios must be dissected in order to establish what the numbers really mean.
- Since ratios are not absolute measures, it may be difficult to arrive at a determination of what is "good" and "bad".

Exercise:
Please analyze the financial statements above and summarize what you think may be areas to work on:

____

____

____

Conclusion
For certain industries and at certain times, ratio analysis is extremely important. Ratio analysis is used in investment analysis, credit analysis, liquidity analysis and management analysis. Ratio analysis compares relationships within the balance sheet or income statements. Used properly, they indicate possible strengths and weaknesses of an entity or indicate trends of improvement or deterioration.

The DuPont Analysis

Assessing Management – The DuPont Analysis

The dynamics of what makes a company profitable are illustrated by the DuPont Model. In essence, this is a return on investment analysis. This model illustrates the importance of asset leverage and operating leverage. The management of assets is referred to as "asset leverage" and the management of sales and expenses is referred to as "operating leverage." The bottom line is to manage assets, sales and expenses.

What does the DuPont Model look like?
Return on investment is designed to relate profitability and turnover to return on assets. Return on assets is then compared to financial leverage to determine return on investment.

What do the formulas look like?

Mathematically

$$\frac{\text{Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Assets}} = \frac{\text{Income}}{\text{Assets}}$$

$$\text{Profit} \times \text{Turnover} = \text{ROA}$$

$$\frac{\text{Income}}{\text{Assets}} \times \frac{\text{Assets}}{\text{Equity}} = \frac{\text{Income}}{\text{Equity}}$$

$$\text{ROA} \times \text{Leverage} = \text{ROI}$$

Page 53

55

Business: Simplified
Cash Flow: Optimized

Each o
f these indicators helps paint a picture of where the company is going in the long-term.

> **Note for Advisors**: You may want to discuss your ratio analysis with your client only when it provides relevant and pertinent feedback that you want to share.

As an example:

Strategies for Financial Performance - 2014

Net Income / Sales	x	Sales / Assets	=	Net Income / Assets	x	Assets (EOY) / Equity (EOY)	=	Net Income / Equity
5.64%	x	208.87%	=	11.77%	x	239.55%	=	28.21%
Operating Leverage Profitabiity		Marketing Leverage Turnover		Return on Assets ROA		Financial Leverage Leverage		Return on Equity ROE

Performance Ratios - 2014

Profitability		Turnover (Avg. Days)		Activity		Liquidity		Cushion of Ownership	
Gross Profit Margin	1,848,000	Receivables	55	A/R Turnover	8	Net Working Capital	909,241	Debt (total) to Equity	1.40
Net Profit	372,072	Inventory	43	Inventory Turnover	11	Current Ratio	2.3	Assets to Equity	2.40
Gross Profit Percentage	28.00%	Payables	36	Accounts Pay. Turns	7	Quick Ratio	0.0	Return on Equity	28.21%
Return on Sales	5.64%	Operating Cycle	98	Sales Leverage	208.87%	Long term ratio	2.3	Return on Assets	11.77%
		Cash Cycle	119	Sales to Working Cap.	7				
Summary									
Net Income	$372,072	Return on Investment	28.21%	Breakeven	$4,831,886				

Create strategies to increase return on investment include increasing margin, increasing turnover or increasing the use of leverage.

____
____
____
____

What is the function of the DuPont model?

The DuPont Model makes it clear that the primary concern of management is the amount of assets it takes to generate a profit, and the proper mix of debt and equity to create a favorable return on investment.

The DuPont Model relies on understanding the interrelationship of numbers and the way you do business. Let's discus each one in detail:

- *Operating Leverage (profitability):* For every $1 of sales, how much goes to the bottom line?
- *Marketing Leverage (activity and turnover)*: How many dollars of sales is generated by each $1 of assets?
- *Return on Assets*: For every $1 of assets, how much goes to the bottom line?
- *Financial Leverage (liquidity and solvency)*: For every $1 of equity, how many dollars of assets are there?
- *Return on Investment (debt and equity)*: For every $1 invested in the entity, how much do we get back?

Note for Advisors: You can use this analysis to isolate potential problems before you focus on individual ratios. I also compare these ratios to industry standards and historic ratios for the company.

Determine what you want to know and what tools are appropriate. As indicated above, third parties, investors, lenders, etc. each use the financial statements with a certain goal in mind.

It's not the tool that is important; it's how you use it!

Our Starting Point: Historical Perspective

This is my best tool for proving to a client (both potential and existing) that I can help them. The first step in going forward is to know where you are and how you got here. Only then can you truly know how to get "there from here." The clearest way to understand where your company stands is to look at the numbers.

Let's look at common financial numbers shown below. More specifically, let's look at your numbers for this year, last year, two years ago, and three years ago.

In this section, put in your historical numbers and determine your percentages. Look at your best and worse years. Then determine what percentages of revenue would be an ideal allocation to hit your profit goal.

Let's look at Vandelay Remodeling. We covered the fact situation in the introduction to this workbook.

This section is the starting point for everything we do.

Here's how we do it:

Step 1: Before we start forecasting our next year, we need to look at our history. It has been said that "Those who do not learn from history are doomed to repeat it [George Santayana]. In this section, put in your historical numbers.

NOTES:

Performance History								
	2013	%	2014	%	2015	%	2016	%
Revenues	200,000	100.0%	300,000	100.0%	400,000	100.0%	500,000	100.0%
Cost of Goods	160,000	80.0%	234,000	78.0%	304,000	76.0%	385,000	77.0%
Gross Profit	40,000	20.0%	66,000	22.0%	96,000	24.0%	115,000	23.0%
Total Payroll	26,000	13.0%	39,000	13.0%	56,800	14.2%	70,000	14.0%
Sales and Marketing Expense	6,000	3.0%	9,000	3.0%	13,200	3.3%	15,000	3.0%
Other Operating Expense	10,000	5.0%	16,500	5.5%	24,000	6.0%	30,000	6.0%
Total Expenses	42,000	21.0%	64,500	21.5%	94,000	23.5%	115,000	23.0%
Net Income Before Taxes	-2,000	-1.0%	1,500	0.5%	2,000	0.5%	0	0.0%
Revenue Growth Year Over Year - %				50%		33%		25%
FTEs (Full Time Employees)	3		3		4		5	
Revenue Per FTE	66,667		100,000		100,000		100,000	
Net Income Per FTE	0		500		500		0	

Look at your key metrics for previous 4 years and determine:

- What went well, and why
- What went poorly, and why

Answer the following questions:

- Where is your company in terms of quantitative performance? Are you trending up, down, or status quo?
- What has been your rate of growth over the past 3-4 years in revenues, gross profit, and net income? Are you trending up, down, or status quo?
- How are your key products/ services doing in terms of market share?
- If you are growing, how fast? If you are winning or losing, define your wins or loses quantitatively and explain why. What percentage of your leads become jobs? What percentage of leads become customers/jobs?
- How is your overall market doing? How is your market trending?
- How is your company performing in comparison to your competitors? Better? Worse? Status Quo? Why? This may be defined by gross margin, net profit, assets…..
- How does your market share performance compare to your competitors? Better? Worse? Status Quo? Why?

To get the numbers go to the tax returns (if you don't have internal financials). As an example, go to the 1120S.

- Gross revenues: Line 1c plus line 4 and line 5
- Cost of Goods Sold: Line 2
- Salaries: Lines 7, 8 and 17
- Advertising: Line 16 (also look in statement attached to line 19)
- All other costs: Line 20 less amounts included in Salaries and Advertising above.

Step two: Target your percentages. Determine your percentage goals. Look at your best and worse years. Then, determine what percentages of revenue would be an ideal allocation to hit your profit goal.

Performance History									
	2013	%	2014	%	2015	%	2016	%	Target
Revenues	200,000	100.0%	300,000	100.0%	400,000	100.0%	500,000	100.0%	100.0%
Cost of Goods	160,000	80.0%	234,000	78.0%	304,000	76.0%	385,000	77.0%	75.0%
Gross Profit	40,000	20.0%	66,000	22.0%	96,000	24.0%	115,000	23.0%	25.0%
Total Payroll	26,000	13.0%	39,000	13.0%	56,800	14.2%	70,000	14.0%	12.5%
Sales and Marketing Expense	6,000	3.0%	9,000	3.0%	13,200	3.3%	15,000	3.0%	3.0%
Other Operating Expense	10,000	5.0%	16,500	5.5%	24,000	6.0%	30,000	6.0%	4.5%
Total Expenses	42,000	21.0%	64,500	21.5%	94,000	23.5%	115,000	23.0%	20.0%
Net Income Before Taxes	-2,000	-1.0%	1,500	0.5%	2,000	0.5%	0	0.0%	5.0%
Revenue Growth Year Over Year - %				50%		33%		25%	
FTEs (Full Time Employees)	3		3		4		5		
Revenue Per FTE	66,667		100,000		100,000		100,000		
Net Income Per FTE	0		500		500		0		

Step 3: Put in your project sales forecast. Once you put in your projected sales forecast and FTE's everything else will get targeted accordingly:

Performance History										
	2013	%	2014	%	2015	%	2016	%	Target	Projected
Revenues	200,000	100.0%	300,000	100.0%	400,000	100.0%	500,000	100.0%	100.0%	600,000
Cost of Goods	160,000	80.0%	234,000	78.0%	304,000	76.0%	385,000	77.0%	75.0%	450,000
Gross Profit	40,000	20.0%	66,000	22.0%	96,000	24.0%	115,000	23.0%	25.0%	150,000
Total Payroll	26,000	13.0%	39,000	13.0%	56,800	14.2%	70,000	14.0%	12.5%	75,000
Sales and Marketing Expense	6,000	3.0%	9,000	3.0%	13,200	3.3%	15,000	3.0%	3.0%	18,000
Other Operating Expense	10,000	5.0%	16,500	5.5%	24,000	6.0%	30,000	6.0%	4.5%	27,000
Total Expenses	42,000	21.0%	64,500	21.5%	94,000	23.5%	115,000	23.0%	20.0%	120,000
Net Income Before Taxes	-2,000	-1.0%	1,500	0.5%	2,000	0.5%	0	0.0%	5.0%	30,000
Revenue Growth Year Over Year - %				50%		33%		25%		20%
FTEs (Full Time Employees)	3		3		4		5			5
Revenue Per FTE	66,667		100,000		100,000		100,000			120,000
Net Income Per FTE	0		500		500		0			6,000

Put in a target net income, then the target cost of goods sold. That will determine how much is left for expenses. Put in your payroll expense and sales and marketing expenses. The balance is what is left for operating expenses. Key question: Are these expenses realistic?

Wall Street vs Main Street: Notice that I started with a profit goal. This is extremely important and related to the key distinction between Wall Street and Main Street. We covered Wall Street verses Main Street earlier. Bottom line: the ***big companies*** work off a different equation: "Revenue minus profit equals cost." Expenses are the leftovers, not profits. Do you see, especially here how this is transformational? Wall Street reverses the formula. This says that whatever is left after you make money can be allocated to run the company. They start with a profit goal and make the adjustments necessary in their budget to achieve it. Very proactive. See the difference? Pay yourself *first* not last.

Again, this worksheet will drive your 7 key numbers and your cash flow planning. In the future, it will also drive strategic planning and exit planning.

THIS is our starting point. We started with the end in mind. We put in a "Net Income before taxes" goal (5%) and our sales projection of $600,000. Everything else self-calculated. You can play with this and change percentages highlighted in Yellow.

CAVEAT. This format is not cast in stone. For instance, if you are in the construction business, you may be concerned with indirect construction costs as a major category of expenses. In that case, you would insert a line below Cost of Goods Sold and then readjust your formulas so that you get the correct percentages and results.

REMEMBER, we are shooting for a $30,000 profit, our sales goal is $600,000 and our fixed expenses are $120,000. These numbers are important and will carry forward in everything we write from this point forward.

You can use a more sophisticated form to this to track the profits all the way to cash.

Performance History										
	2013	%	2014	%	2015	%	2016	%	Target	Projected
Revenues	200,000	100.0%	300,000	100.0%	400,000	100.0%	500,000	100.0%	100.0%	600,000
Cost of Goods	160,000	80.0%	234,000	78.0%	304,000	76.0%	385,000	77.0%	75.0%	450,000
Gross Profit	40,000	20.0%	66,000	22.0%	96,000	24.0%	115,000	23.0%	25.0%	150,000
Total Payroll	26,000	13.0%	39,000	13.0%	56,800	14.2%	70,000	14.0%	14.0%	84,000
Sales and Marketing Expense	6,000	3.0%	9,000	3.0%	13,200	3.3%	15,000	3.0%	2.0%	12,000
Other Operating Expense	10,000	5.0%	16,500	5.5%	24,000	6.0%	30,000	6.0%	4.0%	24,000
Total Expenses	42,000	21.0%	64,500	21.5%	94,000	23.5%	115,000	23.0%	20.0%	120,000
Net Income Before Taxes	-2,000	-1.0%	1,500	0.5%	2,000	0.5%	0	0.0%	5.0%	30,000
Decrease (Increase) in Assets (exclude Cash)									0.0%	0
Increase (Decrease) In Liabilities									0.0%	0
Increase (Decrease) In Equity									0.0%	0
Ending Cash									5.0%	30,000
Revenue Growth Year Over Year - %				50%		33%		25%		20%
FTEs (Full Time Employees)	3		3		4		5			5
Revenue Per FTE	66,667		100,000		100,000		100,000			120,000
Net Income Per FTE	0		500		500		0			6,000

This version is just a little more difficult to work with but will give you even more insight (it combines the income statement, balance sheet and source and uses of cash into a format that business owners can understand). But, this can be the foundation for a very simple projection which can lead into other engagements (such as a 90 day cash flow challenge, budgeting, and financial projections).

Chapter Conclusion

Evaluating a company in preparation for performing the Business Check-Up doesn't have to be difficult, and rarely will all the formulas or ratios be used for any given company. Still, these tools are available and easy to apply to gain deep insights as needed.

The consultant should be thorough and observant, paying particular attention to exceptions or deviations from the norm that might indicate a problem either with the company being evaluated or the way the data was compiled. With good data and a keen eye, and by using these tools at your disposal, you will quickly be able to accurately evaluate a company's health and management. Armed with that, you'll be ready to conduct the in-person part of the Business Check-Up, which we'll discuss next.

Chapter 4: Conducting the Check-Up

So far we've received an engagement letter from the client and we've conducted an initial operational analysis by looking at their financial statements and their preliminary 7 Key Numbers.

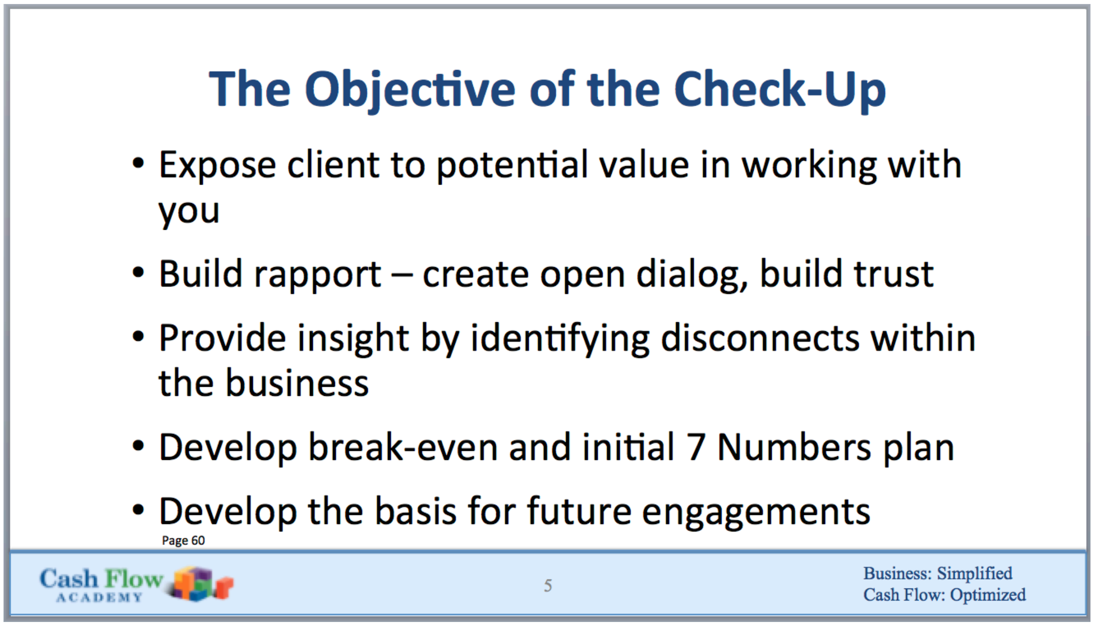
The next step is to meet face-to-face with the client. In this section we'll teach you a simple, proven process that will quickly give you actionable answers to what would otherwise be hard-to-ask questions. You'll learn how to apply the "Sales Diamond" that will instantly get the client to realize that they need you in order to fulfill their long-term goals. In addition, you'll learn a technique using the "Wall Street Questions." Then you'll see how to conduct the Check-Up using the 7 Key Numbers and the 8 Pillars.

The Process

Prior to meeting	The Interview		Performing the work			Additional Services
	Bonding & Rapport	*Up Front Contract*	*Operational Analysis*	*Ratio Analysis*	*7 Numbers*	
Purpose: The purpose of the tune-up is to expose a potential client to the value inherent in working with us. This tune-up serves as the first step in harnessing the power of the 7 key numbers and does much more. It includes: • An operational analysis to spotlight their current position, their strengths and weaknesses and the "pains" within the organization. It also highlights the disconnects in their organization. • A break-even analysis to identify what actually defines success in terms of sales and units sold. • A 7 key numbers model for their business. This identifies the specific goals for each aspect of their business funnel, from sales to costs to cash in the bank. Before the meeting: • Have client fill out the operational analysis • Get 3 years of tax returns • Perform a ratio analysis • Get current financial statements From this meeting, the interviewer determines whether or not our services can add any value to the potential client.	The objective of building rapport is to establish the bridges of trust that are necessary for the sales process to take place. Fundamentally: • People buy from people that they like • People like people who are like themselves • Hence, people buy from people who are like themselves BMS will actively work to build a trusting relationships with our prospects. Theme: Ordinary things consistently done produce extraordinary results. Note: The best way to build rapport is to match: • *Tone* • *Tempo* • *Breathing (location in chest and rate of breathing)* • *Gestures and body posture* • *Sensory predicates (Visual, auditory, kinesthetic (feel); description words like: see, look, hear, feel…)* A problem is a problem until you reduce it to a procedure.	An up-front contract is a mechanism by which BMS and the prospect agree, before a meeting, to what will take place during the meeting. There are five elements of an up-front contract: • Purpose of the meeting • Prospect's agenda and expectations – What do they want to get out of the meeting? • Interviewer's agenda and expectations • Time • Outcome General Framework • **3 Key Resources:** Time, energy & money • **4 ways to create profit**: Customers, jobs (items), Employees & vendors • Key metrics: 7 numbers **Imagine** what your monthly income could be a year from now. Now multiply it by 12 months. Now multiply it by 10 years. You should have come up with a number between 1 and 3 million. Now multiply by 5. That is the benefit of working with us.	The purpose of the operational analysis is to identify the pains and disconnects in the business. Process • Go through the 8 P's. • Whenever you come across a potential problem, say "Tell me more about that" • Use the Wall Street questions to quantify the costs and determine the extent of the pain. • Each section of the questionnaire is designed to uncover a need. During this part of the analysis, plant the seeds for the 6 keys to running a successful business: • An exit plan • Specific plans to achieve success • Good processes and systems • Predictable sources of cash flow • Effective teams and advisors • Fixate on feedback (both financial and non-financial).	Although we don't tell the client, we use an internal spreadsheet to look at their data for the last 3 years. Ratios are broken down into: • Liquidity ratios • Debt ratios • Asset Management (turnover) ratios • Profitability ratios In addition, we look at operating leverage, marketing leverage, ROA, financial leverage and ROI. Each of these indicators helps paint a **picture of where the company is going in the long term**. It also helps spot where there are problems that Impact the 6 keys to success.	Through the 7 numbers framework, we can drive both breakeven and goal setting so that an owner gets both a salary and return on their investment for their time, energy & money. Start with where how much they want to make as an investor and work backwards to how many leads do you need to generate? Next, turn it upside down and now you can ask the client what strategies need to be implemented to achieve those goals. Make sure the goals are in alignment with the up-front contract (where do they want to be). Challenge: what are they doing to get them there?	Most people overestimate what they can do in 6 months and underestimate what they can do in 5 years. Their success will depend on leadership, management, and execution: • Leadership – a clear, compelling vision, standards of accountability and accountability. • Management – creating an environment of success – 7 number workbooks • Execution – doing things that get you to the vision. Sales: • **Find the difference that makes the difference.** • Most companies who are struggling usually use time to save money, but time is your most important commodity. • Where you spend your time will dictate your success more than anything else – not where you spend your money. • **Focus on what should I be doing, not what am I doing.** Upsell: • 7 number workbooks • Consulting • Strategic Planning • Financial controls – focus on budget, bus. Plans, financial statements • Software

Backroom™
MANAGEMENT SERVICES

Once we've received the filled-in operational analysis form from our client (discussed in the previous chapter), we will send them a series of four emails designed to reaffirm the sale and make them look forward to their business Check-Up.

