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CPAs and advisors

Manufacturing and Distribution

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Management & Operations

Work with Updated KPIs to Improve Performance

Every manufacturing and distribution business owner uses some form of key performance indicators (KPIs) to assess how the business is doing. In the past, many owners "went with their gut" to get a sense of performance. Now, most have technology and data analysis in place to precisely measure how the company is performing in various areas.

If you haven't assessed your KPIs lately, now is a good time to do so. You may find that some of the metrics you're using are not particularly informative or relevant—and you may be missing some KPIs that could be useful to you and your team.

Why KPIs?

KPIs come in many flavors, and different measurements are relevant to different businesses. What all KPIs have in common that they are indicators of direction and trends. KPIs can help you compare performance from one period to another and benchmark your performance against that of your competitors or industry standards.

KPIs promote informed, data-based decision making up and down the org chart and help your entire team learn and grow.

Framework First

With so much data available, it can be difficult to determine what's important and relevant. What data should you collect, and what should you do with it?

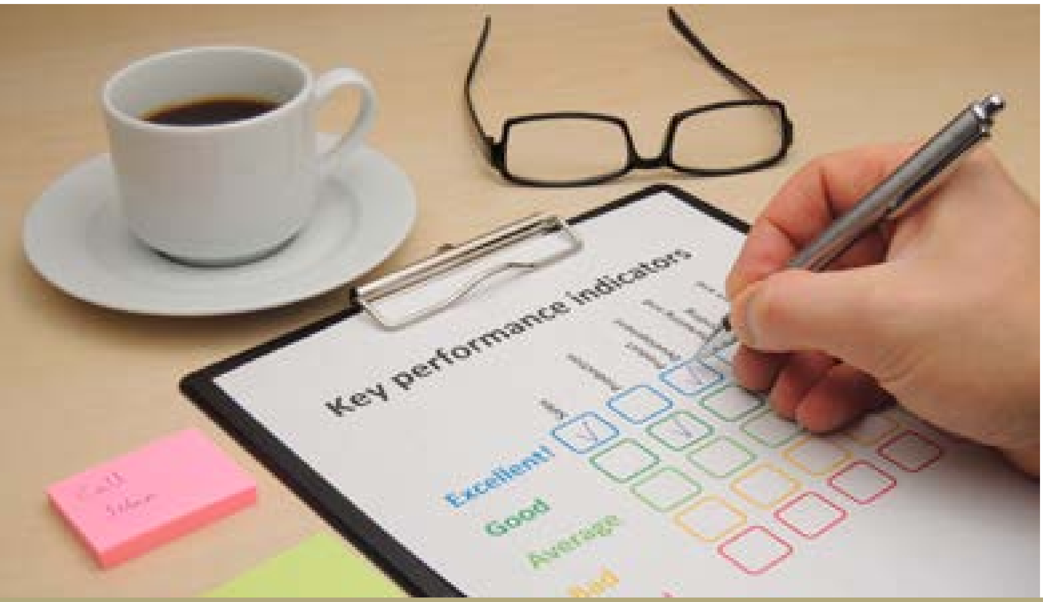
KPIs should be directly aligned with the company's strategic objectives relative to operations and building value. Consider building your KPI framework using these four steps:

1. Identify key operational processes and financial indicators that support your company's core ideology, business strategy, and important value drivers.

2. Select metrics that meet these criteria and will assist in tracking performance.

3. Build KPIs by identifying where data will come from and how it will be analyzed to produce the metrics you want.

4. Forecast and track KPIs against your company's historic performance, current expectations, and peer performance.



What to Watch

Among the common KPIs measured by manufacturing and distribution companies are those involving cycle times, inventory turns, quality factors, on-time delivery, safety, and of course costs. But given the availability of data and sophisticated analytics, you can expand specific metrics to show different angles of performance. You can also factor in both leading and lagging indicators.

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Word to the Wise

Valuation 101: What You Need to Know

It's normal to muse upon the value of your business. How much is it really worth?

Unfortunately, many manufacturing and distribution business owners think their companies are worth more than they really are. Your business means everything to you, but if you sell it, a potential buyer sees it only as a transaction.

So when you ask yourself, "What's my company worth?" the answer is, "It depends."

What Buyers Seek

Plain and simple, buyers are looking for a return. They're looking for future cash flow and earnings. But they may also be seeking synergy with their other holdings, a new market presence, a better handle on supply chain and distribution, or other benefits.

Buyers don't like risk. And though all purchases have some risks, generally speaking, the lower the risk the higher the price a buyer will pay.

While you know your company well, it's the hard numbers that will help buyers determine the potential return on their investment.

Valuation vs. Calculation

The only way to truly determine value is to engage a credentialed analyst for either a full valuation or more limited engagement called a calculation of value.

By definition, the outcomes of a valuation and a calculation are different—and a calculation can be considerably less expensive.

According to the American Institute of Certified Public Accountants (AICPA), a "valuation engagement requires more procedures than does the calculation engagement. The valuation engagement results in a conclusion of value. The calculation engagement results in a calculated value."

Further, in a valuation engagement, "the valuation analyst estimates the value of a subject interest and is free to apply the valuation and methods he or she deems appropriate in the circumstances."

Regarding a calculation engagement, the "analyst and the client agree on the valuation methods and approaches the valuation analyst will use and the extent of the procedures the valuation analysts will perform …"

While a full valuation is generally required for court cases and tax filings, a calculation is useful for owners in other circumstances.

For example, a calculation is helpful if you are considering retirement or sale and want an estimate of what the company might bring in terms of value. A calculation can also be useful if you want to vet an unsolicited offer for the company or for periodic reviews of buy-sell agreements (see page 4).

