Better Financial Control

The Balanced Scorecard

management of information and the balanced scorecard

leading to continuous improvement and improved quality of management decision making, which inevitably leads to improved bottom line performance.

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Management of information and the Balanced Scorecard

The print marketplace is widely believed to be more competitive now than ever before and certainly profit margins are under constant pressure, with the average profitability of a print company usually at only around 2-3%. In such tough conditions, fine-tuning a business is vital for long-term survival. However the widely held opinion is that printing companies in general do not manage information well or use their Management Information System (MIS) effectively and consequently are missing out on opportunity for cost reduction and operational improvement. This is particularly the case with smaller companies who often cannot afford a dedicated person to develop the use of their MIS or review performance data. Many think it is not worth the effort and they cannot afford the time given the daily production pressures.

The reality is that an MIS or shop floor data collection properly used will help with the administrative workload and most importantly enable measurement and analysis of the business

The use of information systems in the printing industry shows the opportunity for performance improvement that is being missed. MIS systems are primarily looked upon as a means of improving speed and efficiency of administrative processes, not as a means of measuring, controlling and developing the business as a whole.

Producing more estimates is usually a primary reason for many companies to have embarked on using an MIS in the first place but estimates are primarily seen as a means of generating a quotation, not as the foundation of the entire MIS process.

Utilisation is a critical issue that many companies monitor closely using their MIS

but very few regularly compare job cost against estimate.

The majority of companies do not analyse the profitability of job by types/customers/ market sector to establish the profit and loss generators for their company. The consequence of this lack of insight is that you cannot have an effective sales and marketing process if you don't know where your profits are coming from and what an ideal client for your business looks like.

Benefits of Management Information

- The ability to maintain control of the business – keep a finger on the pulse through real-time data and information and take corrective action at the earliest possible time if a problem is detected.

- The ability to make end-of-month projections on a daily basis.

- Measurement of the business as the basis of continuous improvement

- The ability to identify profitable and unprofitable work and/or customers so that the companies selling activity can be appropriately directed.

- Improved pricing decision-making

- Assist in the production planning process, which improves the overall efficiency of production management.

A lot of companies use a variety of Key Performance Indicators (KPIs) related to production management but Operational Efficiency of Equipment (OEE) is only used by a handful.

Analysis of production, tends to be done on an individual job basis rather than taking a consolidated view from which a bigger picture emerges to drive more strategic decisions.

It is important to establish KPIs for all key operations in the business and create targets for all the KPIs as appropriate. Displaying the results is important to get employee engagement so use departmental noticeboards and follow up as the basis for continuous improvement, either in team meetings or with individuals and departmental managers.

To manage information in a more coherent way in order to drive continuous improvement it is advisable to concentrate on the use of a "Balanced Scorecard" which focuses on four main aspects of the business:

- Financial
- Production
- Sales
- Customer service

The information required can be gathered directly from an MIS system or can be manually collected in a simple and effective way. The following diagram illustrates the simple information structure required to control each area of the balanced scorecard

the balanced scorecard

The Balanced Scorecard

The information from a balanced scorecard can give a snapshot of the key performance indicators in a business. This allows quick visual identification of month- by-month variations and developing trends. As can be seen in the table below worrying downward figures for turnover and average job value, plus an increase in complaints can be quickly investigated and rectified.

Finance

The finances of a business obviously need close monitoring on a daily basis, however a balanced score card perspective allows management to have an overall picture of how the business is performing. The following scorecard is recommended as a health check for the company finances.

