

How Knowledge of the Accounting Equation Won Me a Client.

Assets = Liabilities + Equity. An equation all accountants know well. But we underestimate the power of this knowledge.

On Thursday 30th March 2017, I attended a meeting with a prospective new client. Steve was an electronics engineer; his home automation and security business was established 18 months earlier.

This is a growth industry with many opportunities across a wide market segment. Put simply, the business has an array of product and services that deliver the ability to control the electrical operations, communications, and visual security of a home from a mobile phone.

The business was establishing a foothold in the market, two technicians were on the road, another was in training. The first administrative assistant had been employed and sales professional was soon to be appointed.

During our one hour meeting we were interrupted by three times by visitors to the open plan office / showroom, and four times by “urgent phone calls” the proprietor simply had to take.

“ Yes our technician is due there this morning, I expect he is not far away”

“There should be cameras for each of the four bedrooms, the living room, kitchen, and garage.”

It was fun, an out of control business that looked as though it was heading in the right direction.

Steve showed me a very detailed spreadsheet with his product costings and sales prices, he *seemed* to have that side of things under control. He thought he did, but I was not convinced – more about this later.

He then showed me a very impressive sales plan document he and his marketing advisor had put together.

This document, another spreadsheet was 5 columns wide and 10 panels long, at least. Each panel containing many lines of narrative. The columns represented market segments the business has the capability to operate in. The rows provided details of the potential customers within each segment, demographics, socio economic data, potential market size, expected customer requirements, possible customer objections, response to objections, substitute products and services available, plus a lot more I could not take in. It was an impressive document.

Steve explained to me he did not have the capacity to cover all potential areas in the next 2 years so he was going to select a segment based on several criteria that were effectively volume and operational ease related.

“What do you think he asked?”

And this is where $A = L + E$ kicked in for me.

I know the most important thing any business must get right is profit.

Not once, across all the spreadsheets did I see the word mentioned.

This was my simple response to Steve’s question:

“There is something missing from your sales plan. It is a most impressive document, however, under each column there should be row that records the gross profit per hour you expect to generate on the products and services you reasonably expect to sell into the market segment. Across the 5 market segments there are quite an array of products and it is unlikely they will generate the same gross profit per hour. Given you have limited capacity and a limited marketing budget it would be sensible to factor in which products are the most profitable before where deciding to focus your efforts.”

It was at this point I was invited to consult to the business on an ongoing basis.

And what I said was so obvious. Equity is driven by capital contribution profits and drawings. If we are going to grow a family business where shareholder capital is limited, we need to focus on profit.

Business owners and sales consultants do not seem to prioritise profit.

Before closing out this story I refer to my review of Steve’s costing sheet. You will often find owners have a record of input and labour costs of a product, they may even include an overhead allocation. This is all good information, sought of. It is better than not having it, but, what does it really tell us in respect of planned profit? Not much.

It is only part of the story. As we discuss in our Contribution Based Activity Lessons it is necessary to extrapolate this information and add to it the capacity of the organisation. How many production hours are available, what is the gross profit per hour (use the client data outlined above for this) and what are the total of overhead expenses?

Philip Arnfield March 2017