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Good sales don't always help profits

By James E. Rudnicki

"At \$15 million in sales our manufacturing business makes almost \$1 million a year. So if we double sales to \$30 million then we should make at least \$2 million."

It all seemed pretty straightforward to "Carl" and "Jack." Unfortunately a year and a half later it hadn't turned out the way they had thought.

Sales had risen dramatically, but profits were way down. More importantly, the company had gone from having a small cash reserve to never having enough money. Several unpaid suppliers were threatening to file suit. It was getting tough just to cover payroll.

Carl and Jack had allowed uncontrolled growth to consume all of the company's available cash, including its bank line of credit. They were being forced to make every decision with an eye towards conserving cash – instead of meeting delivery schedules, beating job cost estimates and making a profit.

The company was like a runaway freight train headed for a terrible crash. After a short investigation, I told Carl and Jack that they needed to slam on the brakes...by "firing" some customers, regularly forecasting cash flow and refocusing on sound management practices. Below is the logic behind my advice.

• "Firing" some customers

In order to grow sales, Carl and Jack had started working with a lot of new customers. Some of these relationships had turned out well. Others had not.

With some help, Carl and Jack were able to rate their customers. The ones who negotiated fairly, paid on time and wanted a "win-win" relationship were given an "A". The customers who only cared about price, always paid late or believed that Carl and Jack would have to "lose" if they were going to "win" were assigned "C's." The ones in between were given "B's." Management then had frank conversations with the "C's." Several changed their ways. The others began placing their orders elsewhere.

This approach soon improved cash flow by shrinking receivables and inventory. It also increased profits by eliminating what were generally the lowest margin customers.

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• Regularly forecasting cash flow

Many suppliers had stopped giving Carl and Jack their best pricing. In fact, with all the broken payment promises some of them didn't even care if they kept their business.



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In order to regain their suppliers' trust Carl and Jack had to begin "regularly and conservatively" forecasting cash flow. These forecasts consisted of predicting what the Company's cash receipts and disbursements would be by week for each of the next several months. All promises to suppliers had to be reflected in the plan. "Regularly" meant updating and extending the forecast each week. "Conservatively" meant making realistic instead of optimistic assumptions regarding cash receipts. As such, the actual results were generally better than the plan.

Once Carl and Jack began paying as promised (and occasionally earlier than expected!) their suppliers became a lot more interested in having them as a customer.

• Refocusing on sound management practices.

During the company's rapid growth a lot of its best practices and procedures had been forgotten. The management team had become "too busy" to meet and resolve quality control issues on a weekly basis. New bids were being sent out without a final independent review and sign off. Production scheduling was being done haphazardly, with the loudest customers (often "C's") getting the most attention. No one was watching employee productivity.

By refocusing on sound management practices, instead of growth, Carl and Jack were able to return to what had been the original source of their success. Quality work. Priced properly. Delivered on time.

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I gave Carl and Jack a lot of other advice too. Including ways to cut fixed costs and develop higher margin specialty areas or "niches." All of Carl and Jack's problems aren't behind them... but things are definitely headed in the right direction. Who knows, with a little luck they might even be able to make \$2 million a year.

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