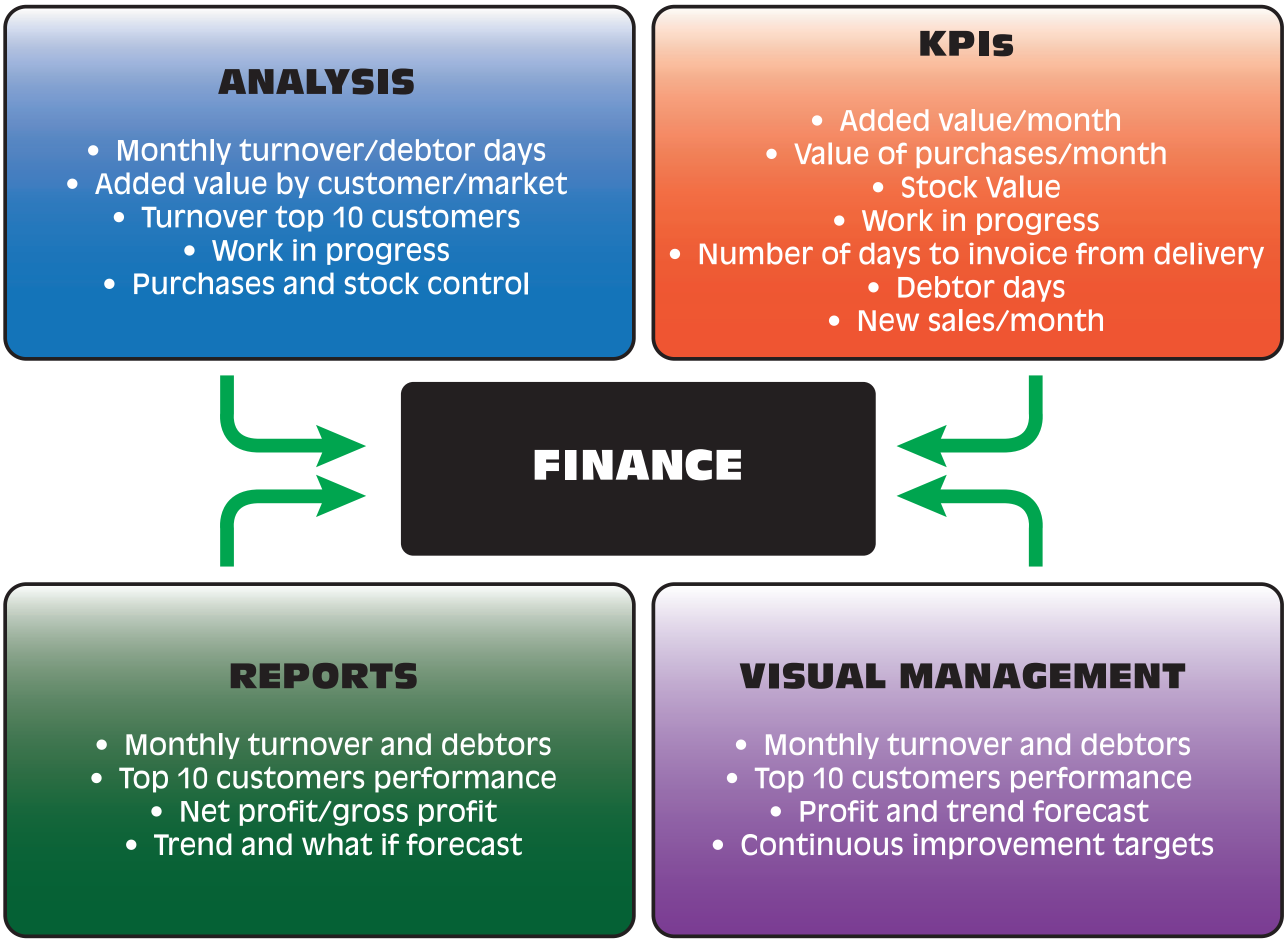
A common tendency is to overestimate utilisation and hence arrive at hourly rates, which are too low.

Indicator	Current value €	Target	Variation	Trend
Financial				
Turnover to date	3,600,000	3,500,000	100,000	▲
AV	2,000,000	2,000,000	0	–
EBIT	250,000	230,000	20,000	▲
Production				
Utilisation%	84	83	1.0	▲
OEE%	62	60	2.0	▲
Added Value/Direct Wages	1.9	2.0	-0.1	▼
Sales				
Estimate conversion %	24	25	-1	▼
Average job value	740	760	-20	▼
Customer service				
On time delivery%	92	95	-3	▼
Value of complaints	22,000	10,000	12,000	▲

The following section will concentrate on the balanced scorecard for each key business area and what information needs to be collected.

Finance Balanced Scorecard

In addition to using the scorecard for high-level performance monitoring there needs to be regular reviews of other critical factors like hourly rates, working capital and overall profitability.



