Synchronous Solutions

The continuous pursuit of excellence

Making Money

If you haven't read The Goal by Dr. Eli Goldratt, you should. If it has been more than a year since you read it, you should read it again. This is one of the best books on business management ever printed. It is written as a novel and tells the story of Alex, who is the manager of a manufacturing plant. Alex and his Team have every problem you can imagine. Their lead times are way too long, quality is poor and employee morale is terrible. Customers are constantly complaining. As a result of all this, they live in chaos every day. It was not a pleasant place to work for anyone.

The product made at Alex's plant was never identified, because it really doesn't matter. The concepts described in the book are applicable to any product in any industry.

Early in the book, Alex runs into an old college professor, Jonah, who asks him a basic question: What is the goal of your company? Alex rattles off a long list of things including customer satisfaction, quality of product, shorter lead times, improved employee morale and less chaos. "Very good" said Jonah, "but if you are not making money, none of that matters."

Jonah was right. Even with perfect quality, excellent customer satisfaction, great employee morale and seamless control of the product flow, if you aren't making enough money to justify your existence, you cannot stay in business. That is a fact of life.

There are three important bottom-line metrics to consider in your analysis of financial performance:

- **Net profit** is an *absolute measure*. If your total income exceeds your total expenses, you made a profit. If not, you lost money. You probably track this information monthly, but it is important to look at multiple months to see the effects of seasonal trends and other anomalies that can make a single month look unusually good or unusually bad. Another factor affecting a single month is material purchases. You could buy raw material in one month that may not be turned into finished products for several months later. Looking at trends over multiple months will minimize this potential issue.

Another factor that could affect a single month's performance is production for the commercial market, which typically has a much longer process time from sale to completion. This is a good market to serve and can be very lucrative, but it does require "deep pockets" to withstand the longer time period for realization of income.

A variation of the **Net Profit** metric is **EBIDTA**, which is earnings before interest, depreciation, taxes and amortization. Essentially, it's a way to evaluate a company's performance without having to factor in financing, accounting or tax decisions. It negates the cost of capital investments like property, plant, and equipment and isolates the operational performance of the business enterprise.

EBITDA = Net Income + Interest + Taxes + Depreciation + Amortization

- **Return on Sales (ROS)** is a *relative measure*. If your annual profit was a million dollars on twenty million in sales, that is a 5% ROS, which is not very good. If your annual profit was a million dollars on ten million in sales, that is a 10% ROS, which is not bad. In fact, the general rule of thumb for an entrepreneurial (privately owned) company, is that it should earn at least a 10% ROS every year. Monthly fluctuations are expected, but the annual EBIDTA profit should exceed a 10% return every year. A properly managed business with a strong market can realize 15% or more.

  By the way, Walmart, the world's largest retailer and not a privately-owned company, had net income last year of $6.7 billion on $514 billion in sales. That is only a 1.3% ROS. But, $6.7 billion in profits is not bad either. Public companies, like Walmart, commonly earn less as a relative measure than do privately owned companies.

- **Cash Flow** is a *survival measure.* The age-old adage is "if you have positive cash flow, it is not important. If you do not have positive cash flow, nothing else is important." Cash flow is important because it determines your ability for payment for things that make your business run: expenses like payroll, raw material purchases, rent and other operating expenses. Essentially, cash flow is a metric relative to time. You can be profitable and have a good ROS, but still have a negative cash flow due to delayed payment for your goods and services. Managing cash flow is critical to a successful business enterprise.

Essentially, as a manufacturer you exist to do three things in business every day:

- You provide a **quality product**. This is not a competitive opportunity. You must produce (and have the earned reputation in providing) a quality product on every order. If you don't there will be no opportunity to continue in your market. Of course, mistakes happen. How you deal with them to satisfy the customer is the important part. You should do whatever it takes to make the customer happy.

  A comment about price reductions. Don't do it. If your customer is not happy with the final product and you offer some money off the price, they will still not be happy. They will still point out the error to every visitor to their house. Do whatever it takes to make them happy every time.

- You provide **reasonable pricing**. This is also not much of a competitive opportunity. You do not need to be the cheapest provider. In fact, you should strive not to become a commodity producer. Someone can always do it less expensively than you can. You should market your company as a producer of custom, high-end products that will enhance the beauty of any jobsite and should justify a reasonable price.

  Pricing of your products is ultimately determined by your customer's perception of value and availability. It has little to do with the cost of your production. More on that in future articles.

- You provide **timely availability** (aka customer service). This ***is*** a competitive opportunity. If you provide a quality product at reasonable prices, what can set you apart from your competition is speed. If all other things are equal, most customers will buy from the company that can be the fastest and most reliable.

But, having said all that, your business system must be set to make a profit, or you will not stay in business. In The Goal, Dr. Goldratt states it this way:

> "The goal of a company should be to make more money now and in the future."

Your system should be organized and managed to assure that you will be profitable every year and it should maintain the culture that you will always be seeking continuous improvement. You should never be satisfied.

"There is no finish line." Dr. Eli Goldratt 1986

For more information on how to make more money now and in the future, contact:

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