Crowe Horwath™



Tips for Sound Financial Planning and Governance

We all know the importance of robust accounting systems and processes to provide accurate financial data. Real value, however, comes from the decisions made when data is converted into key financial business indicators.

1. Cash is king

This is a reminder that maintaining a positive cash flow is a must. How do you achieve this? Treat each job, project or customer as its own cash flow centre, making sure you diligently manage cost over-runs and late payment of debts as though each job was your only one.

As Warren Buffet famously said
"Rule No.1: Never lose money.
Rule No.2: Never forget rule No.1."

Get a cash flow forecast that looks at the cash requirements for the whole business, but also allows you to drill down and find the areas to focus on to fix cash flow problems.

2. Management by ratio

If you regularly look at your profit margin, then you are already using a key financial ratio to manage your business. Converting dollar values into ratios enables you to compare your business with others and other investments.

Financial ratios fit into four categories:

1. Profitability ratios – as the name says, ratios that help you understand profit.

2. Liquidity ratios – indicators of cash flow and solvency.

3. Leverage (gearing) ratios – indicators of borrowing compared to capital investment.

4. Efficiency ratios – track how well you are using resources to create value.

Ratios also have a hierarchy. Top level ratios summarise the overall business performance, but you should drill down to ratios at job or function level to assess issues.

Some key ratios are listed in the table on the following page.

3. Meet and review

Your management team should meet regularly to review the ratios against standards for comparison (benchmarks) along with non-financial indicators (such as staff performance).

A traffic light system alerts you to ratios that are "green" (under control), "amber" ("watch me closely") and "red" ("action now!"). Then use the lower hierarchy ratios to analyse the causes of issues.

Good financial management sits at the heart of a successful business.

Type	Top Level Ratio	Description
Profitability	Gross profit margin %	Gross profit is obtained from subtracting cost of sales (for example: labour and materials) from revenue. Helps you determine how well you are managing jobs overall.
	Profitability %	Is calculated using net profit (which is after paying all overheads) to track your overall performance from sales and managing all costs.
Liquidity ratios	Current ratio	Surplus of current assets over current liabilities (should be at greater than 2).
	Quick ratio	Ability to pay short-term creditors immediately from liquid assets (should be greater than 1).
Leverage	Debt to equity	Measures how the business is funded. Lenders will want to understand this ratio before they consider further lending.
Efficiency	Activity ratio	This is the amount of revenue earned from every dollar used in the business.
	Return on capital employed	This is a measure of the earnings of the business generated by the capital in the business. Enables you to compare returns from your construction business.

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How can Crowe Horwath assist you?

Crowe Horwath has an online dashboard tool that helps you measure, monitor and manage financial and non-financial performance.

Visit www.analysis-one.com for more information and sign up for your complimentary 14 day trial, or ask your advisor for a personalised business financial health check report.

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The relationship you can count on

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