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Panning For The Gold Mine In Your Business

by Terry Soifer
Consulting CFO, Inc.

The search for the "gold mine" in your business begins, rather than ends, when you receive your financial statements from your accountant. To succeed in this search, you have to look "underneath" the numbers. You must analyze what is going on and, as a result of this analysis, improve the management and profitability of your business.

From a financial perspective, there are two components which you must analyze to successfully manage your business. These components are the income statement and the balance sheet. The income statement examines the relationship of sales to costs; the balance sheet examines the relationship of your assets to your liabilities and equity. This article will suggest several ways to analyze your sales.

When we analyze our sales, it is common for most of us to compare sales for the current month to sales year-to-date. However, our analysis is not complete because we fail to compare the current month's sales to a budget. Only by comparing to a budget are we in a position to understand if we are making progress toward our goals. Let's look at an example:

	Actual			Budget		
All	Pounds	$	Unit Price	Pounds	$	Unit Price
Products	116,716	6173	.5289	129,081	61022	.4727

We can see that total sales exceeded budgeted sales by $710. However, if we stop there, we fail to understand that there are different reasons for this favorable variance. For example, volume had an adverse impact of $5,994 on sales. This is calculated by comparing the pounds actually sold to those budgeted and multiplying the difference by the budgeted unit selling price [(116,716 - 129,081) x $.4727]. Conversely, price and mix of the products sold had a favorable impact of $6,704. This is calculated by subtracting the budget unit selling price from the actual unit selling price and multiplying the difference by the actual pounds sold [($.5289 - $.4727) x 116,716].

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While sales appear to be basically on budget, by using this methodology, we were able to understand that this favorable variance is the result of a shortfall in volume being offset by price increases.

However, this analysis takes on even more meaning if we look at it by product, or product group, rather than for all products.

Let's look at the same example in more detail:

	Actual			Budget		
	Pounds	$	Unit Price	Pounds	$	Unit Price
Group A	8506	5770	.6783	15686	7775	.4957
Group B	108210	55962	.5172	113395	53247	.4696
All Products	116716	61732	.5289	128081	61022	.4727

We still have a total sales difference of $710 but the variance analysis shows the following:

	Volume	Price	Total
Product Group A	($3558)	$1553	($2005)
Product Group B	($2436)	$5151	$2715
Total	($5994)	$6704	$ 710

Both groups of products had unfavorable volume variances and both had favorable price variances. However, the favorable price variance for Product Group A was unable to offset the unfavorable volume variance. Why? Maybe the last price increase we initiated for product Group A was not followed by our competition. As a result, our customers are now buying our competitor's products. Perhaps our competitors were heavily promoting their products, and as a result, sales fell. The point is that, unless our analysis looks at more than total sales, we are not in a position to ask the right questions. Therefore, we cannot understand why our sales are lagging.

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Is it possible to analyze sales without a budget? Yes. For example, a public warehouse company decided to analyze their monthly sales by tracking storage revenue on a monthly basis by customer. Why? Because by calculating a customer's monthly storage revenue per square foot, the warehouse company was able to significantly raise prices of those customers who were below the warehouse's costs; at the same time, the warehouse avoided chasing away their good customers through unwarranted price increases.

The point is whether you compare sales to a budget or use some other means, the key is to decide which parameters you need to analyze your business and develop the support systems (manual or computerized) that will give you this information.

Panning For The Gold Mine In Your Business *is a part of a four-article series available from Consulting CFO, Inc. Additional topics include: asset management, inventory management and expense reduction. For additional articles, or for additional reprints of this article, contact Terry Soifer, President, Consulting CFO,* ***(407) 628-5534.***