Process Paper: Small Business Data-Driven Planning Process

Introduction

The next statement I am going to make is a universal requirement of sustained success:

“The best organizations in the world make informed decisions.”

Here we’re focused on business, but the principles are universal. Families, schools, churches, small businesses, large corporations, charities, not for profit organizations, writers, publishers, websites, and more are all better off when they pursue the quality information and make informed decisions.

The highest performing businesses among us seek out quality information that looks at issues from multiple lenses, consider the information, review a range of perspectives, and make convicted decisions about a path forward.

In 2019, I launched a consulting and advising practice called Velocity Advisors LLC. My goal is to help every business I can realize success with informed decision making. Companies differ in their product offerings and the people on the team, but they universally need to gather the right information for their leaders to drive a strategic pathway toward success.

Over the past 20 years of my professional career and 37 years of life a few common observations have been made:

1. Human beings overcomplicate everything
2. Groups of individuals don’t get along all the time
3. Most choices we make are irrational or impulsive
4. Solutions are chosen often without understanding the real problem
5. Bad habits are repeated and seldom corrected

I have bookshelves filled with books on self-improvement, business, investing, finance, supply chain, and more. In all of that reading there are some great resources and some that I was disappointed in. Some books are all sizzle but no steak, all anecdotal and few tangible facts. Most small business owners aren’t interested enough in numbers to power through all that reading.

In Business Success with Metrics, I wanted to provide a quick read packed with information that if implemented will transform your business. A roadmap to some of the right numbers to review in your business and to bring into your team’s everyday rhythm and culture.

If this content clicks for you but your desire to do data work ends at keeping up your QuickBooks, check us out at Velocity Advisors (www.velocityadvisorsllc.com). We’re here to help whether helping define the data initially, building the tools, finding systems, or bundling the information together monthly for your ongoing business planning.

If you build a process where you set a rhythm in your business to use the metrics outlined here for planning, I can guarantee it your company will improve. Reviewing these metrics and following through with actions and plans based on the findings will transform culture. Your teams will collaborate in fact and not fiction.

You’ll have a better understanding of the drivers of your financial results, customer performance driving revenue growth, the effectiveness of sales and marketing activities, the efficiency of your operation, and identify opportunities for cost savings.

Drive Performance with Data and Metrics

Velocity Advisors is here to help your business transform by integrating data and metrics to your everyday planning and collaboration. The creation of key performance indicators and a review of key business metrics serves four main purposes:

1. Gather insights from a company's financial statements
2. Evaluate leading indicators that drive financial performance
3. Benchmark company performance versus competition
4. Drive decision making with facts and data

It is simple. In order to achieve results, you have to transform your culture and decision making. The differences in decisions, culture, and outcomes below are summarized in the table below:

	Poor Outcomes	High Achievers
Decision Making	Driven by Opinions	Data Driven
Collaborative Culture	Silos and Politics	Consensus from Facts
Successful Outcomes	Lucky and Inconsistent	Planned and Expected

Businesses of all sizes are led by a collection of founders, managers, investors, and more. If a business is led by only one person, that person still needs the right information to make informed decision. If more than one person, then data and information are pivotal to settle disagreements and eliminate bias in decision making.

Understanding Leading vs. Lagging Metrics

Performance metrics are designed to evaluate company results with data and drive decision making by leaders. If you are in business you can get started with your company's Financial Statements: Income Statement, Balance Sheet, and Cash Flow Statement.

To fully transform, financial statements only get you so far. Sure, you can file your taxes, and know if you are making money. Financial statements are a part of a wholistic planning solution, however incomplete since they measure the outcome or the results. They are like the score at the end of the game. Though effective, they serve as ***lagging indicator*** based other business activities.

To truly transform your company's decision making, it is critical to put additional key business metrics in place that evaluate ***leading indicators*** to financial performance. Its like measuring the effectiveness of each at bat in the baseball game or drive in a football game that led to the eventual final outcome.

Collaborative Planning Process

The best companies have a rhythm to their planning cycle in reporting of information and collaborative discussions. The size and complexity of the company will dictate the amount of resourcing, tools, data requirements, and meeting frequency of the planning process.

The process comes down to information gathering and collaboration. Beginning with the data and reporting, my recommendation is to ***make all key performance metrics visible to the business monthly***. Gathering critical information should become a part of a frequent cycle in your business. Surprises do happen, and you want visibility to them so if a more frequent discussion is needed as an exception the data exists to drive the conversation.

Continuing to the collaborative discussion frequency, my recommendation would be to ***have collaborative reviews of company performance at least quarterly***. If you enjoy it and you find you require more frequent conversations, then increase the cycle to monthly. If strategic decisions are needed more frequently, then monthly will help too. The recommendation for quarterly meetings to start is to ensure engagement, have plenty to talk about, and to not lead to burnout.