A Starting Point

If you are interested in a valuation, contact your CPA to discuss which type of service best suits your circumstances. Your CPA will discuss with you the scope of the engagement—what is required in terms of documentation and input from you, and how the valuation analyst uses that information. He or she will also discuss schedule and timing.

Regardless if a sale is imminent, a valuation or a calculation can be an excellent point of reference for owners looking to build value. The information in the analyst's report will help you identify risks and position your company for the future.

Our valuation team has worked with many manufacturers and distributors. Call us today.

How to Protect Your Assets

Disrupting the Fraud Triangle

Manufacturers and distributors are often victims of occupational fraud. In fact, according to the Association of Certified Fraud Examiners (ACFE), manufacturers are among the top four industries targeted by fraudsters in terms of median losses.

What causes people to steal from their employers? The "fraud triangle," developed decades ago by criminologist Donald Cressey, explains the motivation behind occupational fraud.

Three Components

The fraud triangle represents the "perfect storm" for unethical colleagues seeking to defraud the company for their own gain:

1. Financial or emotional pressures: Life has its ups and downs, but when someone is facing what appears to be an insurmountable problem, he or she might be prone to criminal actions.

For example, gambling debt or drug activity might cause potentially embarrassing financial pressures that the person doesn't feel comfortable sharing with friends, family, or colleagues. Similarly, living too close to the financial edge—spending too much on lifestyle choices like cars, homes, or vacations—can create pressure.

In addition, a high-pressure business environment can contribute to fraud. If people are compensated or bonused via quota, it's not unheard of for an employee to create fake accounts or otherwise violate the company's code of conduct.

2. Opportunity: People who would otherwise not engage in fraud might be tempted to do so if an opportunity presents itself in a way that the individual perceives to be undiscoverable. If he or she believes that the fraudulent activities can be conducted in secret, the opportunity might be appealing enough to act upon.

3. Rationalization: This is how fraudsters justify their actions. Rationalizations might include the idea that the company is big enough to absorb the loss, that the fraudster "deserves" what he or she is stealing, or that the "noble" nature of the need—paying for an ailing relative's care, for example—justifies the theft.

Stop, Look, and Listen

To deter fraud, employers must take a hard look at their corporate environment, their expectations, and their own behavior.

Create awareness. Regular ethics training is a must to keep occupational fraud top of mind for the entire employee base. Sharing occupational fraud statistics and the impact of fraud on everyone's livelihood can disrupt the "opportunity" side of the fraud triangle.

Add deterrents. Good internal controls—and a strict policy of following them—create barriers to fraud. Technology can also play a big role. Inventory tracking devices and security protocols can deter physical theft of supplies or finished parts. Document blocking, imbedded tagging, and encryption can stop intellectual property theft.

Check yourself. The tone always starts at the top. Owners and executives must set an example with impeccably ethical behavior. Those who flaunt the rules, treat lower-level colleagues with disdain, or are even loose with petty cash or their expense accounts may open the door to others acting similarly.

Don't let your hard-earned assets slip away. Encourage all of your employees, suppliers, and customers to be on the lookout for suspected fraud, and make your zero-tolerance policy well known.

Interested in fraud-proofing your company? Let's discuss next steps.

Updating KPIs

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For example, knowing your working capital ratio is certainly helpful, but knowing your operating income margin would likely illuminate financial stress. Sales conversion rate is a meaningful indicator, but excess sales pipeline value and pipeline attrition will give you a different view.

Also note that executives will likely benefit from tracking KPIs in a different manner than managers and supervisors, so keep that in mind as you choose your metrics.

Design Your View

Remember that KPIs can be used for predictive measures to help you determine the direction of the company. But looking historically can also be useful in identifying business cycles and learning from past decisions.

Using a dashboard to visualize your KPIs is an easy way to get a quick view of your performance. ERP programs generally have a built-in dashboard feature that's easily customizable to your needs. If desired, you can also pull in external data such as economic information or industry benchmarking to give you a richer view of your data in context.

Follow Through

Updating your KPIs may sound like a major undertaking, but the results are worth your investment of time and resources. There's no doubt that having the latest and most meaningful information at your fingertips gives you the confidence to make better decisions.

Your financial advisors can help you develop a strategic execution framework and determine which KPIs can give you the best indicators of your company's performance.

Buy-Sell Agreements: A Must for Owners

When you start a company, creating a buy-sell agreement is rarely at the top of the list of things to do. But that's precisely the time to consider the future. For example, what do you want to happen if an owner wants to leave, is incapacitated, becomes terminally ill, dies, or divorces?

Buy-sell agreements are legal documents that detail how and when an owner can sell his or her interest in the business. It outlines how the business interest will be valued and to whom the interest can be transferred or sold.

Having a buy-sell agreement in place means that nothing will be left to chance in the case of an owner's departure, planned or unplanned. The goal of the agreement is to ensure an orderly transition of ownership and voting rights so that the remaining owners aren't left with a departed owner's ex-spouse, children, or estate as a business partner.

The agreement typically covers the following:

Triggering events: The document defines various events that trigger the agreement. For example, death, retirement, bankruptcy, substance abuse, fraud, or divorce might cause the agreement to go into effect.

Buyout method: Most buy-sell agreements include a cross-purchase agreement or a redemption agreement. A cross-purchase agreement, typically funded by a life insurance policy, allows remaining partners to buy the departing owner's interests. A redemption agreement allows the company itself to buy out the owner.

Non-compete clause: Often, departing owners are prohibited from competing with the company via a non-compete agreement.

Purchase price: The buy-sell agreement should outline the process by which the interest will be valued, detailing the valuation date, standard of value, and even a valuation formula to be used.

If you don't have a buy-sell agreement in place, it's never too late to create one. It's also important to keep it up to date.