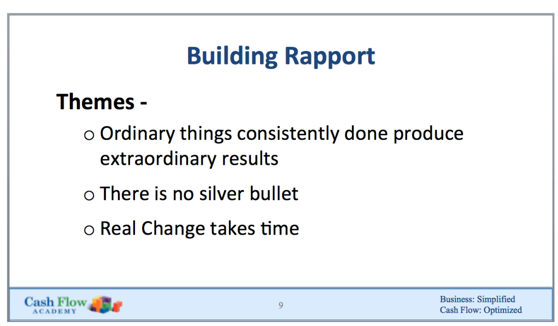


So, let's focus on the objectives of the Business Check-Up. The first is to expose the client to potential value in working with you. The second is to build rapport, create an open dialog and build trust. The third is to provide insight by identifying disconnects within their business. The fourth is to develop your break-even analysis and their initial 7 Key Numbers plan. And your final objective is to develop the basis for future engagements.

So, what does a Business Check-Up include? It includes an Operational analysis, a break-even analysis, we give them a 7 Key Numbers model and we talk about our next steps. But underlying the analysis, we uncover the client's pain points without sounding like a sales person.

The Process. So far the client has completed their operational analysis, they've supplied you with three years of tax returns and financial statements and the purpose of that is to see if both the tax returns and the financial statements agree, especially in the equity section. You have completed the ratio analysis, reviewed their financial data and tax returns, and reviewed the operational analysis. Together, you're going to have a meeting to discuss your findings and discuss their answers to the operational analysis.

The first thing you need to do is build rapport and make your client feel comfortable. The objective of building rapport is to establish the bridges of trust that are necessary for the sales process to take place. Remember, people buy from people that they like; people like themselves.



During the building rapport section, I like to build on a couple of themes.

- Ordinary things consistently done produce extraordinary results.
- Bottom line, there is no silver bullet.
- Real change takes time.

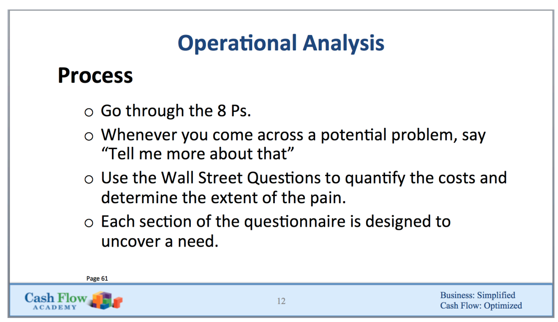
To build rapport, try to match the tone, tempo, breathing, gestures, and body postures of your potential client. This is a technique called "mirroring" and will make your client feel more confortable and engaged. Also, listen for clues like, "I see", "I hear", "I feel," etc. and use those clues to your advantage.

The Front-End Contract. An Front-End Contract is a mechanism by which you and the prospect agree before the meeting as to what will take place before the meeting. There are five elements of an upfront contract:

- What's the purpose of the meeting?
- Determine the prospect's agenda and expectation – what do they want to get out of the meeting?
- Let them know your agenda and what you want out of the meeting
- Determine if they have allocated enough time for the meeting – if they haven't, ask them if they'd like to reschedule.
- State your outcome. "At the end of this meeting we have only one objective, to determine if we want to go forward or not." Simply ask, "Is that okay with you?"

During this phase I'll sometimes talk about the three resources of an owner -- time, energy and money; and the four ways to create profit: customers, job or inventory, employees and vendor. Then, I use this very powerful line: **"Imagine if you are making $5000, $10,000 or even $50,000 or more a month… Now multiply it by twelve months. Now multiply it by ten years. You should have come up with a number between one and three million dollars. Now, multiply that by five. That's the benefit of working with us."**

The Operational Analysis.



The purpose of the Operational Analysis is to identify the pains and disconnects within the business.

Here's the process:

- Go through the 8 Pillars
- Whenever you come across a potential problem, say, "Tell me more about that."
- Use the Wall Street questions (which we discussed below) to quantify the cost and determine the extent of the pain. Find the Delta!

Remember, each question you ask should be designed to uncover a need.

Again, the purpose of the Check-Up is to expose a potential client to the value inherent in working with us. This Check-Up serves as the first step in harnessing the power of the 7 Key Numbers—but it also delivers genuine business value, regardless of how your relationship with the client proceeds.

It includes:

- An operational analysis to spotlight the client's current position, their strengths and weaknesses and the "pains" within the organization. It also highlights the disconnects in their organization.
- A break-even analysis to identify what actually defines success in terms of sales and units sold.
- A 7 Key Numbers **model** for their business. This identifies the specific goals for each aspect of their business funnel, from sales to costs to cash in the bank.

You'll use this meeting to deliver value as you also showcase the power of the 7 Key Numbers.

General Framework

Keep these in mind as you perform your Check-Up that this is how you wow your customer.

3 Key Resources: Time, Energy & Money
4 ways to create profit: Customers, Products, Employees and Vendors
7 Key Numbers

During this part of the analysis, plant the seeds for **6 Success Factors** every business owner should know and follow:

1. **Have an exit strategy.** This time specific horizon (usually five-years) forms the basis of every decision you make.
2. **Make specific plans.** Chart out your business plan, your financial plan, and much more.
3. **Develop documented systems.** Replicable systems ensure predictable and profitable results.
4. **Ensure predictable cash flow.** Find the ideal balance between debt and equity.
5. **Find people who can execute.** Surround yourself with the best directors, advisors, employees, and consultants—and give them an environment in which they can thrive.
6. **Fixate on numbers.** It's imperative to have crystal-clear insight into both your financial and non-financial data. You also have to fixate on feedback (both financial and non-financial).

The key to success is to insure that you are always generating more cash than you spend. You want to do this consistently over each quarter and over each year.

Qualifying Questions: The Sales Diamond

The Sales Diamond is a graphical tool for qualifying your client. The client's pain is divided into four categories:

1. Marketing & Sales
2. Operations
3. Finances (Cash Flow and Profits)
4. Lifestyle

We use this questionnaire to ask our questions:

1. Are you satisfied with your sales and marketing? 1 2 3 4 5 6 7 8 9 10
In evaluating this question, think about the following: Least satisfied Most satisfied

- Can you identify which marketing efforts are succeeding?
- Can you identify which salespeople are performing?
- Do you have a steady flow of projects and leads?
- Do you close an acceptable rate ?
- Do you know which lead sources deleiver and who follows them up?
- Are the leads you get the right type of customer?
- Are you're pricing your products correctly?
- Are you're sales people are making money?
- Do you have a clear picture as to which products and customers are making you money?

2. Are you satisfied with your operations? 1 2 3 4 5 6 7 8 9 10
In evaluating this question, think about the following: Least satisfied Most satisfied

- Are you spending most of your time on your core talent? Or are you occupied with a lot of administrative tasks?
- Are you estimating your costs properly?
- Are jobs completed on time?
- Are jobs completed within budget?
- Are jobs meeting your profit objective?
- Are customers happy?
- Are you controlling your direct and indirect costs?

3. Are you satisfied with your finances? 1 2 3 4 5 6 7 8 9 10
In evaluating this question, think about the following: Least satisfied Most satisfied

- Are you meeting the profit goals you establhished for your business?
- Do you have consistent and predicatble cash flow?
- Are you able to use up-to-date numbers to make financial decisions to run your business?
- Are you worried about making payroll?
- Do you have the resouces you need to achieve your goals?

4. Are you satisfied with your lifestyle? 1 2 3 4 5 6 7 8 9 10
In evaluating this question, think about the following: Least satisfied Most satisfied

- Are you reaching the goals you had envisioned when you started?
- Are you enjoying the business?
- Are you on target to exit your business? That is, are you building wealth in your business?
- Are you earning what you expected when you started the business?
- Do you have the time you want to spend with friends and family?
- Are you in control? Or do you fell at the mercy of your bookkeeper?

Overall assessment: ____ out of 40

Within each category, there are a series of questions you ask to determine the client's location on each axis. The further they are along each access, the more likely you are to meet their needs.

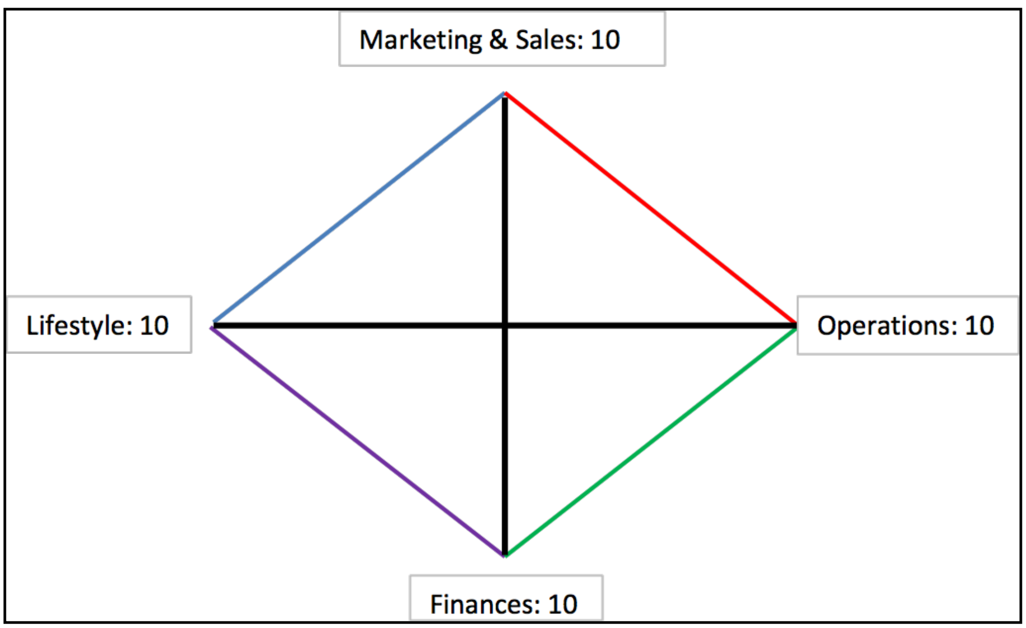
You'll notice that these axes closely match the three basic areas of concentration for a business:

- Marketing and Sales (I always say marketing first as that drives sales)
- Operations (both production and management)
- Financial Management (accounting, cash management and financing)

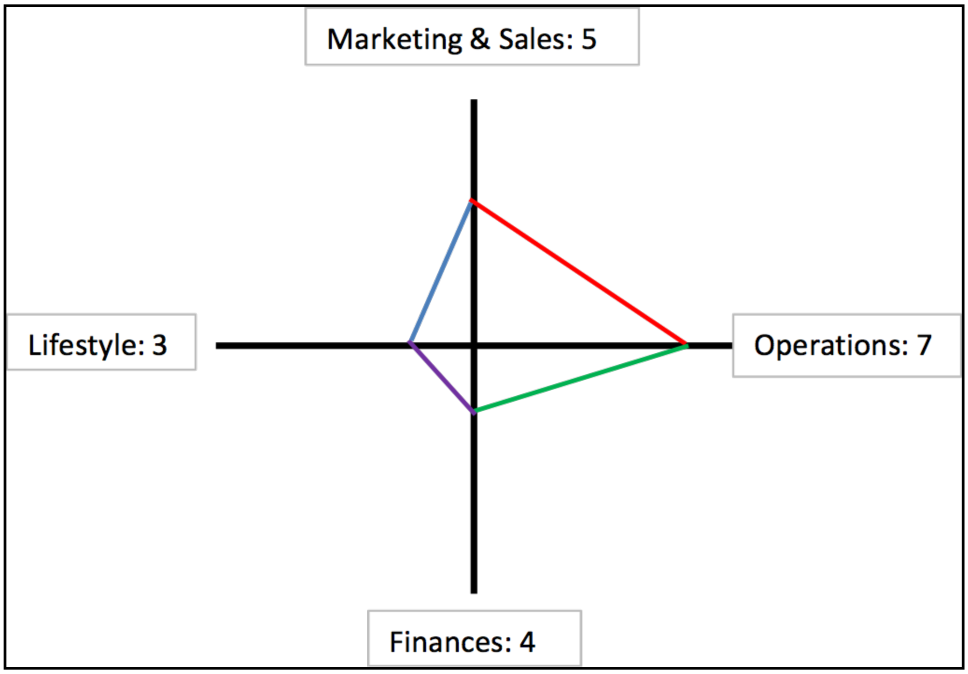
I need to get their temperature in order to determine if there is a fit and if there is anything I can do to help or improve their current business. So I ask them to grade themselves again on a scale of 1 to 10. Frequently, you'll find that owners tend to overestimate where they are. I wait until I'm in the actual Check-Up before I get their real grade. But, it is through skillful questioning and taking a real interest in what they are saying that you'll be able to get them to give you the real score.

Based on these answers, you will know if the client is qualified for your service. Let me show you how!

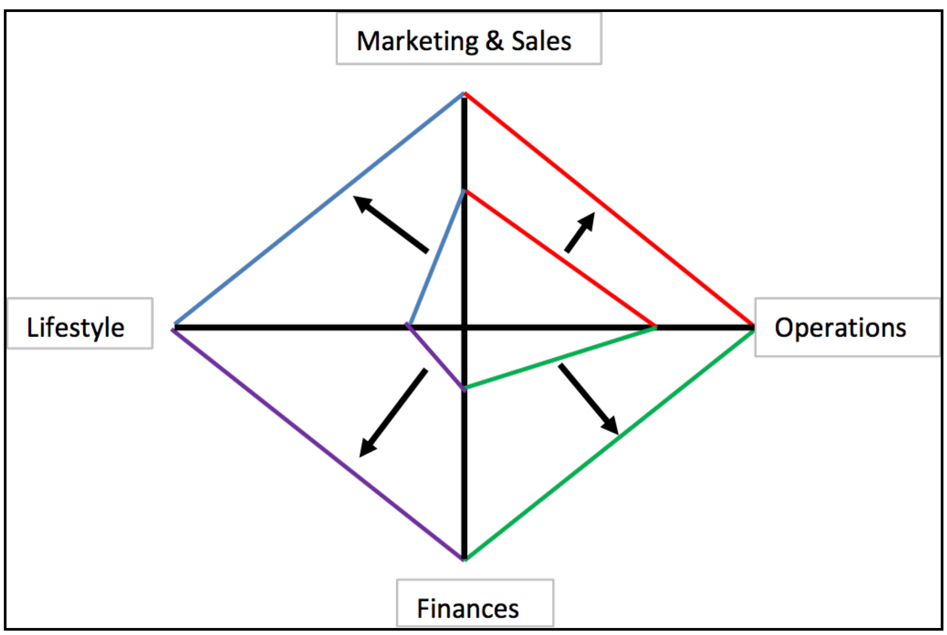
In the example below, you see the "perfect" Sales Diamond. This owner is ecstatic with everything in their business and lifestyle. This is what you want all owners who work with you to look like – *after* you complete the engagement (not before). But, as a prospect, this isn't a very good candidate because they don't have any (or *feel* they have any) real issues, pains or challenges.



In the case below, Vandelay answered a 3 in Lifestyle which means they have the opportunity to improve by 7. There is also room for improvement in all other areas. Finances can improve by 6, Marketing & Sales by 5 and Operations by 3. (These scores are pulled from the Operational Analysis performed earlier.) Based on these numbers, Vandelay may be a good fit or likely to want to work with an advisor.



Now that we've quantified the "delta" between their current status or perception and their desired level and it becomes our mission to determine how we close the gap.



Remember, owners will want to start where *they* want to start, not necessarily where *you think* they should start, so you need to cater your proposal to the side of the Sales Diamond they select. Once you are in and you see a clearer picture of what's going on, you can reassess quarterly. That will give you the opportunity to re-plot the Sales Diamond and propose additional services.

We also know if an owner sees little opportunity for gain they either have a great system already in place or they are over-confident and will not value your assistance long term. This little tool will help you attract more quality customers and let you pass on those who might not have a propensity to work with you now.

The Wall Street Questions

Once you identified a pain, don't stop to fix it. Remember to keep your impulses in check and delay the gratification of solving the problem for the client. Get to the underlying emotional response to the pain. As you are uncovering the pain behind the problems, remember to ask probing statements. Probing statements are statements where the prospect shares more information with you. There are six levels of questions:

- Background Questions
- Vision questions
- Obstacles
- Impact Questions
- Prospect's Solution
- Test the Reality, then summarize

To summarize: **Give the prospect their story.**

Once you have performed your needs analysis, you should have uncovered at least three areas of "pain." If you have not accomplished this task, continue asking questions. This is not necessarily a steadfast rule, but a good practice. It will ensure that you have truly asked all of the right questions and will keep you from jumping into solutions too quickly each time you find an area of need. Continue to take notes until you have uncovered all areas that you can help the client, and then present your solutions. Once you have completed your questioning, tell the prospect what you uncovered. This helps clarify that you heard them correctly and they are in agreement that these are their issues.

Uncovering a Need

Here is your real challenge and, really, the key to developing a working relationship:

> **Realize that your client must have an unsatisfied need *that he/she thinks* you might be able to satisfy or you would not be there.**

You certainly don't know what it is yet, and, ironically, your prospect might not know what it is either. But, something must be lacking or they would not be meeting with you. Your challenge then is to uncover this need (or these needs). Then and only then will you be able to target a solution and ultimately convince your prospect to engage your services on an ongoing basis.

The key to uncovering these hidden needs is to first ask direct, open-ended questions, then *LISTEN* to your prospect's response. What do we mean by direct, open-ended questions? Simply, questions pertaining to your area of expertise that probe for problems your prospect faces. The purpose of these questions is to get your prospect talking about themselves (or their company).

Therefore, the questions must be phrased in such a way that makes a simple yes or no answer difficult. Questions should try to uncover a problem. They should start with:

Who What When Where How Why

Use these beginning words to pose a general question that may uncover a need or a pain your prospective client has. Then continue the questioning to probe deeper into the problem/need. Consider this to be a multi-level questioning process.

Here is a spreadsheet you can use to help you formulate your questions.

Cash Flow ENGINEERING®

In order to understand where your business stands as it relates to your objectives, please rate your company on a scale of 1 to 5 (with 5 being the most satisfied and 1 being the least satisfied). Priority is rated as 0 (this doesn't apply), 1 (not critical), 5 (very important) or 10 (critical).

DESCRIPTION	RATING	PRIORITY	WHAT WOULD MAKE IT A 5?	REASON	**What results will you measure (goals, objectives)?**
Are you satisfied with your marketing and sales?	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)
Are you satisfied with your operations and organization?	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)
Are you satisfied with your cash flow and Profits?	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)
Are you satisfied with your lifestyle?	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)
	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)
	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)
	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)
	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)
	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)
	0 1 2 3 4 5	0, 1, 5, 10		Time • Energy • Money • People • Tech • Processes • Training • External factors • Other _____	Increase (decrease) number of ___________ from ________ to ________ by ____________ (date)

You can have blank lines to work with any number of topics.

Background questions (deal with time and frequency of the problem):

- Current Status (rating): You indicated ________ was a _______ (score), Why did you give yourself only a _______ (score)?
  - Tell me more about that….
- Priority: On a scale of one to 10, what type of priority is this?

If there is no priority or a low priority, move on to the next topic.

- What have you done to address or fix the problem? How is it working? What else did you do in response to ____________?
- What are the obstacles to fixing it?
- What is making you take a look at his now?

Let them answer and listen to each response. By following this process you will quickly pick up on any possible needs or problems the prospect might have. Then go a step deeper.

Vision questions (deal with what it would look like)

- Prospect's solutions & strategies (if any): It sounds like you've given this a lot of thought? In a perfect world, what do you think you need to do? What will change look like?
- client input: What results do you want? What would make this a 10? What would it look like if this issue was resolved (or this was a 10)?
    - Why do you feel you are having these kinds of problems? What do you think is wrong with _________?
    - What do you think is causing it?
    - Why is this problem?
    - Give me a specific example…
- Past history: Looking at the past, was there any time when it was better?
- Time: How long has it been an issue? When exactly did the change occur? How long has this been going on? How long have you been worrying about this?
- Frequency: How often does this happen?

Obstacles: What are the obstacles to fixing it?

- Level 1: obstacles to fixing the problem: Time, energy, money, people, technology, processes, training, external factors, other __________
- Level 2: Obstacles to working with us: Are there any obstacles to you working with us to fix the problem? Try to find the REAL reason they haven't fixed the problem.
    - Existing vendor relationships
    - Cost of fixing the problem
    - The hassle of taking time to fix the problem
    - Conversion costs
    - Time of conversion
    - Loss of data

The next level of questioning tries to turn a pain into an emotion. The answers to these questions become the benefit you can provide your client. These are impact questions (people believe their own statistics):

Impact questions (people believe their own statistics). The purpose of this level of questioning is to turn a pain into an emotion. The answers to these questions become the benefit of you can provide your client.

- Emotional impact:

   - <u>Pervasiveness of the problem</u>: Are others in your industry experiencing the same problem? How are others in your industry reacting? What are they doing differently? Will you do what they do? How are customers reacting? How many jobs are you bidding per month? How many times are you not getting the bid?
   - <u>How is it affecting or impacting you</u>: (your personal or business life), the organization, your vendors, your customers?
     - Why is this important to you?
     - How do you feel about that?
- <u>Future size of the problem</u>: Is the problem going to stay the same or get bigger? Are you sure? If you continued doing what you are doing would your business grow, decline or stay the same?
- <u>Outcome if do nothing</u>: What's the worst thing that will happen if you do nothing?

Prospect's solution (sounds like you've given some thought to this)?

- <u>Quantifiable results</u>: What <u>outcomes</u> are you looking for? How would you measure it? How would you know if the <u>solution</u> is working? <u>Find the Delta (cost in time, energy or money)</u>:
   - <u>Magnitude of the problem</u>: Avg. Transaction size? Transactions per month (basically, the 7 key numbers)? What would you like to see (what is your goal) and where is it now? OR what did it use to be and where is it now?
   - <u>Compare</u> the past to the present (if they lost ground). <u>Past history</u>: What was it like before it became an issue? Compare thee present to the future
   - <u>Cost of the problem</u>: What is it costing you (personally, the organization) in time, energy or money (TEM)? I.e. $250,000 per year, how long: 3 years or more, cost to date: $750,000 or more. Are you working more hours than in the past (time)? Are you burning out (<u>energy</u>)? Are you making enough to live on (money)?
- <u>Action to fix the problem so far</u>: What have you done to fix it? How is it working?