Below is a listing of topics to review at each planning meeting:

1. **Sales Trend and Key Drivers**
    a. Revenue and Margin Trends
    b. Service Metrics
    c. Marketing Investment
2. **Operating Performance**
    a. Expense Trends and Savings Opportunities
    b. Labor and Capacity Utilization
    c. Cost of Materials and Inventory Efficiency
3. **Financial Results**
    a. Revenue Trends and Profit Margins
    b. Debt Levels and Leverage
    c. Ease of paying down liabilities
    d. Efficient use of assets and equity
4. **Competition Review**
    a. Price Competitiveness
    b. High Level Financial Comparisons (where publicly available)
    c. New Products and Locations
5. **Decision Points**
    a. What changes are needed to improve underperformance above?
    b. What strategic choices exist to take positive performance and make even better?

If you follow this planning cycle and review of these topics, your culture will transform with alignment and preparedness for the future. Most Fortune 500 companies and the ascending businesses of tomorrow review these topics and more. It is necessary make decisions and align your business around these topics to realize consistent and sustainable performance.

The rest of this writing will highlight the critical metrics to review with your broader leadership team as a part of collaborative planning meetings.

Sales Trend and Key Drivers

Customer service performance and marketing efficiency are often leading indicators into revenue and revenue growth trend. Ineffectiveness in either of these areas can lead to missing sales goals and projections. Ongoing performance challenges lead to a lack of trust by customers and transitioning business to competitors. Below are some of the key metrics to include in discussions on revenue trends and key drivers of performance:

Revenue Growth Rate: measuring the percentage increase (or decrease) in sales revenue versus a past period

Revenue Growth Rate = 1 – (Current Period Revenue / Prior Period Revenue)

Sales Lead Conversion Ratio: measuring the percentage of the sales leads that become actual paying customers

Lead Conversion Ratio = New Customers / Total Leads

Cost per New Customer Acquisition: comparison of marketing expense to new customer additions either in aggregate for the company or as a part of specific marketing campaigns

Cost per Acquisition = Marketing Expense / New Customer

Order Fill Rate: measuring the percentage of demand ordered by customers is provided to them in full by your company

Order Fill Rate = 1 – (Units Cut from Orders / Total Ordered Units)

On Time Delivery (OTD) Percentage: measuring the percentage of orders placed by customers that were delivered to them on time

OTD Percentage = 1 – (Late Orders / Total Orders)

On Time-In Full (OTIF) Percentage: a combination of order fill rate and on time percentages, OTIF is the percentage of units ordered by customers provided in full quantities when requested

OTIF Percentage = 1 – ((Order Cut Units + Late Delivery Units) / Total Ordered Units)

Operating Performance – Labor Efficiency

Labor efficiency metrics serve as a leading indicator to one of the biggest expenses on most companies' income statements. Review and optimization are critical in efficiently utilizing labor resources and managing both excessive labor and potential burnout (opposite extremes). Some of the most common labor efficiency metrics are:

Operating Labor Utilization: measuring how efficiently a company utilizing the labor hour incurred versus how many hours should have been required to perform the task

Labor Utilization = Actual Hours Worked / Expected Hours Worked

Absenteeism Rate: the percentage of hours a company pays for employees not working due to sickness, vacations, skipping, and injury.

Absenteeism Rate = Non-Working Hours Incurred / Total Labor Hours

Overtime Rate: the percentage of labor hours paid for employees incurring overtime (often at higher rates per hour)

Overtime Ratio = Overtime Hours Incurred / Total Labor Hours

Operating Performance – Cost and Inventory

In addition to labor, the greatest investments companies make are in the raw materials of production and the finished goods available to sell to customers. Driving cost savings and efficient turns of inventory in these areas are critical. One interesting case is in capacity utilization, which a result too low requires potential decommissioning of assets and too high could result in excessive costs associated with equipment breakdowns and failures. Some of the most frequent operating and inventory cost metrics are below:

Expense Trend: the period over period change in any experience the business has identified for review for potential cost savings or tracking

Expense Trend = 1 - (Current Period Expense / Prior Period Expense)

Gross Margin Percentage: the percentage of revenue remains after the costs of materials and production

Gross Margin Percentage = (Sales – Cost of Sales) / Sales

Gross Margin Trend: the change in gross margin versus a previous period (month, quarter, or year)

Gross Margin Trend = 1 – (Current Period Gross Margin / Prior Period Gross Margin)

Capacity Utilization: measurement of the percentage of the production capability used by your business versus the maximum possible output

Capacity Utilization = Actual Production Units / Max Output Production Units

Production Efficiency: the percentage of the time a business spends making product absent of breakdowns and changeovers versus the total time available

Production Efficiency = 1 - ((Changeover Time + Downtime) / Total Available time)