Key Financial Measures

Hourly rates

The estimating and costing processes both depend on the use of hourly rates for machines and processes. A critical factor in determining hourly rates is the assumption made about utilisation. A common tendency is to overestimate utilisation and hence arrive at hourly rates, which are too low. Absorption costing is the most commonly used method in the printing industry and is based on all-inclusive hourly rates. Hourly rates are most meaningful when they include the full cost of operation, the major elements of which are direct wages, depreciation, interest charges, rental and building costs, energy costs, and an allocation of overheads such as admin, management and sales costs.

The key issues with hourly rates are:

- Know how they have been calculated – i.e. what they include and exclude

- Know what assumptions they are based on, in particular what utilisation rate has been assumed

- Review them regularly

As printed job value is continually reducing it is vital that the cost of administrative processes and the selling activity related to each job reduces too. In many companies these costs are not monitored at all.

Activity based costing is a useful process but a better approach for smaller companies, is to undertake a regular spot check of average selling and admin cost/job and use this to examine the overall profitability of jobs/customers.

Other key financial performance measures are seen in the table.

Working capital funding requirement

This can be expressed in various ways but is based on:

1. Current assets, i.e. cash or "near" cash, including monies owed to the company (accounts receivable) and finished goods stock (where this can be readily sold for cash).

2. Financial obligations to be paid in the current operating year, or period (accounts payable).

For cash flow control purposes, the measure required is (1) – (2) which should always be positive.

This is also frequently stated as a ratio (Current Ratio)

$$= \frac{\text{Current assets}}{\text{Current liabilities}}$$

Gross profit margin

Gross profit = Turnover – Cost of sales

$$\text{Hence gross profit margin} = \frac{\text{gross profit}}{\text{Turnover}} \times 100\%$$

Net profit margin

Net profit = gross profit – expenses (but before Interest and Taxation)

$$\text{Hence Net profit margin} = \frac{\text{net profit}}{\text{Turnover}} \times 100\%$$

Return on Capital Employed

$$\text{RoCE} = \frac{\text{Profit (after interest etc.)}}{\text{Capital employed}} \times 100\%$$

This basically addresses the question – would you be better off putting your money in the bank?

Note also the related ratio, Return on Total Assets =

$$\frac{\text{Profit before interest and taxation)}}{\text{Total assets}}$$

This is regarded as a measure of operational performance, compared with RoCE, which is more a measure of business performance.

Gearing

$$\text{Gearing} = \frac{\text{Long Term Liabilities}}{\text{Equity Shareholders' Funds}}$$

Gearing is concerned with the relationship between the long terms liabilities that a business has and its capital employed. The idea is that this relationship ought to be in balance, with the shareholders' funds being significantly larger than the long-term liabilities.

Added Value

Note that Added Value is a very useful concept in relation to printing businesses because materials costs are often a high proportion of turnover and focusing on the latter can therefore be very misleading. Definitions of Added Value vary, but this does not matter as long as an agreed definition is used within a given company. A typical definition is:

Added value = Sales value – (all external expenditure directly attributable to a job)

Thus, typical external expenditure would be the sum of paper costs, ink cost, raw material, outwork cost, and delivery cost. Added value is therefore a direct measure of the "wealth" created and retained by the company in connection with a given job. It is not influenced by arbitrary decisions about allocation/distribution of overheads.

For a typical general print company, Added Value is usually 40-60% of sales. From a company's annual budget it is relatively straightforward to calculate what the minimum added value as a percentage of sales has to be. If a job is accepted with a % Added Value less than this, the company will effectively lose money on the job. Typically this figure is about 30%.

A related and very useful concept is AV/hour or AV/Direct Wages. These are measures of productivity. Minimum acceptable values and target values can be determined from the budget. These provide another very effective way of considering the pricing of a job.

For those companies who do not have a Management information system using simple data collection sheets is an effective and quick way to collect the key data required to monitor the business.

Finance Data Collection Sheet

Finance Monthly Analysis Trends			
Measure	**Incidents**	**Trend**	**Target**
Monthly turnover	€86,000	▲	90,000
Debtor days	86	▼	80
Turnover top 10 customers	66,000	▶	70,000
Added Value top 10 customers	50%	▼	55%
Work in Progress	24,000	▼	
Most profitable job type	16pp brochure	16pp brochure	