Again, these are who, what, when, where, how, and why questions. Note also that you have not told them anything yet.

If the prospect is giving you abbreviated answers and you want to get more conversation going, simply ask "and…?"

If the prospect is giving you too much information and you want to get him back on track, ask, "And how does that apply to ... (the question you asked)?"

Test the reality. (Is the problem really a problem? Is the problem big enough to…? (I.e. change vendors; replace foreman; bring it in-house vs outsourcing)? Bring up the unspoken objections (the elephant in the room).

Then summarize. Give the prospect their story back again. However, RESIST giving the client more than a *glimpse* of the solution. We want to save solutions until we have time to assess *everything* we uncover during the Check-Up. However, this doesn't mean that you can't offer solutions – you want to get them excited about using your services so you have to give them suggestions. However, in the formal write up we will spell out not only our findings but a course of action for the short and long term.

See Appendix 2 for a transcription of a roll play using a combination of the Sales Diamond and the Wall Street Questions.

If you have having a real problem getting the prospect to open up, ask, "If I could solve one problem, what would it be?"

The Engagement

Now, it is time to sit down with your client. You are armed with a good understanding of your Customer Journey, the 7 Key Numbers and the 8 Ps, the sales diamond and the Wall Street questions. Next, go through every question on the questionnaire and use the Wall Street Questions to make sure the client elaborates on potential problems, get a better understanding of their business and triangulate on the areas that they think are the most important problems.

Using our techniques, you should have picked up on possible problems or needs that the prospect has and how it affects them personally. Finish up the investigative process with final hypothetical questions such as, "If you could design your 'perfect' business situation, *and* if cost were no object, *what* would your business look like?"

In reality, based on the engagement, I can go through the questionnaire in as little as a couple of hours. But, I find that if I do it that fast, I really haven't understood the business in a way that makes the write up faster. So, over time, I've learned that anything less than a full day may be a wasted effort.

I've also had bizarre things happen. Once I worked with a husband and wife team and found out that the business was creating havoc in their relationship. Having had my wife work in my business for many years, I ended up doing marriage counseling on how a couple can work together and keep the marriage strong. Of my 8 allotted hours, I spent over 5 of them just talking about their relationship. Note, that the relationship was absolutely necessary to discuss as part of the problem in their business. As of this writing, they are still my client.

See Appendix 3 for a short sample of a business Check-Up.

Obviously, each Check-Up is different. If you get nothing else out of this course, remember the key to consulting is to always be asking questions. (Just as an aside, count how many times I use the word question or questions in this manuscript.)

Creating Goals for the 7 Number Scorecard

Through the 7 Key Numbers framework, we can drive both breakeven and goal setting so that an owner gets both a salary and return on their investment for their time, energy, and money.

Start with how much they want to make as an investor, and then work backwards to how many leads the need to generate. Next, turn it upside down and ask the client what strategies need to be implemented to achieve those goals.

Make sure the goals are in alignment with the up-front contract ("Where do they want to be?"). Challenge: what are they doing to get them there?

Winning

- To win, your score must be better than your opponents
- To know this, you must keep score.
- To score, you must have a strategy and execute it well.
- To execute a strategy, you must make good decisions.
- To make good decisions, you need to know the score.

In some ways, business is like a game. Let's take baseball as an example. How do you win? You win by scoring more runs than your opponent. Both the manager and the players understand they need to score more runs but every opponent is different with unique strengths and weaknesses. So to score more runs, a team needs a strategy that will be effective against their particular opponent. They need to execute that strategy well, starting with making good decisions regarding the roster and batting order. They also need to make good decisions as the game progresses and circumstances change. What pitches should be thrown or where should the ball be hit? To do this effectively they need to know where they are in real-time. And, strangely enough, the score of the game itself can affect what strategies are employed.

You see how it's circular? It all comes back to the need for you to know where you are at all times. But nobody wants to go through their financial statements every single day, which is why the 7 Key Numbers are so powerful. They're like headlines for your business: you glance at them every morning to know what's going to impact you that day.

So it all comes back again to the 7 Key Numbers which shows a business owner where to invest their time, energy and money in order to profit.

- #1 Number of leads: For measuring your marketing effectiveness
- #2 Sales conversion rate: For measuring your sales effectiveness
- #3 Customer retention rate: For driving long-term customer value
- #4 Number of transactions per customer: For driving cash flow and repeat business
- #5 Average price per transaction: For driving cash flow and boosting margins
- #6 Variable costs: For managing your production expenditures
- #7 Fixed Costs: For managing your overhead and efficiencies

Let's now analyze more closely the 7 Key Numbers as they relate to Art Vandelay.

Step 1: The first thing I asked him was to determine the amount of cash he wanted to target as a return on his investment. (One of my paradigm shifts is to have business owners look at their businesses as an investment). By the way, don't think of a return on investement as a four letter word. Positive cash flow and profits are the lifeblood of any company and can allow your business to do any number of things it would be incapable of without them. Positive cash flow will make your business venture worthwhile and will allow your company to thrive and grow.

Profits can be used to reduce debt, pay taxes, invest in your people (raises, bonuses, increase benefits, increased training), invest in your company (savings for that rainy day, improve work facilities, expand the business) or pay yourself (dividends or pay it forward).

Art said his goal was to generate $30,000 from his business. Again, this doesn't include his salary. The return on investment is his compensation for his sweat equity. As a business owner myself, I have a different definition of sweat equity. Sweat equity is compensation for waking up at 3 in the morning wondering how you will make the next day's payroll.

Step 2: Determine your fixed costs. These are the costs of keeping your doors open. In Art's case, it costs him $120,000 per year to keep his doors open. We made certain that Art included his salary as part of these fixed costs as well as his overhead like his administrator's salary, rent, utilities, insurance, permits, and so on.

Step 3: Determine your variable costs as a percentage of sales. These costs included the hourly rate for his two workers, the cost of running the vans and any materials needed to complete the jobs. Because Vandelay had started taking such small jobs their gross margin was pretty low, averaging about 25% of their sales revenue. Based on his profit goal and his fixed costs, we know Art needs to generate $600,000 of sales revenue.

Step 4: Determine average sales price or revenue per job or transaction. In this case, Vandelay started taking smaller and smaller jobs. As part of their new sales strategy they would not turn down any work whatsoever. They found they were not being called to remodel a basement nearly as often as they were called to caulk a shower or repair some drywall that a teenager has kicked through. As the years went on and they accepted more and more small jobs, their average revenue per job dropped from $10,000 to $600.

Step 5: Determine the number of transactions per customer. Vandelay had a reputation for superior work in their field. As they reverted to doing more and more handyman work coupled with their strategy to not turn away any work, they started having more transactions per customer. In fact, they do keep a list of their customers, and they send out mailers every so often to keep customers coming back. It seems to work, because their customers tend to call them about four times a year.

Step 6: Determine the number of existing customers and the retention rate: Over the years Vandelay has a history of keeping approximately 50% of the customers that they started the year with. Of the 100 customers they had at the beginning of the year they still do work for 50.

Step 7: Determine the rate at which they convert leads to sales: In terms of sales, they're not very sophisticated – whoever answers the phone is the salesperson of the moment. So from that respect, they actually lose a lot of business because they don't really have a process for turning leads into customers. As a result they only convert 1 out of every 4 leads they get which translates to a 25% conversion rate.

Starting with the profit goal of $30,000 and considering all the information gathered in the other 6 steps in the process, the company needs to generate 800 leads per year in order to reach their profit goal. This is illustrated in the following chart.

Key Number	Plan
Profit goal	$30,000
7. Fixed costs	$120,000
6. Variable costs	75%
Revenue goal	$600,000.00
5. Average price per transaction	$600
Units sales goal	1,000
4. Number of transactions per customer	4
Number of existing customers	100
3. Rate of customer retention	50%
2. Conversion rate	25%
1. Leads target	800

With the analysis we completed, Art now has a pretty good picture of what needs to happen for Vandelay Remodeling to achieve their profit goal. Believe it or not, we actually painted a very specific picture of this company using essentially seven key metrics - The 7 Key Numbers.

Proactive vs. Reactive:
It's worth noting that sales revenue was not one of the 7 Key Numbers. In working with Art we were able to calculate that the company has a sales goal of $600,000 but that shouldn't be his focus. Sales are the result of other activities. In building his 7 Key Numbers we can see that Art needs to focus on the activities that will allow him to generate his sales and ultimately his profit goals. If Art and his team focus on these key activities and achieve the metrics they planned the sales, and ultimately the profits, will be there.

Reverse the direction:
Now that we have created some benchmarks and expectations, let's turn the numbers upside down so that we can manage the company and generate an action plan. In the following chart you can see the 7 Key Numbers starting with the 800 leads Vandelay needs to generate. The numbers are the same as our plan but just presented in reverse order. This is how we use them to manage our progress toward achieving our goals.

Key Number	Plan
1. Number of leads generated	800
2. Conversion rate	25%
Number of existing customers	*100*
3. Rate of customer retention	50%
4. Number of transactions per customer	4
5. Average price per transaction	$600
Number of units sold	*1000*
Revenue	*$600,000*
6. Variable costs	75%
7. Fixed costs	$120,000
Profit	$30,000

Comparison:
When managing a business it is important to remember that a number is meaningless until it is compared to another number. So let's move the clock forward and look at how Art is doing against his plan. The column on the right in the following chart is the company's actual performance. The column to the left of it is the plan we created. We can see our actual results compared to those Art thought were going on or achievable.

Key Number	Plan	Actual
1. Number of leads generated	800	**500**
2. Conversion rate	25%	**25%**
Number of existing customers	*100*	*100*
3. Rate of customer retention	50%	50%
4. Number of transactions per customer	4	4
5. Average price per transaction	$600	**$500**
Number of units sold	*1000*	*700*
Revenue	*$600,000*	*$350,000*
6. Variable costs	75%	**80%**
7. Fixed costs	$120,000	**$120,000**
Profit	$30,000	($50,000)

Again, a number in and of itself has no value. You need a benchmark, a number to compare your results to. Managing your business is nothing more complicated than comparing two numbers.

If you have a benchmark, then you can say something is good or bad and requires attention. You don't need to be a mathematician; you just need to be able to point your thumbs. Thumbs up or thumbs down. It seems so simple. But that's really the essence of accounting: comparing two numbers and deciding which one you like better.

And one of the reasons the 7 Key Numbers is so powerful is because it creates a framework for reducing complex business problems into simple thumbs-up-or-down decisions.

To generate leads, Vandelay relies primarily on neighborhood flyers and door hangers as well as Google ads and the yellow pages. Using these marketing tools they only generate approximately 500 phone calls a year.

As we discussed earlier there is no formal sales process, sales training or people assigned to sales. On average, they closed 25% of the leads they generated. They had 100 existing clients at the beginning of the year and kept about 50% active during the year. On average, they closed 4 jobs per customer at an average price of $500 per job. As a result of their performance on these key activities they only made 700 sales as opposed to their goal of 1,000 and only generated $350,000 in revenue compared to their goal of $600,000.

In addition to coming up short on their revenue their profit margins are being squeezed because of the lower prices they are charging to get business and the high costs of sending their vans all over the town. They set a target that they would keep their variable costs, as a percent of sales, at 75% which would have generated a 25% gross margin. Instead their costs have risen to 80% of sales generating on a 20% margin. That means for every dollar they earn, 80% of it goes to cover the cost of producing the unit leaving only 20% to cover their fixed costs and profit.

You've probably guessed that things aren't looking good. In fact they actually lost $50,000. Guess where that money comes from? Yes, you guessed it. It comes directly out of the owner's salary. Obviously, this is not a sustainable situation.

So we're all going to put on our "trusted advisor" hats and help them become profitable. By focusing on the 7 Key Numbers, we can get management to react before the situation becomes a disaster. Believe it or not, these 7 Key Numbers are everything you need to manage your business. As an analogy let's look at how we read the *Wall Street Journal.* The paper is jammed with information which is generally far more than we need or have time to read, let alone process. We rely on the headlines to know at a glance what's going to impact our business today.

The 7 Key Numbers are like the **headlines for your business**. They simplify management by showing you what you need to pay attention to today.

So, what can we do? Let's determine what changes are necessary to get Vandelay back on track. We've already used the 7 Key Numbers to build his plan and he can now compare his results to the plan to see what's working and what needs attention.

One of the first places to look is sales or, more specifically, key activities that generate sales. In talking with Art we agree that his sales process needs to be more formalized. Without much effort, he can ask his team to stop trying to handle every call themselves. They could create a fact-finding sheet to identify the needs of their prospect and give it to Art so that he could follow up and close the sales loop. As it turns out Art has a real talent for working with customers to develop rapport, build trust and close a sale. By leveraging this they believe they will be able to increase their closing rate from 25% to 35%.

In addition to the need to generate more customers, the dashboard is suggesting that they should look at how they could increase the average price they get on each job. After some discussion with Art and his team we decided that by becoming more selective as to what jobs they took they could go after more jobs that allowed them to focus on their skills and services as opposed to price. By doing this they will be able to increase the average price per job from $500 to $750.

Let’s look at how these points look on the matrix we introduced earlier.

		Strategies							
	3 Key Disciplines	**Marketing and Sales**					**Operations**		**Finance**
	8 Pillars ➔ **7 Key Numbers ↓**	**Purpose**	**Product**	**Promotion**	**Price**	**Place**	**Production**	**People**	**Profit**
Goals	1 Number of Leads	x		x		x			x
	2 Conversion Rate	x		x		x			x
	3 Average Price	x	x	x	x		x		x
	4 Retention Rate	x		x					x
	5 Avg. # of Transactions	x	x	x	x				x
	6 Production Costs	x	x				x		x
	7 Fixed Costs	x						x	x

As a result of these two changes, improving the sales process to close more sales and increasing the average price per job, Art and his team should be able to dramatically improve Vandelay’s situation. If they execute their new strategy and keep focused on the numbers they can improve their revenue from $350,000 to $675,000 without even increasing the number of leads they generate.

While they are short of Art’s profit goal of $30,000 these changes will significantly change the trajectory of the company. As they continue to focus on their 7 Key Numbers and work to improve their variable costs they should be able to hit their target.

The important realization is that with few changes in their operations and little or no additional costs they were able to use the key headlines to manage their business to achieve success.

Key Number	Plan	Actual	Focus	
1. Number of leads generated	800	**500**	**500**	
2. Conversion rate	25%	**25%**	**35%**	
Number of existing customers	*100*	*100*	*100*	
3. Rate of customer retention	50%	50%	50%	
4. Number of transactions per customer	4	4	4	
5. Average price per transaction	$500	**$500**	**$750**	
Number of units sold	*1000*	*700*	*900*	
Revenue	*$500,000*	*$350,000*	*$675,000*	
6. Variable costs	70%	**80%**	**80%**	
7. Fixed costs	$120,000	**$120,000**	**$120,000**	
Profit	$30,000	($50,000)	$15,000	

This is the essence of the 7 Key Numbers and how to use them to improve how you manage your business to improve your results. Now, this was the quick Band-Aid. In this course, we will give you a system for not only identifying problem areas, but improving business performance, month after month, year after year. One of the value drivers in the ultimate sale of your services will be consistency of earnings.

Upselling to a Long-Term Relationship

A Few Key Phrases

"Imagine what your monthly income could be a year from now. Now multiply it by 12 months. Now multiply it by 10 years. You should have come up with a number between 1 and 3 million. Now multiply by 5. That is the benefit of working with us."

"Most people overestimate what they can do in 6 months and underestimate what they can do in 5 years."

Their success will depend on ***leadership, management, and execution***:

- Leadership – a clear, compelling vision, standards of accountability and accountability.
- Management – creating an environment of success
- Execution – doing things that get you to the vision (a commitment plan from each participant in the organization)

Sales success tips:

- Find the difference that makes the difference.
- Most companies who are struggling usually use time to save money, but time is your most important commodity.
- Where you spend your time will dictate your success more than anything else – not where you spend your money.
- Focus on what you *should* be doing, not what you are doing.

Make the Upsell to…

With the "WOW" of the Business Check-Up, you should be able to upsell indefinitely. However, you want to be sure you match the right customer to the right product.

- Consulting
- Strategic Planning
- Financial controls – focus on budget, business plans, financial statements
- Bookkeeping services/software

Chapter Conclusion

If you reviewed the conversation above, you see that the hard questions were asked, but the questions really weren't hard to ask at all. Based on your preparation for the meeting, the tools you used to set up and conduct the Business Check-Up – the Sales Diamond, Wall Street Questions, and analysis tools, and your helpful, non-judgmental demeanor, you've been able to lead the client to keener insights about their business as well as a deeper appreciation for your skills and knowledge as an advisor. Think of this as a paid sales call.

Now, it's time to deliver another WOW. That will come in the form of your written report or summary, the topic of the next chapter.

Chapter 5: The Write-Up

What You Have Done Thus Far -

By this point in the process, you have done your homework. You have your client's financial statements and tax returns, and they have filled out the questionnaire. This information gave you everything you needed to prepare for your meeting with the client

During *The Business Check-Up* you used the "Wall Street Questions" to discover your client's needs and desires, or their delta, and the combined results gave you the strategic tools you needed to help them see their business more clearly and to understand the value of retaining your services to help them move toward their goals. Finally, you were able to diagram your client's Sales Diamond, a visual representation of the balance, or most likely imbalance, between the performance of your client's company and their satisfaction with their personal life.

All of this leads up to a point where you can produce an actual report that outlines the following:

- Your deep understanding of your client's business
- Your client's pain points
- Operational issues revealed through your DuPont Analysis and other financial indicators
- Potential solutions (but not all of them!) to their problems
- Helpful hints that lead them to need more from you
- Concluding remarks that lead to additional business for your company

These are the primary elements included in the Business Check-Up Report. In the following section, we will use our sample company, Vandelay Remodeling, to illustrate how to assemble the Business Check-Up report.

Our Example: Vandelay Remodeling

Our fictitious company, Vandelay Remodeling, provides an example of what must be done to produce a Business Check-Up Report. To create the report we should first discuss the issues that were discovered through The Interview and the Prerequisite analysis.

If you'll recall, Vandelay Remodeling is a company that is having a difficult time achieving their objectives. They're a ten-year-old company in Arvada, Colorado founded by Art Vandelay. A mom and pop operation, Art's wife Susan handles the books while a couple of hourly employees and an administrator keep track of all their jobs and projects and keep their vans rolling to the right locations. A couple of years ago, they specialized in basement remodels and their average sale was $10,000. As the economy worsened they made a decision to do handyman work in order to keep their crews working and their doors open.

Art is struggling but doesn't know what to do. His accountant provided a balance sheet and income statement but Art really doesn't understand his business or how to read these reports and use them. In short he doesn't know the score. Recognizing that he was in trouble he's hired you to help him.

Through your diligent work in the preceding two chapters, you've discovered the following issues that Vandelay Remodeling faces:

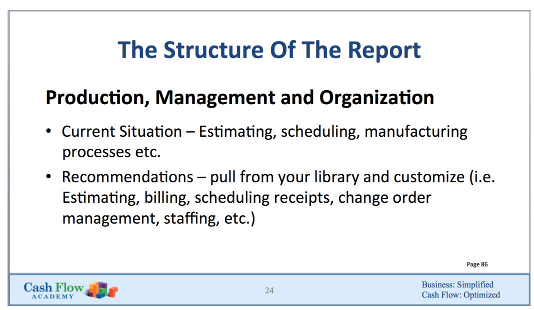
- Vandelay has cash flow problems – the company needs cash infusions from the owners to stay afloat.
- The company is growing, but none of that growth translates into more cash for salaries or reinvestment in the company.
- Remembering there are three major areas of a business (Operations, Marketing & Sales, and Financial Management), you've identified weaknesses in the areas of finance and marketing & sales.
- Even though the company has attributes that could set them apart from the competition, the company lacks any effective marketing materials differentiating themselves from their competitors.
- The company lacks focus in its overall marketing efforts.

In short, Art works too many hours, with not enough safety cash, and for low pay.

Now that we know what problems Vandelay faces, we construct a Business Check-Up Report that demonstrates to the client that they need your help to succeed. But before you start writing, think about what you want them to do next – "Your Customer Journey" from Chapter 1.

Set the Stage (Preamble)

When you begin to write a Business Check-Up Report, you will often struggle finding the best way to break the ice and transition smoothly into discussing the heart of the problem. A successful Business Check-Up reads like a well thought-out, personalized document, even though this course is teaching you how to assemble one within a very short time from templated elements. Much of this personal touch is conveyed within the first few paragraphs of the Business Check-Up.



The purpose of the document is to clearly state the problems the client faces, demonstrate your deep understanding of those problems and reinforce the idea that you have the solution – and that they need your help to implement it.

Open with an acknowledgement of your client's participation in the process. Specifically, you want to make them understand that you appreciate the time and effort they have put into the process and reinforce how they will benefit from their investment by implementing the solutions you suggest. Next, you will want to tell them why you are the best person to help them out of their current predicament.

Opening your document in such a way helps reinforce the reason why your client hired you to begin with – you're the expert and you can help them succeed. This will help you continue to

develop the rapport that you should already have with your client. On top of that, everyone likes to be told that they've made the right choice!
Next, remind your client of the goal of this entire process (and the key to success for nearly any company) – CASH FLOW, and, if they follow your guidance, improving cash flow by making it both consistent and predictable is not only possible, it's easy.