Inventory Turnover: how many times a company replaces or sells through inventory over a period

Inventory Turns = Cost of Goods Sold / Average Inventory

Inventory Days of Sales: the average number of days of inventory a company holds inventory prior to sales to customers

Inventory Days of Sales = 365 / Inventory Turns

Financial Performance - Profitability

Profitability ratios evaluate the ability to generate income versus the company's top-line revenue, operating costs, shareholder equity, and assets on the balance sheet. Some of the most common profitability ratios include:

Return on Equity: how efficiently a company uses shareholder equity to generate income

Return on Equity = Net Income / Shareholder Equity

Return on Assets: how efficiently a company uses assets on the balance sheet to generate income

Return on Assets = Net Income / Total Assets

Gross Margin Percentage: the gross profit of a company as a percentage of net sales to show profit after cost of goods sold

Gross Margin Percentage = Gross Profit / Net Sales

Operating Margin Percentage: compares the operating margin of the company with net sales to track operating efficiency

Operating Margin Percentage = Operating Income / Net Sales

Financial Performance - Leverage

Leverage metrics are critical and measure a company's debt levels. Evaluating both the magnitude of debt levels and the ability to repay. Some of the most common leverage metrics include:

Debt to Equity Ratio: the amount of debt versus the shareholder equity (investment) in the company

Debt to Equity Ratio = Total Liabilities / Total Equity

Debt Ratio: measures the amount of debt a company possesses versus the assets it owns

Debt Ratio = Total Liabilities / Total Assets

Interest Coverage: the ability of a company to pay its interest expenses

Interest Coverage = Operating Income / Interest Expenses

Financial Performance - Liquidity

Liquidity ratios exist to evaluate a company's ability to repay its debts. Some of the most common liquidity ratios include:

Current Ratio: ability to pay off short-term liabilities with current assets

Current Ratio = Current Assets / Current Liabilities

Quick (Acid-Test) Ratio: ability to pay off short-term liabilities with quick assets

Quick Ratio = (Current Assets – Inventory) / Current Liabilities

Cash Ratio: ability to pay off short-term liabilities with cash and cash equivalents

Cash Ratio = Cash and Cash Equivalents / Current Liabilities

Operating Cash Flow Ratio: number of times current liabilities can be paid off with a period's cash flow

Operating Cash Flow Ratio = Operating Cash Flow / Current Liabilities

Financial Performance - Efficiency

Efficiency metrics use financial statements to evaluate how well a company is utilizing resources. Some of the most common efficiency ratios include:

Receivable Turnover: the number of times a company turns receivables to cash over a given period

Receivable Turns = Net Credit Sales (per period) / Average Accounts Receivable

Asset Turnover: the ability of a company to generate sales from the assets in possession

Asset Turns = Net Sales / Total Assets

Strategic Outcomes and Decision Making

Based on the metrics reviewed about, you will have a clear view of the successes and opportunities areas for your business. A review of the metrics and information above should lead to conversations about desired outcomes.

From my experiences, this is the fun part as you transform to a high performing culture that makes decisions with data and information. With the right information in hand, the opportunity now exists to lead with confidence and get consensus around the activities necessary to move in the right direction.

A list of ten potential topics could include:

1. Actions to correct negative trends in revenue, costs, and efficiency
2. Business Growth: where, when, and how?
3. Ways to better utilize existing equipment, people, and resources
4. Strategic uses of cash and working capital
5. Drive efficiency in paying bills and getting paid by customers
6. Activities to drive advantages versus competition
7. Improve the effectiveness of marketing dollars spent
8. New products and trends in market to potentially add to portfolio
9. Ways to improve the perception of your business in the eyes of your customers
10. Possible strategic business acquisition opportunities in the market

Conclusion

As I mentioned in the introduction, the purpose of this writing is to be short and sweet. I have read thousands of pages of books, self help guides, college studies, and articles online and in print to come to these conclusions. It is not complicated, but it is unfortunately not common either.

My hope is that in your reading of this short work that you were able to picture a better business with financial success. To see yourself leading in a strategic way with the right information in hand, rather than guessing and hoping tomorrow brings better outcomes.

I truly love what I do. Most people go into business because they do something great. Maybe they make a great hamburger. Perhaps their town needs a carwash and they have the expertise to make it happen. Most people who start a fashion line did it because they love clothes and not because they have no clue how to coordinate an outfit.

Planning and collaboration are what I enjoy and am great at. What is great is that this passion can help make you profitable at what you do just like your hamburger, carwash, or fashion line make my life better.

I wish you the best in your business future and I am convinced if you implement this model your life will be transformed. If you need help implementing this model visit www.velocityadvisorsllc.com and we'll be happy to help in your business transformation.

All the best,

Velocity