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Chartered Accountants

Key drivers to boost profitability and cash flow

It's important to identify and monitor the key drivers of your small business to boost profitability and cash flow.

Boost profitability by recognizing your key drivers

Identifying the key drivers of your business is critical to boosting profitability. A key 'driver' is something that has a major impact on the performance of your specific business.

A whole range of factors can affect the performance of every business. The secret is to focus on a handful of drivers that:

- Affect the performance of your business significantly.
- Are measurable.
- Can be compared to a benchmark such as last year's figures or an industry average.
- Can be acted upon.

Make use of benchmarking

Use past figures as a benchmark for current performance. Figures for last year or last quarter provide hard facts and established patterns that expose potential problems and opportunities.

Also try to compare your business with other similar businesses, especially competitors. Your accountant, bank manager or industry association may be able to supply industry benchmarks.

What are some of the key drivers in business?

Critical drivers vary from business to business, and they include:

- Sales leads in a capital goods or service business.
- Sales per square foot in a retail business.
- Market share where only the biggest will survive.
- Machine downtime in a factory.
- 'First-time fix' in a maintenance business.
- The morale of staff in a nursing home.

Even direct competitors may have different drivers. A prime location is not a key driver for an Internet-based electronics business but it is for a 'bricks and mortar' competitor that relies on well-located retail stores.

Some of the following drivers might be relevant to your business.

Converting leads into sales

The number of leads (information requests or quotes given) provides early warning of any peaks or troughs in your sales. If you have an established leads-to-sales conversion ratio and know the size of an average sale, you can use the pace of leads to forecast sales.

Monitoring sales figures can show:

- Which categories of product are selling well.
- What each salesperson has achieved.
- If lead conversion rates are improving.

Keep your costs under control

Maintaining a healthy gross profit margin is critical. If your gross margin percentage is falling, take swift corrective action. The causes could include higher input prices, a changing product mix, production inefficiencies or excessive discounting.

If you run a service business that bills out time, it can be useful to treat consultants' salaries as a variable rather than overhead costs because this makes it easier to work out who is making you money.

Collecting receivables efficiently

Your accounts receivable collection period (the number of days on average to collect payments from customers) is an important driver to monitor. Try to improve on your past performance and at least match the industry standard.

If the standard is 35 days, and you're taking 45 days on average to receive payments from customers, then improve your collection activities immediately. Bill promptly and highlight overdue payments for prompt action.

The key is consistency – late payers should know that you'll unfailingly contact them.

Optimal inventory levels

Your inventory turnover rate is the ratio of cost-of-sales to inventory. Most businesses aim for a high inventory turnover rate because it indicates an efficient use of capital resources. If the ratio decreases, find out why.

For example, you may be over buying or purchasing inventory that you cannot sell. The more you can break down your inventory figures into separate product categories, the easier it will be to pinpoint problems.

Hours billed

A management consulting firm had a disappointing level of monthly sales for years until the owners realized that hours billed per consultant per week was the key driver.

Once they began monitoring this, they could see which consultants were earning the revenue. Attitudes changed overnight and sales increased significantly. The firm was then able to target small improvements that were manageable – such as billing 30 minutes more a day each.

Turning over staff

A travel agency recognized that staff turnover was their driver. An experienced sales person was found to be three times more productive than a new recruit. The recruitment and training process for new salespeople was also a major burden on the business.

To reduce staff turnover, the travel agency introduced a long-term incentive element into salary packages. It also introduced quarterly performance reviews.

Defective goods

An engineering company found that the defect ratio was a driver. Defects led to goods being returned, extra time wasted on rework, delays in payment, and lower profit for the business. The company reorganized the workforce into ‘quality cells’ and productivity increased significantly.

Identifying the five key drivers you need to focus on

What are the key factors that enable your small business to outperform its competitors? Try to identify the five key drivers you need to focus on.

The questions you need to ask yourself are:

- What drives the sales figures?
- What drives the costs?
- What drives the cash flow?

For most small businesses, the key drivers include major cost-efficiency items. For example, two important drivers for a chicken processing company were employee costs and yield (the weight of meat taken from each chicken). Both had a major impact on the gross margin.