Finally, you need to help your client see what they've already accomplished with you just through the Business Check-Up. After all, the company is probably not at their desired size and time is a valuable commodity. In addition, your client has probably shared a number of concerns and allowed you to take a 'peak under the hood' in an effort to fix their problems – they probably don't let very many people look at the internal workings of their company. If that's the case, then you have begun to transition in their minds from "outside consultant" to Trusted Advisor, and it's time to build on that relationship.

Reviewing the work done thus far shows your client that you are invested in the success of their company. This helps to develop the trust that you'll need to leverage once you ask them for additional business.

Part I: Convey a Sense of Understanding

Once you've set the tone for the remainder of the document and begun to secure the trust of your client, you need to convey a sense of understanding of your client's current situation. If you can do this effectively, your client will believe that you have the experience under your belt to understand their predicament, even if you've never been there.

There are four primary sections that Cash Flow Engineering uses to convey an understanding of a client's situation, and they are:

- The Company
- Management Efficiency
- Company Direction
- Personal Goals

The following provides a brief summary of these sections and outlines what you need to accomplish in each.

The Company
In this section you want to show your understanding of the history of the company and touch on the big-picture things the company itself is focused on. If you are working with a small- to medium-sized company, you should include references to how and when the company started, what its primary focus was at its inception, and the fundamental changes the company has undergone to become the company they are today. At the beginning of this section include a brief overview of the company's holdings and finances, this will help set the stage for the Business Check-Up Report to follow.

Let's take a look at how we might put a section like this together for our friends Vandelay Remodeling:

Your goal in this section is to demonstrate that you have a working knowledge of your client's company, what they want to get out of their company, and what they've done to get where they are today. Although tempting, this is not the place to delve into your client's pain points and areas of difficulty. Instead, take the time to, in a way, congratulate them on their business and convince them that you know where they've been and why they have done what they've done.

Management Efficiency
The second section is the first time you begin to talk about the specific strengths and/or weaknesses of the company. Specifically, you'll be telling your client how effectively the company is being managed. While this can sometimes be painful, it's a discussion that is vital to the overall success of the company. As a Certified Cash Flow Engineer, you have a standard Excel template where you can run these numbers and then copy them into the document.

Owners of companies typically lose money because they fail to test for good management. An efficient management team with the right systems in place will guide companies toward success. Unfortunately, many companies rely on the outlook for the industry, new products, or a plausible story for protection – and often lose.

This is a real example of how you can illustrate management efficiency.

- **Test I: Driving Force of Management:** Management, as indicated by the past record, has the ability necessary to expand sales. The rate of sales expansion is illustrated in the table below.

Year	Sales	Growth Rate
2012	5,978,743	
2013	8,965,838	49.96%
2014	11,566,886	29.01%

- **Test II: Gross Margin:** Management seems to have the ability to maintain gross margin.

Year	Gross Margin	As a % of Sales
2012	992,379	16.60%
2013	1,292,343	14.41%
2014	1,997,776	17.27%

- **Test III: Earned on Sales:** Management seems to have the ability to maintain profit margins. It shows pre-tax profit margins for each of the last three years as follows:

Year	Net Income	As a % of Sales
2012	571,230	9.55%
2013	481,906	5.37%
2014	630,816	5.45%

- **Test IV: Earned on Equity:** The Company has earned on invested capital from 88% to 148%. Earnings on equity are above industry averages. Based on projected growth, we will see ROI fall but the gross dollar amount rise substantially.

Year	Invested Capital	ROI
2012	385,423	148.21%
2013	547,101	88.08%
2014	577,492	109.23%

- **Test V: Use of Debt:** Debt has been increasing disproportionally over the last five years. The growth in debt has outpaced the growth in sales and based on managerial expectations, is likely to increase. As the debt to equity ratio increases, your inherent risk in terms of survival increases. Be careful!

Year	Debt	As a % of Sales	Debt to Equity
2012	2,115,164	35.38%	5.49
2013	6,048,879	67.47%	11.06
2014	8,315,080	71.89%	14.40

- **Test VI: Owner Compensation** (from all sources – salaries, dividends, etc.)

Year	Owner Compensation	Bonus & Dividends	Total Comp	As a % of Sales
2012	60,000		60,000	3.61%
2013	80,000	30,000	110,000	3.38%
2014	80,000	50,000	130,000	3.10%

As you can see from the metrics presented above, this section is driven, primarily by the internal financial statements as well as your inspection of their tax returns. In general, you should evaluate these metrics against industry standards, if available, to determine the overall performance of your client's company.

Company Direction
The third part of this section is dedicated to conveying your understanding of the company's goals. To be clear, this section discusses the *company's* goals, not the personal goals of the owners (that's the last section). In addition to presenting the company's goals, you should also talk about the current state of affairs, such as who owns the company, who are its principal directors, the company's most recent performance and product lines, to name a few.

While this section is presented largely for informational purposes, it sets the context for the recommendations that you will be making in the following sections. Here's how we put Vandelay Remodeling's Company Direction together:

Again, the purpose of this section is to set up the recommendations that will come in the next section.

Personal Goals
This is typically the shortest of the four parts in this section and is used to reiterate the personal goals that your client outlined during The Interview. This part is important because it allows you to set the goals and metrics required to push the "Lifestyle" leg of the Sales Diamond. For Vandelay Remodeling, the Personal Goals section looks like this:

Part II: Recommendations

This is the where the meat of the Business Check-Up is presented. Up to this point you've been demonstrating your understanding of their business and industry. Here is where you begin to delineate their pain points, show your understanding of their specific goals and issues and propose solutions to these problems. We state these using a SWOT approach. (Strengths – Weaknesses – Opportunities – Threats)

We begin by setting the stage using the Three-Legged stool of management. We then take the first leg of the three legs and discuss Vandelay's position in relation to Marketing and Sales.

Marketing and Sales
In each section of the report make recommendations that are specific, achievable, produce measurable results, and can be tracked on a time-line. This will demonstrate to your clients that you have both the ability and experience to help them grow their business.

Developing a detailed marketing plan is critical for all companies. It represents the difference between proactive management and reactive management. For Vandelay, we structured this recommendation as follows:

> ***Develop a marketing plan**: Get out in front – strategically. Remember that it's not how much you spend, but where and when you spend it. Develop a marketing plan designed to drive cash flow.*
>
> *Most businesses approach to marketing happens when the boss suddenly realizes that the phones aren't ringing. Then a flurry of postcards and emails are hastily tossed around until*

clients suddenly remember the company again. But, if you want consistent cash flow—which is what you NEED to plan for long-term success—then you need a consistent marketing plan. This means testing and tracking your message, then testing and tracking the effectiveness of the delivery tools you use, and then testing and tracking the frequency of delivery until you can predict how much money and effort is required to get your phones ringing. This planning and tracking provides a clear marketing R.O.I. (return on investment) and is critical for deciding when to invest, when to expand, when to cut back, and when to cash out.

You must determine the messages, methods and tools that reach your desired audience most effectively and then communicate with them repeatedly – until they use your services, or refer you to someone who will.

Implications: *Effective Marketing makes sales significantly easier. I suggest developing a marketing plan with a budget and a calendar that clearly reflects what must be done and when.*

Solution: *Don't simply continue to do what you have always done. In order to get the phones ringing again you need to track the R.O.I. of each of your marketing efforts. This means testing and tracking each part of the plan.*

Recommendations – Sales

Problem*: The Company has no consistent sales process in effect. With a relatively small staff only the best sales person should have closing responsibility. That said, we also need to be sure that only pre-qualified leads are handed off to that salesperson. Additionally the staff has received no training on how to qualify leads.*

Implications: *This will be very important as you continue to grow and will especially important if you add additional sales people.*

Solution: *The first step in improving this area will be to create a pre-qualifying lead document for use by the staff. Then use role-playing as the tool to train everyone on how to handle new customer contacts and to make sure you client communication procedures are followed. Art should accept the primary role of sales person.*

Here are some other examples of other topics you can talk about:

- Ways to their client base
- Types of key offers used to attract customers
- Promotional methods used to attract customers
- Online marketing strategies
- Systems to increase customer conversion rates
- Ways to increase their transaction prices
- Ways to increase the lifetime value of customers

We talk about strategies in our course "The 8 Ps – Dealing with a constantly changing business environment."

Production and Operation Management
Typically, this is there area where the owner thinks he is doing the best job. Often that is true because most businesses are started to deliver the products and services that are the area of expertise of the founder. However, knowing how to do something well does not mean you know how to manage others to do the same thing. For Vandelay, the struggle between selling the projects and delivering the projects is a constant stress for Art.

Production and Operational Management encompass both the management of production and operations (estimating through delivery of the products or services offered) along with general company management.

Recommendations – Production

> ***Estimating***: *Do it now so there are no surprises later. Nobody likes unknowns, especially when there's money involved. Take enough time to estimate each job appropriately and accurately, and adjust your bid accordingly. It's the difference between making a profit and unintentionally running a charity.*
>
> ***Implications:*** *The more attention you give to your estimates, the fewer surprises you'll find down the road.*
>
> ***Solution:*** *Don't estimate the job as a whole instead, break it down into a series of tasks with defined milestones and estimate cost, value and price for each milestone. Tie this into the accounting system.*

Vandelay, like many small companies, does a poor job of both scheduling payments and collecting them. We wanted to point that out with the solution to that problem.

> ***Scheduling your receipts:*** *Know what happens next. From deposit through each partial payment to the final payment on completion, scheduling the job is the main tool for determining cash flow. But in addition to scheduling the tasks consider scheduling your cash receipts. Use that schedule to help monitor cash as well as job progress.*
>
> ***Implications:*** *When you, your subcontractors, your employees, and your clients all understand the schedule of deliverables, expectations and payments then things happen when they're supposed to. This shortens the time it takes for the job to get done. And every hour you save represents a cost not incurred and puts you one hour closer to getting that final check.*

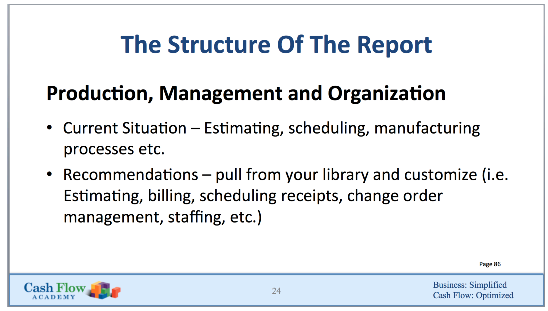
If it weren't for people, managing a business would be easy. As a Cash Flow Engineer your job is to stand outside the business and give valuable advice based on your experience. Small to medium sized businesses often have people problems. The skill sets needed when there are only three employees change significantly when you grow. Not all employees are able to grow and remain valuable in the roles they may have once filled. Owners often can't see that Sally, who was a good bookkeeper, simply can't handle the job of CFO. For Vandelay we wanted to get them to do a thorough review of all their people and what they are responsible for.

Here are examples of strategies that you can write about. My production strategies are related to input management and costs of production.

Here are some other examples of other topics you can talk about (we break it into two categories: resources and costs):

Other topics dealing with resources or inputs:

- Vendors management
- Ways to increase efficiency
- Ways to generate process efficiencies
- Ways to control inventory levels
- Ways to use technology
- Ways to use facilities, equipment and scale efficiently



Other topics dealing with costs:

- Ways to decrease order processing costs
- Ways to get vendors to lower costs
- Ways to lower people costs
- Ways to lower production costs

Recommendations: People and Management

Staffing: The following questions should be worked through:

- Is the right person doing the right job?
- Do you have enough staff to effectively do the work required?
- Are you training your staff appropriately? (i.e. should you focus on sales training for all employees?)
- Is there a need for additional cross training in case of emergencies?
- Do employees have clear expectations set for the job they are doing?
- Have you got a plan to motivate employees to think more like owners? Evaluate your work structure frequently, and always remember that your employees are direct representatives of your values.

Here is an example of a staffing recommendation:

> ***Get more time – delegate and communicate***: *Create the actions you want. The results are up to you. Lead your business – don't follow it. Define your goals, communicate to your team, delegate responsibility, but remember to also delegate the authority required to get the job done and empower those who can help you achieve your goals. Motivate through leadership, recognition and feedback. Create a positive work environment and give your staff the potential for growth.*
>
> ***Implications:*** *Develop realistic goals, communicate effectively with your team, delegate and empower those that should be supporting your company and its goals. Take the time do put the systems in place to drive success in every area of your company.*

Create action plans for each employee: *Hire deliberately and strategically and get the best people for each job. The better your employees, the better your business. Write specific job descriptions for each position you wish to fill, and recruit based on your needs. Be clear with each candidate on your expectations. Have a measurement system in place to help you keep each team member on track. Remember – you get what you pay for.*

Implications: *Make your job descriptions as specific as possible. Clear job descriptions create a clear picture of what you expect from each employee. Candidates will completely understand what you are looking for and be able to explain to you how their qualifications will help your company. Provide a clear route to future success when they're hired.*

Not every piece will apply to every client, but we wanted to give you examples of what you should be thinking as you put this Production section together for your clients. **Remember to save each problem – solution – implication set in your template library for future use.**

In the following section we will cover how we handled Financial Management for Vandelay. In Vandelay's case, Susan, Art's wife, handled the books and he had an accountant to do his taxes. This is a typical setup in many closely held businesses, but means that financial management is never used as a tool to really help manage the business. It is always, at best, a rear-view management tool looking at what happened rather than helping the owner recognize problems *before* they occur.

Other topics to discuss:

____

____

____

Financial Management
Financial Management is comprised of accounting, finance, job costing, budgeting and planning (both short-term & long-term – tactical & strategic).

Current Situation

Profit & Financial Management*:* *The current financials are up-to-date. Although the company can project breakeven and profitability by job and cost category these reports are difficult to understand and do not provide an effective tool for decision making and taking action. The standard reports used monthly are – Job Costs, Cash Flow Projection, P&L and Balance Sheet reports and % Complete Reports. These standard accounting reports typically show a "rear-view mirror" look into the business. To increase management flexibility and effectiveness you have to have reports that allow you to* *manage by exception and have those reports show what's coming up, not what happened when it is too late to alter course.*

***Financial Management** – Financial Management encompasses far more than bookkeeping and accounting. The current financial management process provides inadequate job cost reporting. This can result in cash flow challenges and ultimately inhibits the potential for growth and reduces overall enterprise value and profit.*

***Implications:** The level of detailed input required to effectively manage Vandelay is only partially available and is often founded on intuition rather than facts. There is no detailed tracking by job (actual to planned), nor is coding done to track type of expense to budget. The current financial reports available are usable only as a look at what happened rather than a tool for management of the business. In addition, the current financial management system is basically structured to make sure the annual tax returns can be created. It is not designed as a tool for managing the company operations. Continuing in this fashion will restrict growth potential.*

***Solution:** See the software section below.*

Recommendations – Software

Vandelay is like most companies. Cash flow is looked at with surprise when it is good and fear when it is poor. Your job is to help your clients change their minds about how to view cash flow and begin to use it as the driving force behind their business.

Here is what we said to Vandelay.

Cash Flow

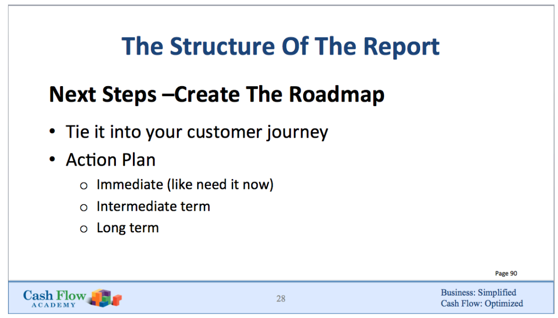
***Start with your cash flow goal and plan backwards**: Here's the way failing businesses are run - the owner works ridiculously hard in the hopes that some money comes in at the end of the month. And here's the way successful businesses are run: The owner decides how much money he or she wants to make each month, and then plans backwards to determine how hard he or she needs to work to achieve it. In other words, good businesses start with the end in mind and then calculate exactly what must be done to achieve it. It sounds simple, but it's a fundamental shift in thinking: when you do this, you learn how to price for profitability, to market yourself for value, and to optimize every expenditure. Most importantly, you learn that an increase in cash flow isn't a happy accident, but a predictable outcome.*

***Implications:** Day-to-day operations are consumed by the most urgent problem rather than managed to a plan. Based on your goals for growth, budgeting backwards will allow you to secure the business and grow it in a logical and controlled manner.*

***Solution:** We suggest that you create your 13 week "abridged budget" for three years out so that we can ascertain that your meet your goals. We'd like the budget produced on a "cash basis" meaning show addition to reserves debt requirements and asset acquisition in the budget. Don't limit it to just income items as in a traditional budget.*

Again, as you build your Business Check-Up reports take each problem / solution / implication set and create a template in your template library. You will quickly build a comprehensive, detailed, and powerful set of solutions that you can pull together quickly for future clients.

Next Steps



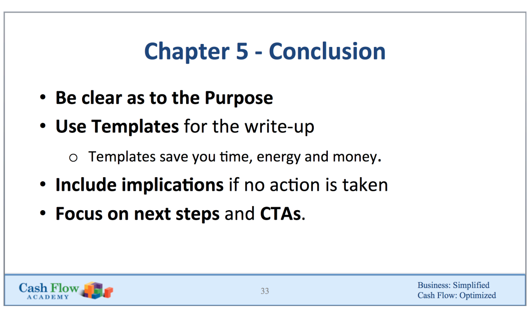
At the end of the Business Check-Up report you will close by taking your client through a proposed series of next steps. This will summarize what you view as the primary problem areas, the proposed solutions and show specifically how you can help your client grow their business.

See **Appendix 4** for an example. This is effectively your "sales letter" and its purpose is to show the benefits the client will receive by working with you.

The short-term section should again reinforce your understanding of the challenges they face and how you can help them make the changes that will result in immediate savings to the client. The immediate steps to be taken are the "low-hanging fruit" projects that are easy to start and complete.

Engagement Fees & Structure
Finally set out the engagement fees you wish to charge. We use a structure that provides the client with a couple of different and easy ways to say yes and get started.

Chapter Conclusion



Properly developed, this is a powerful sales tool for there is inherent value in the document since you are describing not just the problems the business faces, but also showing the solutions available and specifying the implications for the future if nothing is done.

The next Chapter deals with the entire follow-up program. In it we will cover how to turn this initial engagement (The Business Check-Up) into a long-term relationship by creating a compelling customer journey.

Chapter 6: Follow Up

Look at what you've accomplished so far:

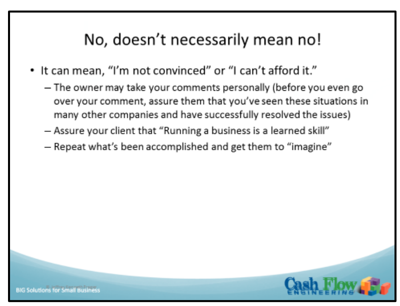
You have taken your customer through the Business Check-Up and created the Business Check-Up Report showing what stands in the way of their success. At this point, one of two things has happened: your client agrees to move forward, or he has given you a no go. In either case, you have already shown the value of the process and have pointed out where the low hanging fruit is to help them move forward.

Let's assume that they want to move forward with you. The next step is to take your new BUSINESS CHECK-UP customer and turn them into a long-term client. Remember; by taking your client through the steps of the BUSINESS CHECK-UP you have demonstrated:

- Your deep understanding of your client's business
- Your client's pain points
- The operational issues your client faces that were revealed through your *DuPont Analysis,* other financial indicators and your questionnaire and questions during the Check-Up
- You see many potential avenues or solutions to take their company to the next level
- You have shown your value to them with a clear direction for moving forward
- Your concluding remarks clearly state your ideal next steps, all of which add far more value than the investment your client has made

Whether or not they decide to move forward with you, you may want to reinforce the value of the engagement and stay in front of your client, even if you didn't make the sale.

"No" doesn't always mean *no*.



What if the client hesitates, tells you he/she needs to think about it before moving forward, or just says no? Don't be discouraged. "No" can mean "I'm not convinced yet," "I'm not ready to face the problems," or simply, "not yet".

What you've revealed in the Business Check-Up is likely a lot for a business owner to take in – business owners tend to take problems personally. You've just shown them what they may take as flaws in his management style or character, and this is hard to come to grips with. Your client may need a little time and reassurance in order to make the right decision.

Without having to become 'salesy,' assure your client that you work with businesses every day, and that most companies face similar issues. Running a business is a learned skill, and since every business faces new challenges every day, our skills need to be continually honed to meet those challenges. Even the most successful business owners have experienced similar obstacles, and the ones that are willing to get help, take action and face their challenges head-on are generally the ones that come out the best.

Then, review again, step by step, what you've accomplished and revealed through the BUSINESS CHECK-UP and the value of what they have learned. The bottom-line question the client will ultimately need to answer for to themselves is, "Do I feel more comfortable taking corrective action now, or letting things go on as they are?"

You don't have to be pushy, but it's not in your client's best interests to let them off the hook and make it easy for them not to take action. Be patient and understanding, but firm in your commitment that moving forward will be of benefit to the client, and be specific about what those outcomes and benefits will be.

Your Customer's Journey

Ideally, you want to reinforce their decision, add more value and get referrals.

In either case you have made a significant investment in your customers by just getting them through the Business Check-Up. This chapter is all about how to turn that single transaction into a deeper, long-term relationship with recurring engagements on a consistent basis.

Taking clients through the Business Check-Up will have revealed numerous opportunities where you can bring significant added value to their operation. Recall your product list from Chapter 4. Clearly determine what services you will offer and how each is integral to helping your client get where they want to be. Those steps represent the *customer journey*.

For example, assume that your business focuses on tax preparation, in your Check-Up you may want to reinforce other "routine services" or move them into another group – i.e. the planning group. In the BUSINESS CHECK-UP you may have said they need a business plan. So, we write a letter (or make a phone call) to congratulate them on their decision to go forward and then start reinforcing their plan of action (moving forward with the business plan).

Most business owners excel in only one of the legs of the Three-Legged Stool of Management (marketing & sales, operations and management or financial management), are reasonably competent in another and may need your help in supporting the third leg.

Each client will be different. For example, the age of the owner will often determine what is most important to them at this moment. Older owners may be thinking about exit strategies, legacy planning or simply selling the business. Younger owners may be trying to determine if they can afford to open a new office or pursue a new market niche. The BUSINESS CHECK-UP has given you all the information to help them, your value lies in your being able to focus your services on their immediate concerns.

Now it's time to demonstrate your professionalism. Once your client has your report, you have to take your ideas and recommendations from the report and present them in a way that corresponds to the client's most urgent needs. Put yourself in your client's mind before you contact them and prepare how you will present your proposal before you call or meet with your prospect. Have your call or communication mapped out, decide what you want to cover and be certain your communication reinforces the benefits they will realize when they move forward with you.

Your goal in these customer contacts is to help them stay engaged and take the next step in ***your defined customer journey***. To that end, you need to have your follow-up funnels structured ahead of time so you can, without reinventing the wheel for each client, simply drop them into your follow-up funnel and let the "system" move them through their journey.

There are four main components to effective follow-up campaigns, they are:

1) Phone Scripts

   In every conversation find a reason to call them back in a few days. If you develop a series of phone scripts this will make it significantly easier. (Note: Most successful salespeople, even the most seasoned, use pre-defined scripts. You should too.)

2) Follow-up letters (real as opposed to digital)

   After every conversation a brief follow-up note or letter should be sent. Simply thank them for their time, review the conversation and offer a free tidbit of wisdom related to the conversation.

3) Email and direct mail campaigns

   The foundation for all follow-up campaigns is an email campaign designed to give value with each new email. Whether that takes the form of an E-newsletter or simply something like a "tip-of-the-week". The first two weeks after you've delivered your report are critical, and consistent, relevant communications will either help them make the decision to engage you or reinforce that decision and prevent buyer's remorse.

4) Referral program

   There is no better marketing technique than having a happy, satisfied customer tell someone else about what you did for them. Depending on your business and what you want to accomplish, you can create a formal referral program with rewards for the referee, or simply establish a way of tracking who recommended you and then thanking them for the referral.

Remember what was in your report to the client. As you contact them, refer to those "pain point items" and the solutions you proposed in the report. Don't forget to bring up the implications of remaining at the status quo and what that means to your client over the next three months, 12 months or over ___ years, depending on their time horizon.

This process is designed to turn you into a valued advisor (their "go-to guy") for all help managing their business rather than just another consultant or just their accountant. The personal touch is important. You must remember, first and foremost, you are always selling *you.*

Here are several examples of what the components of a follow-up funnel might look like:

1) Phone Scripts

   a. Art, how are you and Susan doing? I wanted to follow up with you about your decision to create a business plan. We have prepared a basic questionnaire to help you quickly go through the process. I'll get that to you before our next Meeting.

I could meet with you on _____________ or ______________. What time frame works best for you?

b. Art, one of the key issues we discussed in both the Check-Up and the report was the development of your lead-qualifying document. I have several ideas that I think would help you solidify that process and would really like to get together and work on that with you and your staff. When can we schedule a meeting to design this process and train your staff?

2) Follow-up letters (real as opposed to digital)

a. The follow-up business letter sample.

Dear Art:

I just wanted to thank you for your commitment to moving forward. Our entire team is proud that you have selected us to work with you to grow your business by developing your business plan.

The process has already begun and we will continue to make it as easy and seamless as possible. You won't have to spend your valuable time attempting to re-create the components of a business plan because we've done it for you. We have all the systems, processes and people to make this process as painless as possible.

Your success is our ultimate goal. Don't think about where your business is today; think about where, together, we can take it tomorrow.

Sincerely,
Signature

P.S. Financial success is just around the corner.

b. The follow-up business note sample.

Dear Art,
I just wanted to drop you a quick note to thank you for the time we spent developing the Lead-Qualifying Document for Vandelay. I will be very interested in the feedback you and your team will give me so we can further tweak the document to meet your needs as they become clearer. This will prove a significant help to you as you take over all the sales efforts. I look forward to our next meeting in August where we will continue the work we have begun.

Sincerely,

Note – I do try to get a follow up on everything and every process I help the clients create.

3) Email and direct mail campaigns

a. I suggest using the idea of a *TIP OF THE WEEK* weekly email campaign. In this type of campaign you will create a series of "*evergreen"* tips that will be included in your auto-responder email system. Tips that are "evergreen" can be read at any point in time; they are not based on current events and don't get outdated within weeks or months. They stand the test of time and are just as true, helpful and valuable today as they were years ago and will be just as valuable years from now. **Infusionsoft** is probably the best of the best systems out there, but you can get up and running for little to no money with systems like **MailChimp, Constant Contact**, or **MyEmma.**

Subject: The Value of a Marketing Calendar:

Dear Art,

Without a marketing calendar your marketing efforts will be slipshod and uncoordinated at best. You will find yourself taking reactive measures just trying to get the phone ringing again.

By creating a marketing calendar you take proactive control of both your budget for marketing and the results you achieve. But it requires thought ahead of time, planning, and tracking your results.

Keep in mind that the worst number in marketing is the number 1. Too many business owners try something once and say, "Well that didn't work!" and then try something else. You have to remember that in marketing you have to hit a sweet spot with a prospect. Your message has to hit them when they are looking for a solution you can provide or you have to get them to feel pain they don't even know they have.

Therefore you will want to do things more than once. Never send just one postcard to a list, plan on sending at least three.

If you flood the neighborhoods where you are working on a project with door hangers, try more than one design and track your results.

Create a calendar that takes you through the entire year. Show when mailings will go out and when newsletters (either digital or physical) will be sent. Show when you will use a new ad in the local paper, etc.

This will allow you to create a realistic marketing budget. Equally as important as the calendar is it is critical to track your results. You need to get to the point where you know exactly how much each new customer cost you to create and how much you're investing to get additional business from your current customer base.

In our next Tip-of-the-Week we'll cover tracking methods.

4) **Referral program.**

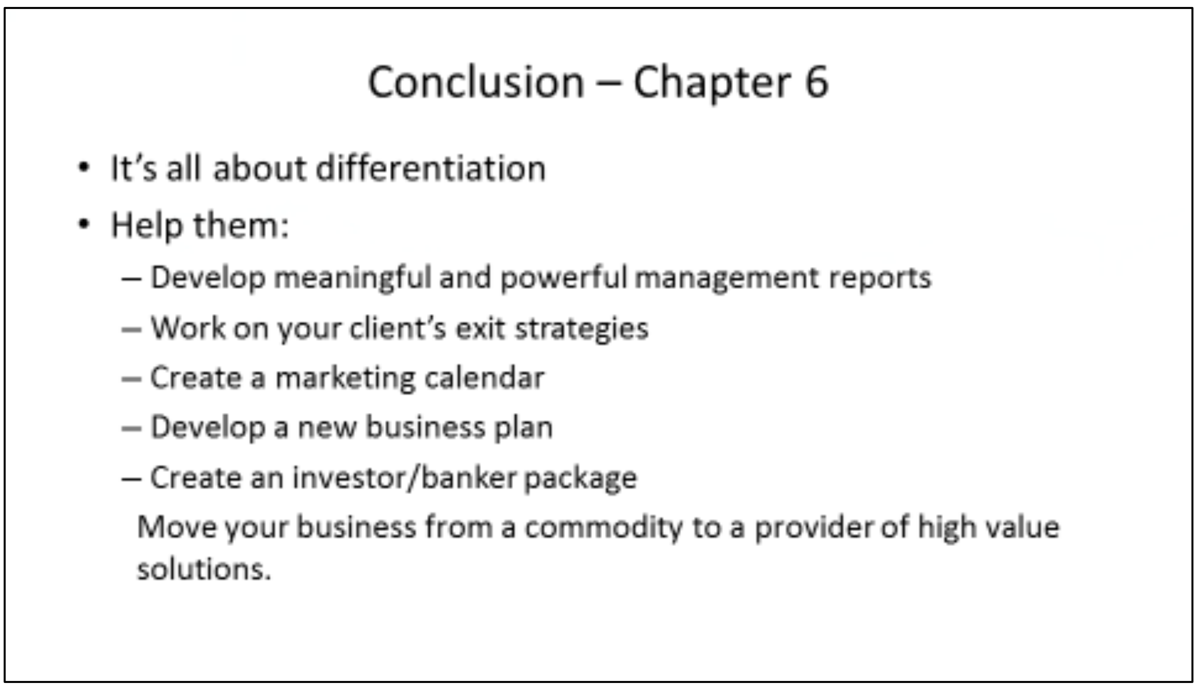
   a. All referral programs are built on one idea. **A COMPLETELY SATISFIED CUSTOMER**. The biggest question people ask is, "How do I get more referrals?" The answer is always the same – you have to ask for them. As a business owner you have to get over the fear of asking for referrals and that comes with having completely satisfied customers. If you have done your job correctly you will have a client who will be close to a raving fan and will be happy to post a review on your blog, post a review on yelp or give you a review that you can use in your sales book. The simplest way to get more referrals would be to ask for them at the conclusion of a project. Use a script something like this:

Art, you're a member of the Denver Chamber of Commerce, right? He will say yes. Then you say, "Do you go to the meetings regularly?" He will probably say yes. Then ask the question, "Do you know two people in that group who you think would benefit from my services?"

By asking for a referral this way you give your client a definite target to think about. And since they are happy with you right now they will be more likely to give you two names right then.

The easiest sales are to people you've already sold to… and to the people they refer to you. Do you have a formalized program to reach out to your past and existing customers? If not, this section will be invaluable to you!

Chapter Conclusion



Get Going

Through this course you've learned to provide a valuable service that offers real, tangible and immediate benefit to your clients and opens up the door for long-term relationships and ongoing services. The Business Check-Up will establish your credentials as a trusted authority and valued advisor, and will be a springboard to help you grow your practice to wherever you want it to be.

You have all the tools and skills you need to perform a Business Check-Up and subsequent services. And, by the fact that you've taken this course and are reading these words, I must conclude that you have the drive, motivation and determination to put these tools and skills to work.

Rest assured, you are not alone. This course is only the first part of a complete support program for Certified Cash Flow Engineers that includes complete marketing materials and/or services, sales tools, additional training, and even one-on-one consulting for your practice. We're committed to your success in the same way that you are committed to the success of your current and future clients.

Create a Goal

Yes, you have everything you need to get started. The next step is yours. **Schedule that first phone call, write that first promotional email, and book that first appointment with someone you already know and perhaps even are working for.** Determine what you will charge and set a deadline for yourself and resolve to perform your first Business Check-Up within the next 7-10 days. Call on us if you need us, and please let us know when you've completed your first Business Check-Up so we can celebrate with you!

Here's how I started: I did the first check-up on my own firm. Then I applied the historical analysis to a couple of my very best clients and gave them a call. I said, "Joe, I've been reviewing your last 4 years of returns and I notice some interesting trends that are costing you a lot of money. Would you mind meeting with me for an hour and talk my findings." How can they refuse? If someone called you, already did the work and said I've been looking at your financials and there are some things that need to be brought to your attention that can make you more money, wouldn't you want to meet with them?

I think a reasonable goal would be to complete at least 2 check-ups in the next 90 days. You don't have to bat one-thousand on your first couple. It's like learning to ride a bike. Maybe you won't knock it out of the park on your first couple, but once you learn how to ride that bikes, you'll always be able to ride that bike. But, like everything, there is a learning curve and it doesn't take much to master this one.

As you move forward, keep in mind these basic tips:

- Be proactive
- Know your plan and live it
- Assign target dates

- Assign responsibility
- Remember:
    - Do it daily
    - Keep it simple
    - Be consistent
    - Sell, sell, sell
- Follow up with letters and post cards
- Track your results

Do these things and your success is virtually guaranteed and unlimited.

Now, it is time for you to take what you learned and put it into action. Here is a sample format to create your action plan.

Goal: Complete (project name) ____________________ by (date) ________________. Goal: To increase the number of Business Check-Ups from _______ to __________.						
Team Leader: ______________________________						
Start Date	Milestone Details (Steps)	Due Date	Comp. Date	% Done		Assigned to

Updates	
Date	Notes:

You can make this as simple as this:

Project Name:					
Team Leader:					
Milestone Details	**Assigned To**	**Due Date**	**Comp. date**	**% Done**	
Do a check-up on our own firm	me				
Isolate 2 or 3 clients and do an historical evaluation					
Set up appointments to talk to the clients					
Get an engagement letter ready					
Meet with the clients and sell them on the idea of doing a check-up					
Write a letter thanking them whether they go forward of not					
Schedule the check-up					
Perform the check-up					
Evaluate					

In all our action plans the last step is always to **evaluate**. Make sure that you are getting your return on investment.

Thank you for completing this course. We salute your commitment to your business and to providing an essential service to your local business community as a Certified Cash Flow Engineer and Trusted Advisor.

To your success,

Jeffery K. Prager | Scott Stroud
Cofounders
Cash Flow Engineering, LLC

Appendix 1 – Ratio Analysis

Below is a detailed discussion of some ratios (note that I haven't discussed any labor or productivity ratios).

Liquidity & Solvency Ratios
Liquidity and solvency ratios - the ability of the company to meet obligations on a timely basis and ability to stay in business. Obviously, if cash outflows will be greater than cash inflows, the liquidity position of the company will deteriorate. Liquidity refers to the ability to meet your obligations over the short term and solvency refers to the ability to meet your obligations over the long term.

Current Ratio = Current Assets/Current Liabilities

This ratio measures the ability of the entity to meet its current obligations with a margin of safety that allows for shrinkage of value in its various current assets (i.e. inventories and receivables). A rule of thumb used for this ratio is 2:1. However, industry standards and trends must be referred to as well. A current ratio much higher or lower than this may indicate inefficient use of resources.

Quick Ratio = (Cash and Receivables)/Current Liabilities

Also called the *acid test*, this ratio measures the ability to pay its current debt with cash and receivables. A rule of thumb is 1:1. However, this ratio can be inaccurate if accounts receivable are not properly valued. This ratio addresses the question: "If your business were to stop selling today, could you pay off your debt (due within 60 or 90 days) with readily convertible funds on hand?"

Look at your balance sheet, specifically at the current assets and current liabilities. Look at your working capital, your current ratio, and your quick ratio. Don't worry about the formulas; think about what these indicators mean logically. They are telling you that to be successful, you must have unencumbered liquid assets and that you must have more liquid assets than short-term liabilities. Become familiar with the concept of working capital, because you simply cannot run a successful business without positive working capital.

Common sense and good judgment say you must be sure you have enough money to pay your bills. These ratios simply quantify what you already knew. By analyzing the change in these ratios over time you can track your progress toward financial stability and measure your business against industry standards.

Debt Ratios
Debt ratios reflect capital structure or the cushion of ownership and measure the ability of the entity to absorb possible losses due to decreased asset values and inaccurate estimates of future cash flows.

Debt to Asset Ratio = Total Debt/Total Assets

Also known as the leverage ratio, this ratio compares the use of borrowed funds to the resources invested by the entity's owners. It measures the ability of the entity's creditors to absorb possible losses from decreased operations and asset values and inaccurate estimates of future cash flow.

Debt to Equity Ratio = Long term Debt/(Total Equity + LT Debt)

This ratio describes the entity's long term financing policies regarding borrowed capital. It also provides some insight into the "cushion" of funds that creditors can rely upon to absorb possible losses from operation, decreases in asset values, and poor estimates of future funds flow. The debt to equity ratio is frequently referred to as the **leverage ratio.**

"Debt" may be defined to include only the noncurrent portion (long term) of the liabilities or all liabilities. Credit institutions very rarely supply capital to entities in which the owners do not have a significant financial stake – or where there are few assets to provide collateral.

Times Interest Earned = Operating Income/Interest Expense

This ratio describes the extent to which interest payments to creditors are protected. It should be noted, however, that this ratio does not measure an entity's ability to repay principal.

Turnover Ratios

Asset management ratios measure how quickly assets can be converted into cash (operating cycle). They are very useful for industry comparison. They measure the effectiveness of distribution, sales and collection policies.

Days Inventory = Cost of Goods Sold (COGS)/Average Inventory

This ratio measures the number of times inventory turns over during the year. It is used to determine the ideal inventory level. A high inventory turnover may indicate a good general economy and excellent merchandising, but it could lead to an inventory shortage resulting in missed sales and/or stockouts. A low inventory turnover may indicate inadequate marketing efforts and/or shrinking market share.

Average Collection Period = Accounts Receivable/Average Daily Sales

This ratio measures the average time in days that receivables remain unpaid. The greater the number of days, the greater the probability of delinquencies and cash shortages. This ratio is a good indicator of an entity's cash management control policies.

Average Payment Period = Accounts Payable/Average Daily Purchases

This ratio measures an entity's ability to pay its vendors. The higher the ratio, the shorter the time between purchase and payment. A low ratio may indicate cash shortages, billing disputes, or raiding of cash by management.

Asset Utilization = Sales/Total Assets or (Sales/Net Fixed Assets)

The ratio describes management's efficiency in keeping an entity's assets employed.

The **operating** cycle represents the number of days it takes for cash to be invested in inventory and become cash again. It is the combination of the average collection period and the average age of inventory. The average collection period is computed after computing the accounts receivable turnover. The average age of inventory is computed after calculating the inventory turnover.

The operating cycle is a key component in determining cash needs. For instance if an operating cycle is 90 days, 60 days of inventory and 30 days of collections, then based on sales volume and anticipated cost of goods sold, one could compute the amount of money to carry operations for 90 days. This is significant when considering the cost of growth.

Anticipated volume	6,800,000
Current year volume	4,200,000

Increase in Volume	2,600,000
Cost of Goods sold	72%

Increase in Cost of Goods Sold	1,872,000
Days Inventory - 60	312,000
Days receivable - 30	216,667

Minimum capital required to fund growth	528,667

Profitability Ratios

Profitability ratios measure management's overall effectiveness in relation to controlling costs, correctly pricing products and generating adequate return on investment. It also measures the ability to create a sales cushion in both dollars and units to enable a business to cover all anticipated costs and obligations without having to enter into a "retraction" and/or a "debt mode of operation."

Profit Margin = (Sales - CGS)/Sales

This ratio describes an entity's general profitability. It measures an entity's ability to meet their general, administrative and selling costs.

Return on Total Assets = Net Profit/Total Assets

This ratio measures an entity's ability to generate sales in relation to total assets.

Return on Equity or (Investment) = Net Profit/Equity

This ratio measures the investor's investment in an entity. When compared to return on total assets, it also illustrates the effect debt has on the entity.

Value Ratios

Value ratios relate an entity's stock price to its earnings (book value) per share; e.g., the impact of profits on future returns.

Book Value = Net Assets Available for Common/Common Share Outstanding

It is a rough measure of the underlying value of the entity. Some measures call for the deletion of intangible assets and preferred stock in determining a useful approach.

Price Earnings Ratio = Market Price/EPS

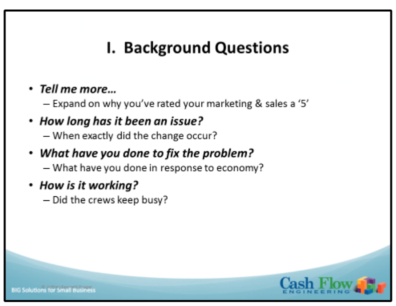
This ratio compares the market price per share of an entity's stock to its earnings per share. It measures the return on the owner's investment as a function of the entity's stock price.

Appendix 2 – Finding the Delta Roll Play

Role playing can be an immense help for you. Practice brings confidence and the ability to listen better verses thinking about what your next question should be. In the next section, I've transcribed an actual conversation with a person who is a professional sales coach and myself doing a role play as Art Vandaley. For your additional benefit, I've added some commentary and references to points I've discussed in this booklet in brackets and italicized [*like this*].

Once again, the purpose of these questions is to determine the DELTA – the difference between where they are and where they want to be. You'll get additional consulting by helping them bridge the gap.

((Jeff)): This is Jeff Prager with Colleen Stanley who is the President and Founder of Sales Leadership, a dynamic sales training firm out of Denver, Colorado. Colleen is going to play the part of the person conducting the business Check-Up and I am going to play Art Vandelay, which is the case study we give you throughout all our training manuals. What I've done, is - on a scale of 1 to 10 - I've rated my marketing and sales about a 5. And I'll let Colleen take it from here.



((Colleen)): So Art, when asking the question on marketing and sales you gave yourself a 5, can you tell me more or expand on that – the reason for the score?

((Jeff)): Yeah, I used to do just basement remodels and I was getting an average of 10 thousand dollars a job and we had all the business we could handle. But as the economy tanked, I took my firm and started doing more and more handyman work to keep my people busy.

((Colleen)): OK. And you know what, you're not the only one *[empathy]* that's gone through that – however, it's not fun when you're going through it. So, when you said it "tanked" tell me exactly when you saw it tanking, was it 2008, 2009? <u>When did this start?</u> *[How long has this been an issue?]*

((Jeff)): Around 2008 we started changing the dynamics of the way that we were growing our firm.

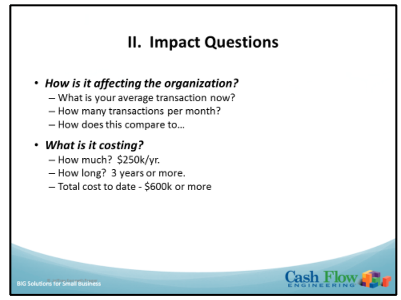
((Colleen)): Knowing that you saw some of these dynamics, as many companies did, <u>what did you do to address or fix the problem</u>? It sounds that you did some handyman work, is there anything else that you've done to address that response to the economy?

((Jeff)): Well, we did a lot more handyman work and took on a lot of jobs with not only existing clients but with new clients because I wanted to keep my crews busy so I didn't have to lay them off.

((Colleen)): And that goal was accomplished? Did the crews stay busy? [*How is it working?*]

((Jeff)): We've kept them busy but to be quite frank with you I'm not making the kind of money I did and I'm wondering how long I can sustain this.

((Colleen)): Alright, that's a fair question. And that's been going on since 2008. Let's take a little deeper look here and maybe analyze some numbers. So, your average transaction was $10,000 per job, what is your average transaction going to since you are doing more of this handyman work?



((Jeff)): I believe that because there is such a high volume of handiwork, our average transaction has gone down to about 600 dollars.

((Colleen)): And how many of those $600 transactions are you doing each month?

((Jeff)): I'd say about 50.

((Colleen)): 50, OK. So you're at about $30,000 a month and is that per contract or is that overall?

((Jeff)): Overall.

((Colleen)): So let's go back to the good old days because we want to see where you need to get back to. So when you were doing the $10,000 jobs as a basement remodeler, how many of those jobs were you doing in the same time frame?

((Jeff)): In about 2007, 2006 we were doing probably close to 60 a year.

((Colleen)): Sixty a year, so you were at about what revenue there?

((Jeff)): $600,000

((Colleen)): OK, so 600 – and you've got to help me out here a little bit, Art, am I looking at my numbers right? Have you gone from $600,000 to 350,000? OK. So you're missing revenue of about $250,000? [*Create a DELTA*.]

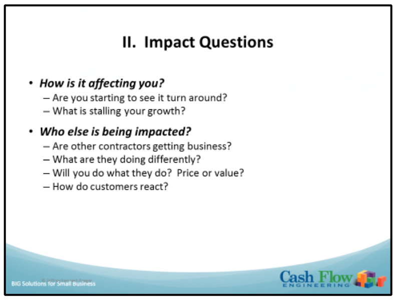
((Jeff)): That sounds about right.

((Colleen)): And that's been going on for 3 years?

((Jeff)): It's been constantly decreasing in terms of our gross revenue.

((Colleen)): So over the 3 years we're looking at – I'm going to say, keep the numbers conservative – maybe $600,000 or $700,000 that hasn't come in the door that should have been coming in.

((Jeff)): Yeah.



((Colleen)): So here's kind of a tough question, you've done some things, doing the handyman work, are you starting to see it turn around with the economy? Are you starting to get back into the basement business, are some of the handyman jobs going away?

((Jeff)): We seem to be stalling in terms of being able to get that basement work back again to the levels we used to have it.

((Colleen)): And what seems to be stalling, because at one time it was coming in. What are you hearing from your prospects?

((Jeff)): There are a lot of unlicensed contractors out there. We're also seeing that in light of the falling prices in the housing market they are still being very conservative in terms of committing to any kind of capital expenses.

((Colleen)): But it sounds as though there are some people out there getting the business?

((Jeff)): Yeah, there are people out there getting the business.

((Colleen)): So what are those contractors doing differently? Is there anything you'd be able to put your finger on?

((Jeff)): Not really. The unlicensed contractors are the people without insurance. There seems to be an overall downward spiral in pricing.

((Colleen)): OK, and knowing there's a downward spiral going on here, do you just need to play that game or is your goal to be able to sell value more than the price game?

((Jeff)): It has to be value because by my calculations I think what people are doing is taking this job to fund the last job. In other words, I don't think they're making money; I think they're losing money. I can't figure out how they can make payroll and overhead and give a quality job. The thing I think is happening is they're constantly change ordering the client, constantly giving the client new change orders saying, "The scope of the work has changed."

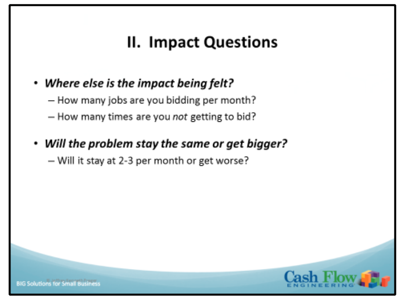
((Colleen)): So when you point that out to prospects when you're meeting with them, that there is potential that they could be change ordered, what is the prospect saying in regard to that?

((Jeff)): Normally it's an "it wouldn't happen to me" type of situation.

((Colleen)): OK, so they actually don't believe that that particular common practice is going to happen to them.

((Jeff)): No they don't feel it will impact them.

((Colleen)): OK. In the last month, how many basement contracts have you even been able to bid? So there are 2 ways we can look at this: sometimes you lose the business when you're up to bat, how many times are you not getting up to bat when you know you should because you offer higher value?



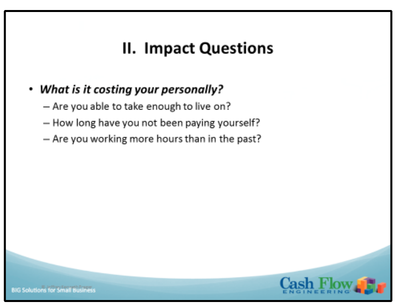
((Jeff)): We're probably bidding 2 a month, maybe 3 a month now, it depends. But we should be bidding at least 7 or 8 of them.

((Colleen)): And where's that 7 or 8 a month coming from?

((Jeff)): That's what I used to bid.

((Colleen)): That's what you used to bid – so that's what you want to get back to. So when you take a look at something like this, the economy is kinda coming back, do you see this challenge staying the same, are you going to keep getting these 2 or 3 a month or do you see it getting worse where it might possibly drop to maybe one or two a month?

((Jeff)): I don't see it getting worse, but it has to get better, one way or another.



((Colleen)): So you haven't been able to strip enough cost out to manage the $350,000 – hey, this is what I'm going to live on?

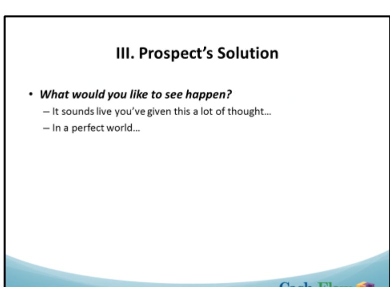
((Jeff)): Yeah, it's having a direct impact on my personal lifestyle. I'm not paying myself right now.

((Colleen)): OK, how long have you not been paying yourself – and that's a tough place to be, by the way.

((Jeff)): When I say not paying myself, not paying myself my full salary, I am scraping some money out, but I haven't paid myself my full salary in about a year now.

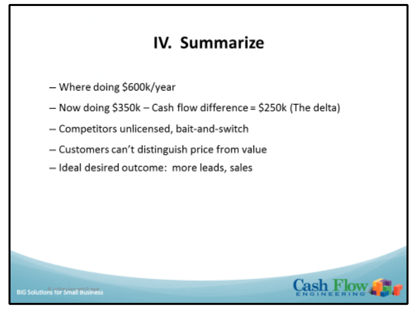
((Colleen)): OK, and I'm guessing you're working more hours then you were a few years ago as well?

((Jeff)): Almost 60-80 hours a week now.



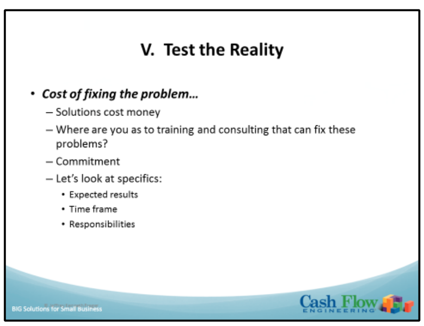
((Colleen)): That's a tough schedule to keep up. It sounds like you have given this a lot of thought. What would you ideally like to see happen? And sometimes I use the expression "perfect world" – what would you like to see happen?

((Jeff)): Obviously more leads, more leads and maybe even a better sales approach – and I'm not sure they aren't hand in hand.



((Colleen)): All right, let me kind of summarize this. So it sounds like, in what we refer to as the "good old days", you were doing about 60 $10,000 jobs for a revenue of $600,000. To your credit, you have made it through this economy when it tanked by taking on some of those handyman jobs which are averaging about $600 – a much lower average transaction size – doing about 100 of those each month, so in a year's time we're looking at about $350,000 which is giving you a cash flow difference of $250,000. Part of the problem you're running into is that you've got some people who are unlicensed and they're doing the change order bait and switch and somehow, for whatever reason, the consumer doesn't see where they're ultimately going to end up paying more. You'd ideally like to see more leads coming in, get back up to where you were back in 2007. So going from 2 to 3 a month to 7 to 8 a month. Did I capture everything we talked about? Did I miss anything?

((Jeff)): No, that sounds like you got it.

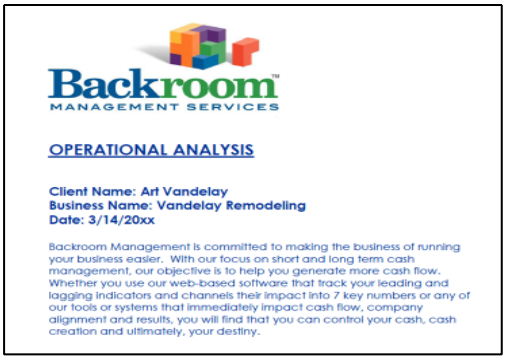


((Colleen)): OK, so here's kinda the tough part here, Art, is whenever I speak with someone you're in this point where there isn't enough money coming in the door, however, in order to get some of the solutions (that could be training, consulting, advice) those things cost money. So when we take a look at this whole thing, in your scale of priorities, what you're trying to balance and your commitment towards that, where are you at in investing in some training or consulting that could possibly help fix some of these problems?

((Jeff)): If I don't do it, I won't survive. And I do have a few reserves, but I have to have results.

((Colleen)): You know what we can do, let's talk about that, because the first thing I like to make sure of is that someone is committed. We can get you the results. Let's talk specifically next about the results you're looking for, when we can ideally get those returns for it, and what part both of us is going to play in getting those results.

Appendix 3 – A brief Check-Up Roll Play


Backroom™
MANAGEMENT SERVICES

OPERATIONAL ANALYSIS

Client Name: Art Vandelay
Business Name: Vandelay Remodeling
Date: 3/14/20xx

Backroom Management is committed to making the business of running your business easier. With our focus on short and long term cash management, our objective is to help you generate more cash flow. Whether you use our web-based software that track your leading and lagging indicators and channels their impact into 7 key numbers or any of our tools or systems that immediately impact cash flow, company alignment and results, you will find that you can control your cash, cash creation and ultimately, your destiny.

In this role play we are going to focus on the whole operational analysis. This is an abridged version, in which we are focusing on the quality of life issue.

Below is a word-for-word dialogue of the Business Check-Up conducted with Art Vandelay:

((Jeff)) Art, you've been in business for about ten years now, you have one employee – your wife – and two hourly employees, you used to do basement remodels.

> NOTE: And as the economy got bad in 2008, Art started taking on handyman work to keep his people busy. And as he did it, his business started deteriorating to the point where he doesn't know where he is anymore. All right, that's a little bit of the background of Art Vandelay. I'll use client and Art interchangeably.

((Jeff)) Art, I wanted to congratulate you on doing this business Check-Up because a lot of people don't want to go through their business and find out what they can improve and what needs to change.

> NOTE: So, number one: congratulations are in order; and number two: I've already built a rapport for the purposes of this conversation.

Art, I've allocated about two hours for the purposes of this meeting; is that kind of what you've done?

((Art)) Yep, that works just fine for me.

((Jeff)) Right, and what are you really expecting out of this meeting, Art?

((Art)) I don't really know, Jeff, I think that if I knew the answers, I probably wouldn't be talking to you. I'm just really interested in your opinion of what's going on.

((Jeff)) Well, our agenda is to primarily review your questionnaire, and frankly, I'm going to ask you every question again that you've already answered. But, what I'm going to do is go looking for more depth to the answers so that we can figure out if there's anything we can do change the course of your business or improve your cash flow. When we're done, we're going to create seven numbers, the 7 Key Numbers we talked about when we were arranging this engagement; so, we're going to find the number of leads you need to generate your closing ratio, your repeat customers, your price per transaction, your frequency of transactions and how to control costs, both fixed and variable.

So, that's kind of where we're going to go and we're going to end up with a game plan so that, at the least, if we don't do anything together after this, you'll have a game plan for going forward. Does that sound good to you?

((Art)) Yeah, that works.

> NOTE: By the way, I told him all this when I got his check. So I don't have to spend a lot of time, but I want to reconfirm his decision. I'm continuing to let him know that I'm working *for* him.
>
> And by the way, I also have my Master Write-Up nearby. My clients don't see it; it's usually on the side of my desk or buried in my papers, so when I get lost, I just pull it out.

((Jeff)) –Art, are you ready for this?

((Art)) Yeah, let's start.

> NOTE: I'm going to editorialize as I go. I've already studied the client's answers and on my copy, I have all my notes in red.

((Jeff)) So, Art, your business is remodeling and handyman work; is that where you want to be?

> NOTE: I changed the question.

((Art)) Yeah, that's kind of what I started out as, so I think that's where I want to be.

((Jeff)) And do you have the product mix you want right now?

((Art)) You know, jobs have been a little bit smaller through the recession, so probably a little bit more handyman, a little less remodeling.

((Jeff)) Okay, why did you start your business? [*This is a trust and rapport question here.]*

((Art)) You know, I was already working really hard when I was working for somebody else and it was just time to… if I was going to work that hard for somebody else, it was time to work for myself. I like doing work in the field and I thought that this remodeling company would be the best of both worlds.

((Jeff)) And do you feel that's happening?

((Art)) Yeah, I think that it's provided me a chance to work for myself, so yes, that's happening and I still get to do the field work, I'm just working a little more hours that I thought I would be at this point.

((Jeff)) How many hours on average are you working?

> NOTE: I don't know all the answers, I just keep asking questions.

((Art)) Usually, it'll be about 65 hours a week.

((Jeff)) Is that what you want, to work about 65 hours a week?

((Art)) If it was closer to 50, so I didn't have to work weekends that would probably be the best.

((Jeff)) *[Okay, I just wrote myself a note, "He's working too hard."]* Too many hours, alright. Art, do you have a business or financial plan to help you run this company and insure you have cash available whenever you need it?

((Art)) No, I do not.

((Jeff)) Do you have a mission statement or a tag-line that you give to your customers?

((Art)) Typically no, I mean, I try to work on my reputation, but I don't have anything written down.

> NOTE: By the way you notice that I'm not jumping the gun and giving answers or suggestions? What I'm doing is developing pains. So I don't want to give him too many answers throughout this whole thing until I get to the very end.

((Jeff)) Art, it says, when I asked you the question, "What keeps you awake at night?" Getting new, quality jobs and cash flow? Every time you get money, you say you're paying bills, are you paying yourself enough right now?

((Art)) When there's money left over, I'll pay myself, but I'm usually the last one to get paid.

((Jeff)) Fine, On your questionnaire under "How are you doing?" It says, seems to be working harder and getting nowhere; can you tell me a little bit more about that?

> That's one of the Wall Street questions.

((Art)) It seems that, I work really hard to go out and sell jobs, I get the money from the customer and it immediately goes out the door, so I never feel like I'm getting ahead of the curve. And I don't have enough extra money to invest, to hire more people or get larger projects.

> See how he's starting to disclose his pains?

((Jeff)) Okay, Art…

Here’s where we get into what we call the Sales Diamond, these next several questions. And, these Sales Diamond are the whole key to our developing an ongoing relationship.

Art, on a scale of one to ten, you rated your cash flow a five and I asked if you’re okay with that and you say, “No, it seems that you’re always using the next job to pay for the last.” How critical is that getting?

((Art)) So far, this spring, it’s been okay because it’s been busy, but I always worry that come the summer and things slow down, if that trend catches up, I could wake up one week and not have any cash.

((Jeff)) If I were to ask you, if you had a war chest, with an amount of cash in it so you knew you had the stability to go from job to job, season to season, year to year, however long – how much money would you like in your checking account?

((Art)) If I have fifty thousand dollars, that would kind of help balance things and I’d sleep a lot better at night.

((Jeff)) Okay, and how much do you have in your checking account right now?

((Art)) I couldn’t tell ya.

I just quantified a problem. He needs fifty thousand dollars in cash now and he doesn’t even know if he has it. So, that’s the first of the Sales Diamond. Now, I don’t do anything with it yet.


- On scale on 1-10 rate your overall growth? 1 3 5 7 9 10
  Are you okay with that? Have a lot more jobs but nothing to show for it started doing more handyman work to get through the recession.
- On scale on 1-10 rate your overall productivity? 1 3 5 7 9 10
  Are you okay with that? I do everything myself and save lots of money.
- On scale on 1-10 rate are you achieving the dreams you had when you started the business? ? 1 3 5 7 9 10
  Are you okay with that? I can’t figure out how I’m going to make real money. I seem to always be working.
- Where do you want to be as a result of being a business owner? Make a comfortable living.
  Lifestyle? Be able to leave the office for 3 day weekends here or there.
  Financial goals? Maybe $150,000 a year.
- Where do you see your business growing? In this recession, I’m taking on smaller jobs. My people need raises, so I guess I’ll work harder.
  Timeline? Don’t know.

((Jeff)) Art, on a scale of one to ten, you said you’re growing at a “seven” and when I asked if you’re okay with that, you said, “Have a lot of jobs, but nothing to show for it, started doing more handyman work to get through the recession.” What kind of growth rate are you experiencing?

((Art)) I couldn’t tell you what percentage or anything, but I do have more customers than I used to.

((Jeff)) Alright, so you’d say that you measured growth through the number of customers?

((Art)) Well, customers and then sometimes by total revenue as well.

((Jeff)) What would be your ideal for growing your company in terms of revenue growth?

((Art)) If I could grow fifteen percent a year, that would be a good amount.

((Jeff)) And, how are you doing so far?

((Art)) Well, last year was a little flat, but since we've started out, we've been able to grow somewhere between fifteen and twenty percent per year.

Note: Okay, this is why we have the financial statements, because we want to see if his perception matches the reality! You don't know how many times this has happened to me; people will tell me their numbers and all of the sudden it has nothing to do with what they said. That's why we do the ratio analysis, even when they're small.

((Jeff)) You know, Art, that's kind of nice, but when I was looking at your financials, you were flat the last couple of years and you were doing more jobs for less money. Is that kind of true?

((Art)) Yeah, you might be right, for a couple years we've had a big project that I wrapped up at the end of the year, so maybe that didn't get included in my numbers.

((Jeff)) Okay. In terms of productivity, you rated yourself a nine, so you're pretty happy with that, right?

((Art)) Yeah, I feel that I get a ton done during the day. I may have a hundred things to do and get them all done myself.

((Jeff)) Okay, so you're doing your own estimating?

((Art)) I pretty much wear all the hats.

((Jeff)) And scheduling and production? Is that interfering with the fact that you're spending sixty-five hours a week working?

((Art)) Oh, of course; if I didn't do it all myself, I wouldn't have to work nearly that hard.

((Jeff)) Why don't you tell me a little more about that?

((Art)) I know there're firms in my industry that hire estimators to do the estimating and they've got production managers so they don't have to drive off to every job to look at things. I've seen people hire other people, but again, I don't have enough money to do that.

((Jeff)) So <u>delegation is a problem</u> in terms of being an issue that you don't enough people to do all of these items, is that correct?
((Art)) Yes, yes.

((Jeff)) Are you looking at this right now? *[By the way, I'm reading the Wall Street questions.]*

((Art)) It always comes to mind when I'm working late on a Saturday; "why don't I have enough help so I don't have to be working as many hours?"
((Jeff)) Have you done anything to fix this problem?

((Art)) I don't have time to spend fixing it.

((Jeff)) Okay, how's it affecting you and your organization?

((Art)) I think what it does is that I'm probably not getting back to some of my new customers as quickly, because I've got work from old customers to come up with, I'm not reviewing my job costs the way that I used to when I had a more balanced workflow.

((Jeff)) Are you losing potential customers because you're not getting back to them as much?

((Art)) I don't have any reports that would tell me that, but I'm sure the faster that you can get back to somebody, the better, so there are people that fall through the cracks.

((Jeff)) Okay. What's your average job size?

((Art)) It depends on if it's remodeling or handyman; it might be six-hundred dollars.

((Jeff)) Okay, and how many jobs do you think you're losing because you're not following up?

((Art)) There's probably one lead a week that I have a tough time getting to.

((Jeff)) And your average revenue is about six-hundred dollars a month per lead?

((Art)) Yeah.

((Jeff)) So, roughly you're leaving twenty-four-hundred dollars on the table because you can't get back to them, per month?

((Art)) Yeah, that sounds about right.

((Jeff)) Alright, if it could, what would you like to see happen?

((Art)) I think if I could get somebody to do the estimating and the job costing; I could spend time with customers at the beginning of the process.

((Jeff)) Okay, so if somebody were doing the job costing and estimating, that's kind of where you see the change happening; you see yourself more in a sales roll?

((Art)) Yes.

((Jeff)) Okay. What are some of your ideas regarding the fix – how are you going to fix this?

((Art)) You know, if I could get a little more cash in the bank or maybe sell a large job, I'd have enough confidence to hire a part time person to start with.

((Jeff)) Okay, but right now, we don't have the cash to do that?

((Art)) No.

You see what I'm doing? We're in section one, we're not even through one of the 8 Pillars yet.

((Jeff)) Art, when we were talking, I asked you on a scale of one to ten if you're achieving your dreams – you said that you were at a three and my question is: "What were you hoping to achieve when you opened your business?"

((Art)) I always saw business owners and heard about business owners and they were always driving new cars and they seem like they have everything in line and so I envisioned myself having that success, the financial success of freedom.

((Jeff)) So it's like you were going to have more hours, more pay?

((Art)) Yeah, I figured I'd have more flexibility and more pay and I'd be okay within the six-figure range with running my own business.

((Jeff)) So, when you say six-figures, are you thinking a hundred, a hundred and twenty-five; what would your ideal be?

((Art)) A hundred and fifty thousand a year.

((Jeff)) And what are you pulling in right now?

((Art)) It really depends on the year, I pay myself a salary of about fifty-two thousand and some benefits that come along with it.

NOTE: Here are the gaps that I've already uncovered:

- *He wants fifty thousand in the bank and he doesn't have anything.*
- *He wants a growth rate of about fifteen percent per year and he's averaging zero.*
- *He can't delegate, so he ends up doing everything himself and it's taking him about 65 hours per week.*
- *Finally, he needs a hundred and fifty grand a year to live and he's only got fifty two.*

Notice how I didn't react to anything he said? I'm going to be using that and if you look at the Wall Street questions, I haven't done the fourth group, which is test the reality. I haven't summarized. I'm just getting him uncomfortable.

((Jeff)) Alright Art, where do you want to be as a result of being a business owner?

((Art)) I think the ideal thing would be to be able to go up to my cabin for long weekends and when I can, I don't always want to feel strapped. I want enough extra income to be able to save and do some extra things and not feel like everything I make is going to paying the bills.

((Jeff)) Have you given any thought to long term goals for your business? Have you set the stage for an exit plan?

((Art)) At some point, I think I'd like to build it up and sell it someday.

((Jeff)) And what would that look like?

((Art)) Hopefully I'd sell it and be able to retire; maybe sell the company for a million dollars.

((Jeff)) And what kind of revenues or revenue growth per year would you have to have to do that?

((Art)) I'm not sure.

((Jeff)) On your questionnaire, it says: "Where do you see your business growing? In this recession, I'm taking on smaller jobs. My people need raises, so I guess I'll work harder." As you grow your business, and your people get more raises, you're taking on more smaller-jobs, is that working to your benefit, or your detriment?

((Art)) It's bring in some cash, but sometimes the smaller jobs take just as much effort as the large jobs.

((Jeff)) If you had preference, would you get rid of some of those smaller jobs?

((Art)) Yeah, if I could get three more large jobs a year, it would allow me to reduce twenty to thirty small jobs.

NOTE: By the way, that's something I'm storing in my mind, that he's already acknowledged that he's taking on too many small jobs and when I get into the promotion section, I want to go back to the three big jobs he wants. See how this all will ferment?

(Jeff)) *[So, now I'm going to take him off the hot-seat a little.]* Hey, Art, you specialize in basement remodels, you often do kitchens and bathrooms, are you doing as many as you used to do?

((Art)) Probably not as many basements, but a lot of kitchens and bathrooms, yeah.

((Jeff)) Are those more profitable or less profitable than basements?

((Art)) It depends on the size of the job, but about the same.

((Jeff)) Okay, and what are the average sizes of you basement, bathroom and kitchen remodels?

((Art)) Basements are probably a hundred thousand, kitchens fifty and bathrooms twenty-five.

((Jeff)) Didn't you say your average price was around six hundred dollars a transaction – are you doing a lot of handyman work?

((Art)) Yeah, we're probably only getting five or six big jobs and the rest is handyman.

((Jeff)) Okay. Do you know your profitability for each of these kinds of jobs; in other words, what's your typical profit margin on your handyman jobs, your basement jobs, your kitchen jobs, your bathroom jobs?

((Art)) We track the large jobs, but we don't track the handyman jobs.

((Jeff)) How did you get into this business? I mean, you told me that you decided to do this because you didn't like working for others, but why did you get into this particular area of construction, basement remodeling and remodeling?

((Art)) I was in the field for a number of years as a framer, so I tended to like that work and see major differences happen in a home, so I started to self-perform some of it on my own.

((Jeff)) So, what are your competitive advantages – you wrote quality, within budget and on time – are you using that in your promotion at all?

((Art)) No, not really.

((Jeff)) Okay. When you do your bookkeeping, are you able to see what you're doing by type of job and what the cost is for each job?

((Art)) I usually review that on an annual basis after I've gotten my financials done.

((Jeff)) Do you know if you're making money on each job – or losing money?

((Art)) I do… after the year is over.

((Jeff)) Do you feel like you could be more profitable if you were able to react to that type of stuff as you perform the work?

((Art)) Oh, for sure, I could probably change materials around or try to select different subs to complete the work.

((Jeff)) Yeah, okay. I notice you do something unusual, you offer three year guarantees on your work instead of one year on what you fix up; that's commendable, but have you communicated that with your customers?

((Art)) When I meet with them, I usually will talk about it, but it's not printed anywhere.

((Jeff)) Do you have a consistent follow up to make sure you're actually doing this?

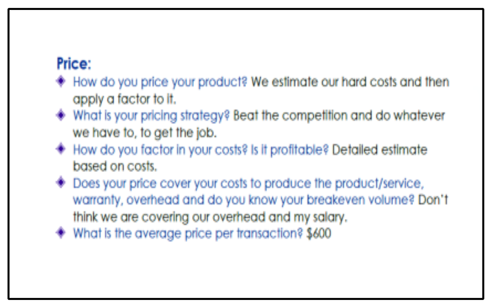
((Art)) No, we usually just wait for them to call in.

((Jeff)) Is that something you'd like to do a little bit better? Can you see the benefit of maybe communicating with them once a year, or twice a year?

((Art)) Yeah, every time I pick up the phone to talk to somebody, they usually ask me to come and do something else for them.

((Jeff)) So if you could… it sounds like if you had a continuity program, a program for keeping in touch with your Arts, your marketing should become a little bit easier?

((Art))Yeah, that would be great.



((Jeff)) For: "How do you price your product?" you said that we estimate our hard costs and then apply a factor to it. In the pricing, do you have a standard system for when you're doing an estimate?

((Art)) Yeah, we use a software program to help us estimate and then I've got spreadsheets and templates and then we mark it up 1.35.

((Jeff)) Where did you come up with that number?

((Art)) When I started out, it was kind of the best practice in the industry that I heard of, so I've just been using that.

((Jeff)) Is it covering your overhead, and does it generate enough jobs so that it generates a profit for you?

((Art)) It probably not consistent, but it seems like it gives me a kind of break-even every year.

((Jeff)) In your next question, you said part of your strategy is to beat the competition and do whatever you have to do to get the job. Do you always hit your thirty-five percent?

((Art)) No, sometimes we have to go down to thirty.

((Jeff)) And does that affect your profitability in a big way, and are those on the bigger jobs, or smaller jobs?

((Art)) Usually the bigger ones.

((Jeff)) So, when you're bidding the bigger jobs, do you have to make up that discount through more volume?

((Art)) Usually, yes.

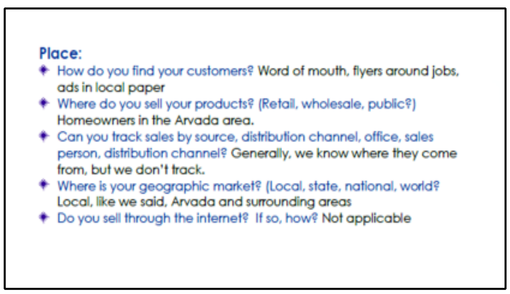
((Jeff)) And are you getting that volume, or did the recession kind of beat the volume down?

((Art)) No, we've been pretty flat.

((Jeff)) So, you're not making it up at this point – is that why you picked up so much handyman work?

((Art)) Yeah, I mean, anything to grow the top-line right now.

((Jeff)) And you don't know until your accountant says whether or not you're making money on your handyman services?



((Jeff)) So, let's talk about your place; that's both physical, as well as internet access and stuff. You find your customers through word of mouth, flyers around jobs, ads in the local paper; are you getting the response that you expected?

((Art)) We don't consistently do that, so, I would probably say yes, but we could probably do better.

((Jeff)) Tell me more about that, how could you do better.

((Art)) Sometimes we don't have time to put the flyers out around the jobs and because our budget's been tight, I haven't run any ads in the paper.

((Jeff)) And that's another thing you could solve if you had a little more cash in the bank?

((Art)) Yes.

((Jeff)) You think if you were able to price your products a little differently or you had a little bit better follow up on the job, that we could fund a little more?

((Art)) Yeah. I'm not sure if I would use that to pay myself a little more, or put it into my marketing.

Notice how I'm starting to go back and forth through my 8 Pillars? I went back into product and price per transaction to begin weaving everything together into a single clear picture.

Again, it only takes going through this a few times before you become proficient at this. Be aware that the first couple of times you may even blow it. In any event, you're going to be asking questions they've never been asked before. And even though they've already given you answers, by listening and the way you ask questions, you will reveal things they didn't want to put on the paper.

NOTE: When you have them fill out the questionnaire, don't let them spend more than a couple of seconds on each question. You want to get their gut reaction. And if you'll notice, all of the sudden as I'm asking the questions, his gut should be getting a little tighter.

Later I'll relieve them of all this gut wrenching pain when I do the 7 Key Numbers. I'm going to give them the answers, but not now. You need to be very neutral, you can't be judgmental at all.

If they're getting too uncomfortable, I just start reading their answers and say, "I get this. I get this. Oh, I get this." At this point, I've probably uncovered 3 or more pain points and in my mind I know what's working and what's not and I probably have already discussed the answers to the remaining questions so I don't really have to go through ever question again. But, I'm also starting to give them ideas to improve their business (i.e. "Have you thought about…"). This establishes my value and ability to help.

And that's when my pace changes. I've already identified his three or four major problems, in the Sales Diamond. All this is doing, is giving me a picture of a solution and what I need to recommend first. So, if I find him getting very uncomfortable, I'll speed this up; like I'm feeling him being uncomfortable right now.

((Jeff)) Alright. So, Art, what do your customers look like?

((Art)) Typically, there's a change going on in their life that they need to either add space or improve the space that they're in.

((Jeff)) And how do you reach those people?

((Art)) You know; a lot of it is word of mouth and I do a flyer once a year and I put ads in the local paper.

((Jeff)) And through those flyers and word of mouth and stuff, you're getting most of your sales leads?

((Art)) Yeah, and occasionally, someone will see my truck in the neighborhood too.

((Jeff)) Okay, and when a call comes in, is it your wife Susan that answers the phone, your hourlies; who becomes in charge of the sale?

((Art)) Whoever's there will write down the information.

> *NOTE: I'm playing off his answers as well. At the same time, this is why you can't program this one hundred percent.*

((Jeff)) Do you have a system of asking questions before it's passed on to you? [This is addressed to Art. We are now trying to assess what systems and processes are in place.]

((Art)) No, usually it's just a name and a phone number and then I'll call them.

((Jeff)) You said you're trying to get a referral program going and we'll talk about that later.

Hey, Art, are you tracking your leads?

((Art)) We track how many we get, but that's about it.

((Jeff)) Do you have a number, oh you have right down here that you get about five hundred leads a year. Do you have a formal process for following up with leads and prospects?

((Art)) No, usually I'll meet with them and run an estimate and I'll call three time and usually if I don't get a response, I'll stop calling.

((Jeff)) But you don't have a formal process for leads and prospect generation?

((Art)) No.

((Jeff)) The reason I'm asking that, Art, is that I found out many years ago in my career that" a problem's a problem until you reduce it to a procedure". And all I'm asking is if you've reduced it to a procedure to help with the process?

((Art)) Well, we used to have something in place when we had more people, but now that we've reduced staff, we just kind of wing it.

((Jeff)) Would you like to go back to a systematic approach?

((Art)) Yeah, if I had the people to do it.

He's giving this excuse, what I'm going to do is tie it into the fact that he's working sixty-five hours a week and then I'm done.

((Jeff)) I see that about twenty-five percent of your prospects become leads.

The reason these numerical questions are in here, is that they're going to play right into the 7 Key Numbers analysis.

Now you're working your handyman services, you're doing a lot more calls per Art per year, right, Art?

((Art)) Yes.

((Jeff)) When you're with your customers, do you set the tone for them giving referrals and getting add-on business?

((Art)) Not really purposefully, but they usually call back for more small jobs.

NOTE: Some of these questions aren't really important, like I see that he is not really dependent on any suppliers, so that's not a problem at all.

((Jeff)) So you don't have a real scheduling system. Is that causing you any problems with your delivery times?

((Art)) Yeah.

((Jeff)) And you're having problems getting your vendors to show up?

((Art)) Yeah, since I don't do large projects as much anymore, I stopped being a priority.

((Jeff)) In terms of tracking employee productivity, you only have two people on payroll and one administrator, but are you tracking your vendors and cost per project based on these people, are you doing true job costing?

((Art)) No.

((Jeff)) And is your accountant doing job costing when he reviews your work every year? Is he really showing you how you can make more money from your vendors and employees?

((Art)) No, we've never had that discussion.

((Jeff)) Your variable costs as a percent of revenue are seventy-five percent; is that kind of across the board, or is it different for different types of jobs?

((Art)) It all meshes together to that number.

((Jeff)) So, you don't have an org. chart, but since there are only four of you, so you really no need for it, would you agree with that?

((Art)) Yes.

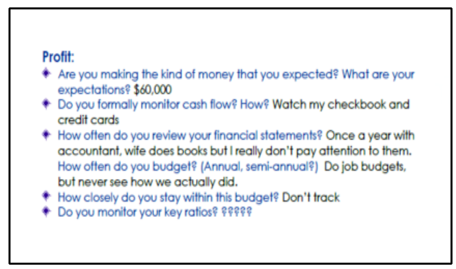
> *NOTE: I gave him one bone there, did you notice?*

((Jeff)) And your accountant is your advisor, is she your only advisor?

((Art)) Yes.

((Jeff)) And is she giving you advice, or is he just telling you how much you own the government at the end of the year?

((Art)) Usually just the taxes.



Profit:

- Are you making the kind of money that you expected? What are your expectations? $60,000
- Do you formally monitor cash flow? How? Watch my checkbook and credit cards
- How often do you review your financial statements? Once a year with accountant, wife does books but I really don't pay attention to them. How often do you budget? (Annual, semi-annual?) Do job budgets, but never see how we actually did.
- How closely do you stay within this budget? Don't track
- Do you monitor your key ratios? ?????

((Jeff)) So you're not getting any help with your numbers and what they're telling you?

((Art)) No.

((Jeff)) And you have been exposed to any systems to control your estimating or your scheduling or your job costing, correct?

((Art)) Correct.

> *NOTE: Develop that on smaller jobs, he's losing money. Talk about gross margin going down.*

((Jeff)) So you're kind of flying blind in terms of your financials and how much money you're making and it looks like what you really do is just monitor your checkbook is that correct?

((Art)) Yeah, I do that and I keep an eye on the credit card balances.

((Jeff)) Do you ever get any gotchas – you get unanticipated bills that you totally forgot about?

((Art)) Usually my wife will handle the books, so maybe just once on a job with a vendor.

((Jeff)) You told me this several times that you review your books with your accountant, but you're saying that she doesn't really give you business advice, does she?

((Art)) No, she'll just tell me what entries I need to adjust in my system and I'll be able to tell how much profit I have and at the end of the year, and how much we'll need to distribute, but nothing about operating the business.

((Jeff)) Hey, Art, do you ever look at your weekly cash flow over the next thirteen weeks to look at your cash and what it's going to look like in the short-term to know what kind of problems you're going to have?

((Art)) No.

((Jeff)) Has your accountant ever talk to you about doing a thirteen week cash flow?

((Art)) No.

((Jeff)) So, when you run out of cash, you basically have to get the next job to pay for the last job?

((Art)) Yeah, usually I try to keep two weeks of cash on hand.

((Jeff)) Okay, do you have a cash flow budget for the year, has your accountant work with you on one of those?

((Art)) No.

((Jeff)) Do you have any other sources of cash in case you get short of cash, like a line of credit with the bank?

((Art)) No, I've got a home equity line of credit, but nothing for the business.

((Jeff)) Okay. Art, I'm getting a pretty good idea what your business is all about and I appreciate you taking this time with me, and what I'd like to do right now is go over your 7 Key Numbers. (Pull in Vandelay stuff.) [Use the 7 Key Numbers to show him hope, consistent sales, average price.

Appendix 4 – A Sample Check-Up Letter

November 21, 2016

Dear Art,

Thank you for participating in your business Check-Up. One of the largest advantages working with a cash flow engineer is that you have an expert's eyes focused on your business from the outside. Although I have decades of experience in a wide variety of businesses including the construction and homebuilding industry, I still come in with no preconceived ideas or notions. This allows me to see problems and ask questions you never even think about.

Cash is King

All my engagements begin with only one assumption. That is, that the primary goal of all business owners is to ***provide consistent and predictable cash flow*** for their company.

Take a moment and reflect on where your business is today and imagine the *future-picture* of your business. This Check-Up provides you with a "paint-by-the-numbers" process to follow to help make that *future-picture* a reality.

The key to the creation of any successful business is the development of all the processes required to run the business effectively. These processes allow the business to grow sufficiently for the owners to enjoy the benefits of **owning** their business instead of *"being owned by"* (i.e. a slave to) their business.

The Check-Up

The Check-Up evaluation process began with an in-depth analysis designed specifically to draw the information from you that we require in order to develop a clear picture of both you and your business. During our meeting, we tried to not only determine where you are but where you want to be. This report is a summary of our findings and provides a springboard for further discussions.

In our experience we have discovered that most business owners *over*estimate what they can do in 6 months and *under*estimate what they can do over 5 years. Business success depends on *Leadership, Management and Execution.* Leadership provides a clear and compelling vision, sets expectations and standards of accountability and holds stakeholders accountable. Management creates the environment for success. Execution is all about doing the right things at the right time to achieve your goals (your vision.)

Part I: Background

A: The Company

Vandelay Remodeling is a ten-year-old company in Arvada, Colorado founded by Art Vandelay in 2005. They're a relatively small operation, with Art Vandelay's wife, Susan, handling the books and most of the incoming phone calls. The company has a couple of hourly employees and an administrator to keep track of all their jobs and projects and keep their vans rolling to the right locations.

A couple of years ago, Vandelay Remolding specialized in basement remodels and their average sale was $10,000. As the economy worsened, business started to slow down. People just weren't spending the money on big projects like they used to. So, Vandelay made a decision to expand the focus of their business and add smaller jobs (handyman work) in order to keep crews working and their doors open.

Purpose

Business start date: The business was founded in 2010.

Why they went into business: Vandelay Remodeling was founded in 2010 with the informal mission to provide remodeling services.

Ownership: The company is an LLC owned by Art Vandelay.

Objectives of a business: In order to be successful, the company must be, "*a **well-positioned, well-defined business** organization generating cash flow that encourages growth and leads to wealth building.*" This fundamental definition of a business applies to nearly the entire universe of businesses. Understanding how to position your company and effectively define your organization is an integral step towards becoming the ***cash flow generating successful organization*** that you envisioned at the onset. The absence of these principal foundations of business can lead to a number of issues within an organization, including inefficient use of capital on projects that don't further the company's goals, lackluster performance in a market that may not be your ideal target market, the feeling that the company is always a step behind the rest of the market in sales and development.

- Currently the company generates $350,000 in revenue, down from $600,000 in 2007
- The owners desire to grow the business by 15-20% per year and generate at least $150,000 in income for the owners by 2017.
- Part of what the Check-Up creates is an outline of the strategic decisions required to "bridge the gap" between current position and desired goal.

The first question to ask is "What is your overarching strategy to get there?" Answer the question: In order to be successful over time, we need to (improve) (build) (attract) (develop) (complete) (introduce) (hire) (build) (implement) (launch) (announce) (create) (maximize) (minimize) __________________.

- Number of Leads: most expensive, 6x cost of bringing back existing customers

- Conversion Rate: USP/guarantee, selling scripts, improve existing advertising
- No. of Transactions: loyalty strategies, regular communication
- Average $ Sale: add on and up sell sales scripts
- Margins: increase prices, increase sales of higher margin items

Strategic Planning, Longer-term thinking: Strategic thinking is a necessity for any business. I usually recommend creating a plan that focuses on your end game (your planning horizon – more than one year). It provides you with a solid description of your business, the direction you want to take it, a view of your defined "future picture" of the business over the next few years. It helps you clearly define the goals needed to achieve that future picture and with that, will help you determine if what you're doing is moving you towards those goals. This ties into your vision statement (your promise to yourself.) Once you know where you want to end up, we can map a profit plan to help you get there. Create a detailed strategic performance plan that identifies:

- What you do? What product lines you offer – now and in the future?
- Who you do it for? Who is the customer for each of those products – now and in the future?
- How you plan to do it since each current and future product offering has different requirements?
- Where you want the company to go? What are the goals for each product offering?

I suggest that you approach the business and your desired changes to it as if you were planning to sell the business in 5 years. Included in that would be to begin grooming your sister to take over.

B. Management Efficiency

Owners of companies typically lose money because they fail to test for good management. An efficient management team with the right systems will guide companies toward success. Unfortunately, many companies rely on the outlook for the industry, new products, or a plausible story for protection and often lose.

1. Test I: Driving Force of Management: Management, as indicated by the past record, does have the ability necessary to expand sales. The rate of sales expansion is illustrated in the table below. This is lower than desired, but with strategic changes, the rate of sales expansion is likely to be much better in the next five years.

Year	Sales	Growth Rate
2012	5,978,743	
2013	8,965,838	49.96%
2014	11,566,886	29.01%

2. Test II: Gross Margin: Management seems to have the ability to maintain gross margin.

Year	Gross Margin	As a % of Sales
2012	992,379	16.60%
2013	1,292,343	14.41%
2014	1,997,776	17.27%

3. Test III: Earned on Sales: Management seems to have the ability to maintain profit margins. It shows pre-tax profit margins for each of the last three years as follows:

Year	Net Income	As a % of Sales
2012	571,230	9.55%
2013	481,906	5.37%
2014	630,816	5.45%

4. Test IV: Earned on Equity: The Company has earned on invested capital from 88% to 148%. Earnings on equity are above industry averages. Based on projected growth, we will see ROI fall but the gross dollar amount rise substantially.

Year	Invested Capital	ROI
2012	385,423	148.21%
2013	547,101	88.08%
2014	577,492	109.23%

5. Test V: Use of Debt: Debt has been increasing over the last five years. The growth in debt has kept pace with the growth in sales and is likely to increase.

Year	Debt	As a % of Sales	Debt to Equity
2012	2,115,164	35.38%	5.49
2013	6,048,879	67.47%	11.06
2014	8,315,080	71.89%	14.40

6. Test VI: Owner Compensation (from all sources – salaries, dividends, etc.)

Year	Owner Compensatio n	Bonus & Dividends	Total Comp	As a % of Sales
2012	60,000		60,000	1.00%
2013	80,000	30,000	110,000	1.23%
2014	80,000	50,000	130,000	1.12%

C. Company Direction

The goal of the company is to, once again, become a premier basement remodeler while continuing to grow the handyman service end of the business.

- **Ownership**: Art Vandelay is the sole owner of Vandelay Remodeling
- **Principles Roles and Key positions**: In terms of responsibility and accountability and the power to execute the plans:
    - Sales – Art
    - Marketing – Art
    - Operations – One director and two hourly employees
- **Financial Management**: Art's wife, Susan
- **Previous experience**: Art grew up in the construction business, being the son and grandson of tradesmen.
- **Company Growth**: Vandelay Remodeling organized as a company specializing in basement remodels a few years before the recession kicked in. Up to that point, growth was hearty and allowed the company grow to its current size. After the recession began, Vandelay Remodeling pivoted and started working on smaller projects to make ends meet.
- **Products**: 2 principal lines of business
    - Basement Remodels – the original reason the company organized
    - Smaller projects, handyman type – service category entered into as a result of slowing business
- **Target Market and Demographics**: Currently, Vandelay Remodeling is a typical construction company when it comes to its understanding of its demographic. Beyond homeowners that are in need of a remodel or small repairs, Vandelay doesn't target a specific demographic.
- **Location**: Arvada, Colorado and the rest of the Denver Metro corridor.

External factors: What external forces can directly affect or change the direction of your business or alter the ways your customers buy? Know what makes your business tick! What internal and external factors can change your expected results (PEST)? The economy? The market? Politics? Social and cultural issues? The marketplace is full of threats and pitfalls that will affect your business — so learn what to look for, and make your decisions accordingly. Use the acronym P.E.S.T. to help begin to identify those external factors.

- Political & regulatory
- Economic
- Social Trends
- Technology

Be aware of the outside forces that can weaken your business or provide new opportunities to your business. We talked a little about the role of planning in terms of a great economy or one that lacks direction. As part of the planning aspect, we should take into consideration what actions we would take in the event of change in our external forces. External forces are those events that we cannot control.

Cash Flow: As an owner your number one concern is to create positive, consistent and predictable cash flow. Cash flow allows a business to keep its operations going – it allows you to pay your suppliers, your employees, keep the lights on in the shop and, most importantly, pay yourself. Companies that lack cash flow struggle to make payroll, pay interest on invoices that are way overdue and have owners who are struggling in their personal lives. It is important to match cash flow with your costs and be certain you pay yourself first. More on this in the Financial Management section.

The difference between Wall Street and Main Street: Expenses should be the leftovers, not profits. Most small businesses run by the traditional formula that Revenue – Expenses = Profit. This is reactive and doesn't let you control your business. Wall Street, on the other hand, reverses the formula to: Revenue – Profit = Expenses. This says that whatever is left after you make money can be allocated to run and grow the company. This is a very proactive approach. See the difference; pay yourself first not last.

Part 4: Company Goals

Art Vandelay is looking to drive an annual profit of $30,000 per year, net of all other costs including his salary. It's important that the $30,000 is free and clear of all other expenses as this is what Art believes is the value of his sweat equity.

Part II: The Three-Legged Stool of Management

Operating a successful business rests on what I call the "***three-legged stool of management.***" The three main areas that support every business are: **Marketing and Sales** (getting the work), **Production & Operational Management** (doing the work) and **Financial Management** (tracking the work - not just accounting).

Marketing and Sales

Current Situation:

Competitive advantage: Vandelay has built a good reputation over the last decade. Their experience in basement remodeling provides them with a superior level of knowledge and experience than "pure" handyman competitors. However, there is a very real concern that the "team" is breaking down.

- **Differentiation:** The key differentiators that set the company apart from and above the competition are:
    - The owner is directly involved in the sales and oversees and monitors the estimating process.
    - The owner of the company is the primary salesman and develops trust and a relationship with the clients.
    - The company's remodeling experience, focus and attention to detail mean that they set and achieve high quality results even on small handyman type jobs.

- **Marketing**: Marketing methods in use:
  - Flyers: On every job flyers are dropped off in the surrounding neighborhoods.
  - Referrals and customer follow up: Although the company gets referrals, there is no formal referral system.
- **Products**: Basement remodels, kitchen remodels, handyman work
  - Features:
    - Feature 1:
    - Feature 2:
    - Feature 3:
  - Benefits
    - Jobs done on time and within budget with the least amount of disruption
- **Place**: Currently the business operates in Arvada, Colorado and in the Metro Denver Area

Promotion

Your marketing plan: A marketing plan is used to help your company get out in front -- strategically. Remember that it's not how much you spend, but where and when you spend it. You must determine the methods and tools to reach your audience and then communicate with them repeatedly -- until they use your services, or refer you to someone who will. Marketing methods in use:

- Trade shows
- Website
- Sales people and reps

Partnerships (Complementors, Colleagues, and Coopetition):
One way to expand your businesses reach is to identify other businesses that pursue the same customers but do not directly compete for those customers. These businesses are called complementary businesses and partnering with them is called Coopetition.

Promotion

- Co-promotions: Hold events with complementary businesses (plumbers, roofers etc.)
- Other promotional opportunities. Provide education events

Marketing Schedule/Calendar: Planning will make marketing second nature. Plan your marketing tactics and implementation schedule. Once you've completed the marketing foundation process, it's time to get down to the specifics. Determine how you will follow up with the leads you generate and hold your sales people accountable.

Lead Tracking & Return on marketing dollars: Adding on to the marketing program, the Company needs to enhance their sales funnel tracking methodology to determine where their traffic comes from; the number of calls generated➔the conversion rate (calls to real leads or prospects)➔ the conversion rate (prospects to actual sales➔Type of sale. Sales funnel tracking method should be broken down by the lead sources categories: which lead generation tactic (i.e. a particular show) and results generated.

Are you measuring the cost per lead? The cost per lead is one of the most important measures you can make. Tracking customers, especially new customers and identifying where they came from is critical to properly spending your marketing budget. Plus knowing what each channel costs to create a new lead will clearly show where you should be focusing your marketing efforts.

Sales

Qualifying sheets: With each lead developed under your marketing program, you might consider developing a qualifying worksheet so that less time is spent going after unqualified leads.

Sales Processes/Sales Mountain: Outline the steps involved in a sale. One of the things that helps outstanding companies is to develop a step-by-step process. Once you identify the steps in the process, then determine what probability of an ultimate sale happens when you get to that step. Also, determine what needs to be done to get to the next step. For instance a one-step process might look like this:

- Bonding and rapport
- Up front contract – determine why you are there and what the client wants from the meeting
- Determine a need
- Determine a budget and timing
- Determine that you are in front of a decision maker
- Close
- Handle objections

There could be more steps like product demonstration, proposal, getting the product into a budget. We should consider getting a sales process outlined and determining the best path to a sale.

What are the steps in your sales process?

Pipeline reports: Related to the sales process is the sales pipeline reports. Pipeline reports are important to know what business is coming up and gives the owner the ability to determine effectiveness of the marketing, sales and if appropriate the estimating process. Create a System for assigning probabilities of closing each deal. Get a clear understanding of what your potential revenue is using pipeline report.

Estimates		Won		Lost	
____________	_____	_______________	___	____________	_____
# of estimates	$$$	# of estimates	$$$	# of estimates	$$$

Pricing:

Pricing Structure: Currently you price to the competition. Make sure that you are pricing to cover:

The margin must be large enough to allow for:

- distribution and sales
- warranty
- service
- amortization of development and equipment costs
- price competition--and, most importantly,
- PROFIT

Recommendations:

Instead of utilizing sales force and other programs to track sales, maybe we should develop a simple spreadsheet that sales people can utilize to track their results, create a realistic pipeline report and also allow management to stay on top of their future demands. This would allow us to quantify and qualify our sales progress and sales people while at the same time eliminate a lot of "sales paperwork" which sales people hate.

Production and Operational Management

Production and Operational Management encompass both the management of production and operations (estimating and delivery of the products or services offered) along with general company management.

Current Situation:

Currently, production and management seems to be working adequately. However, as the company continues to grow, I can see a lot of the current systems not working well and/or breaking down. Specifically, estimating, scheduling and customer communications are areas that could use a review of the systems and procedures. Job cost tracking is another area that if improved will yield significant benefits. Currently Art is working over 60 hours per week keeping all the projects running. Project management is another area that needs to be addressed going forward. There needs to be more time spent on exception management (costs over budget), monitoring change orders (on both the cost side and revenue side – i.e. making sure there is a customer change order that exceed the costs of making changes).

Production

Monthly sales goals, seasonality of the business and effect on production: Once you establish your sales goals (see above) then it is time to look at the effect of the sales schedule on your production facilities. Will you be able to meet the demand for product in a timely manner? Are there any bottlenecks in the production schedule that would hinder your ability to deliver product? Are there any seasonal demands that need to be smoothed out for production to deliver on time (i.e. the sales process involved with hospitals may be tied to their budget review process)?

Monitor performance standards: Performance standards should be established for project on time & on budget, project performance to quality standards and project exceeding expectations. An effective compensation plan should be developed to encourage employees to think and act like owners.

Check in throughout the operational process. Develop a feedback system that allows you to check in throughout the project process. We recommend that you create a punch list so at the end of each project you can walk through with your client and show everything that was done.

We were able only to spend a few minutes discussing production. It seems that you are prepared if volumes begin to swell.

Monitor performance standards: Check in throughout the assembly process. Develop a feedback system that allows you to check in throughout the assembly process. The better the process runs, the better your reputation will be. Once again, I didn't have enough time to assess this nor are you in full production at this time.

Punch list: This is a construction concept. However, consider how you turn over the product for a sale and/or a demo. Do you have a list of things that need to be accomplished before your turn over a machine? Does the client signs off on every item that could become a possible issue and/or warranty item in the future? This reaffirms that the work was done and also helps in your defining you as a professional.

People

People – People represent the core strength of every Company. As owners you must set the example of working smarter. You also need to dedicate time to working on your business rather than allowing your business to devour every waking moment. How many times do you get bogged down with operations and doing the work, instead of working on how to grow and become more successful? Be sure you have sufficient and appropriate staff WORKING IN the business so you can dedicate time to WORK ON the business.

Share your mission and your vision: Your employees and subcontractors directly affect your reputation and will reflect every attitude you have and every action you take. The higher your standards, the better your reputation. Make sure all subcontractors understand and adhere to your company policies. Have written contracts and create methods to enforce your standards and insure compliance. Instill standardized company values, so that all who represent your company do so with integrity. Create straightforward vision and mission statements keeping in mind that your vision statement is your promise to yourself; while your mission statement is your promise to your stakeholders and clients.

Key People: People are your most valuable asset. Your people make the difference. Every person who answers a phone or has any client contact is involved in sales. So make sure that the right people are representing your company -- and make sure that they are invested in the outcome. Everyone should know and embrace your process, and you should ensure the right people are in the places that count most. Make a list of the roles that directly contribute to the overall operation and success of the company and the people who fill them. Create an organization chart that reflects the role, function and accountability each person accepts; this will clearly show how responsibility escalates up the "chain."

- Owner
- Department Managers
- Key Players
- Key Vendors
- Sales Staff
- Project Managers
- Accounting

Examples of roles for each individual may be:

- CEO Mission: Drive the mission & shareholder Value
- Marketing Mission: Find markets…create demand
- Sales Mission: Find customers…close contracts
- Production Mission: Build it to specifications, on time, within budget
- Customer Fulfilment Mission: Keep the promise

Characteristics of extraordinary companies:

- A clearly stated direction or vision
- Employees and managers who clearly understand their roles and responsibilities
- Leaders and managers who regularly clarify expectations
- A commitment of everyone's part to meet those expectations
- A fair and consistent reward system
- A work environment that is safe, rewarding and enjoyable
- Consistency in making their planned numbers every quarter and year
- Increased value growth every year regardless of the economic environment

Employee Ownership Mindset: This is one of the hardest things to achieve. Continued rapid growth requires that employees take true ownership of their respective responsibilities. Any lack of acceptance of their responsibilities, creates delays of the customer's promised and expected results, causes a loss of cost control, and negatively impacts cash flow. If you have toxic employees, as you have stated, it is critical to change the culture that has allowed that toxicity to grow. As you grow, the company should consider creating a "culture of profits" (verses an entitlement attitude).

- Get employees focused on the bottom line
- Why: Growth, invest in marketing and sales, invest in your people

Accountability & Employee Reviews: Manage your employees. Set employee expectations up front. If you don't have a system for hiring, training, managing and firing, GET ONE NOW. Keeping legal records is one the easiest tasks to accomplish – you just need guidance in how to do it. Employee manuals, job descriptions and training programs all help set your expectations for each employee, and their expectations of you and the job. Once set, it's much easier to reward performance and solve problems that can arise. (OP-9) Determine if specific job descriptions can be measured using a dollar value for the company. Thus standards for the employees can be created.

- This way the employees will understand that their work has demonstrable value to the growth of the company.
- They will understand the implications of taking a day off.
- They will also understand their performance's effect on their reviews.
- How do they practice your core values plus **aptitude, attitude and performance**?

Recommendations:

We talked about managing your inventory and standard costs using a spreadsheet. That spreadsheet is substantially done (at least in my brief view). We can further utilize the spreadsheet to establish standard costing, cost estimates based on a sales schedule and further utilize that in doing a cash flow projection (and budgets). We'll talk about that under financial management.

Part 3: Financial Management

Current Situation:

Profit & Financial Management: The current financials are up-to-date. Although the company can project breakeven and profitability by job and cost category these reports are difficult to understand and do not provide an effective tool for decision making and taking action. The standard reports used monthly are – Job Costs, Cash Flow Projection, P&L and Balance Sheet reports and % Complete Reports. These standard accounting reports typically show a "rear-view mirror" look into the business. To increase management flexibility and effectiveness you have to have reports that allow you to manage by exception and have those reports show what's coming up, not what happened when it is too late to alter course.

Financial Management – Financial Management encompasses far more than bookkeeping and accounting. The current financial management process provides inadequate job cost reporting. This can result in cash flow challenges and ultimately inhibits the potential for growth and reduces overall enterprise value and profit.

Financial Management is comprised of accounting, finance, job costing, budgeting and planning (both short-term & long term and both tactical & strategic).

Budgets: Budgets are used to promote growth and manage expenses. Here's a secret: you control the budget. Don't just dream of making ends meet. Plan your dreams. *Budget from the top down – pick a profit goal and work backwards.* It takes money to make money, so figure out both how much you NEED to make and how much you WANT to make. Put your goals on paper and you'll have a chance at achieving them. (P-6)

- **Pick your profit**: Turn your estimate upside down. The first number you set should be your profit. Once you have determined what the profit will be, make all the other numbers fit within the price parameter. You'll find that you're much better at protecting your margin when you know what it is from the start.
- **Identify your income streams**: Determine your sources of positive cash flow. Where is your money coming from? Operations? Investing? Financing activities? Look hard. Now, look even harder – it's easy to be fooled.
- **Cover your salary**: You are the most important player in your company. Make sure you budget money to pay for yourself. It's a common trap to say, "I'll pay myself when I can afford it…" The truth is, you'll never be able to afford it if you don't do it now.
- **Use flexible budgets**. A static budget is valid only for a single level of activity. A flexible budget considers activity for several activity levels.
- **Financial Forecasts:** A financial forecast is a budget over multiple years. You are beginning to work on that through the Upper Quartile.
- Definitely create a cash flow budget (see next point).

13-Week Cash Flow Planning: Follow the Money. Know where your cash is at every point in your transaction. Create the reports necessary to know where your cash is coming from and going to at all times. Understand where there may be cost overruns, unnecessary interest expenses, unreasonable fixed costs and the like. A 13-week cash plan will provide a comprehensive view of all the cash inflows and outflows. Generating long-term cash flow (<u>not</u> profit) is the basic key to business survival. Even companies that are profitable over the long term may fail if their cash flow is inadequate to meet their obligations. We suggest creating a detailed 13-week rolling cash plan. An integral part of this planning process will be to make sure we take into account the payroll tax-repayments required. To assist in that I suggested creating 4 bank accounts: Operations, Salary, Taxes and Profits (see below).

Financial Statement Reviews: I recommend that we invest time to develop a good financial and key indicators reporting structure. In addition, it might be beneficial to build the owners' understanding of the reports including interpretation, implication and next steps based on those reports. A deeper understanding will give them the tools required to better manage the business and drive greater cash flow. You know that making money through profits and driving cash flow isn't something you do without any costs. Take the steps necessary to understand how your costs and profits are related; you'll be rewarded with a better understanding of how to drive cash flow in your company

Financing Growth: Anticipate cash requirements. Create an action plan for knowing how much money we will need and a plan for having that money available when the need arises. Don't wait until your company is in a cash flow crisis (or worse yet, broke!) to create a plan for additional funding. Develop your funding plan when you are in the black — because banks don't like companies that are desperate. Be prepared!

Lack of cash control and financial planning during growth can result in cash flow challenges and ultimately inhibit growth and reduce enterprise value.

Recommendations:

I think we should take a hard look at your financial requirements and reporting. We hear from business brokers all the time that one of the impediments to driving a great value for a company is the inability to show fiscal skills and believable financial reports. I think (at least with the reports that I've seen so far) that this isn't a problem with your company, but I also believe that you are transitioning to a complicated system that won't do as much for you as your spreadsheets. If we tie your spreadsheets into your cash flow projections and budgetary process, then we can put our budgets into QuickBooks and track our performance based on budget verses actual performance.

Next Steps:

Short Term steps to be implemented (next 3 months):

- Assist Art in developing "Lead Qualifying Document" and training staff in its use.
- Assist Art's transition to sales.
- Develop a 13 week cash flow.
- Help develop procedures designed to improve closing ratios and boost average price per project from $600 to $750.
- Develop a better cost accounting system.
- Assist in developing a marketing calendar.
- Define our vision, our overarching strategies to get there and then make sure everyone in the organization know what it is and their roles in getting there
- Create budgets and cash flow projections for 2016 with the goal of growing the business and driving positive cash flow
- Create a monthly financial scorecard to verify that all revenues and expenses are within predetermined acceptable levels. This would include creating report cards throughout the business.

Intermediate terms (6 months to one year):

- Develop a financial plan month by month for the next year, quarter by quarter for the following 2 years and then a yearly plan that covers your planning horizon
- Translate the financial plan into the key 7 Key Numbers you'll need to accomplish your goals
- Create reports to help manage the business.
- Create a strategic plan (a long term plan)
- Planning to build wealth through your business.
- **Quarterly reviews:** I recommend setting up a quarterly review schedule where we go over in detail your financial reports and budgets to be certain that everything is on track.

Long-term:

- Exit Planning: It is never too early to start the planning process for your eventual exit from the business operations.
- Cycle **management:** It is critical for a company's long-term success be support by a strategic plan that accounts for operating:
    - At the status quo.
    - In boom times
    - During a recession.

Creating this type of strategic plan eliminates the panicked fight or flight reflex that a major downturn creates. We know there will be another market cycle. Will you be prepared for it?

I look forward to working with you over the course of the near future, bringing you closer to your goals.

I look forward to working with you over the course of the near future, bringing you closer to your goals.

Engagement Fees & Structure

I'd like to talk to you about creating a periodic review of your financial statements (which we can do virtually) and goal setting (budgets, 7 Key Numbers, etc.). In addition, you might be well served with a semiannual business Check-Up. Finally, I'd like you to consider having a strategic planning meeting to come up with objectives and strategies to carry us through the short term, intermediate term and long term.

The reality of running a business isn't that *"hard work and long hours are required*" to become successful. The problem with that philosophy is that hard work and long hours leaves you no time or energy to work smarter or enjoy the rest of your life. Let's develop a business that doesn't have you just working "in" your business, but allows you to work "on" your business and enjoy the benefits of owning a business.

Our goal is to help you know what to look for, when to look for it, how to use the information, and what the limitations are, so that you can win. We are very pleased to be working with you.

If you have any questions or need additional information, please feel free to give us a call at any time.

Again, we look forward to working with you to accomplish your goals.

Regards,

Jeffrey Prager
Founder
Cash Flow Engineering, LLC