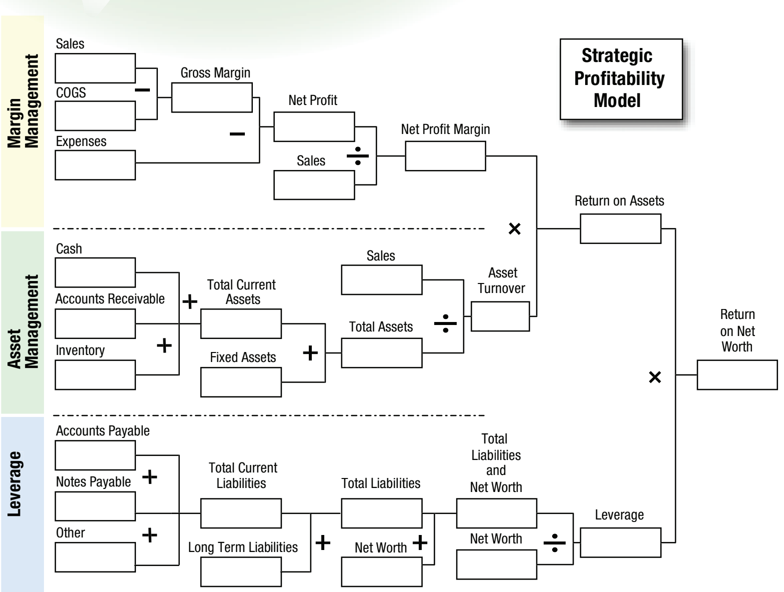
Financial Sustainability in Turbulent Times

By Jennifer H. Dennis

Sustainability is not just about providing lower inputs for plant material; it also involves decreasing inefficiencies in a business. Financial records are important throughout the life of a business and are an area that deserves focus, especially during an economic downturn. Understanding key financial numbers helps to determine where the business could improve and is another way of becoming more efficient.

Most greenhouse owners are good at the technical aspects of the business, such as production of plant material, and have the energy, drive, passion and talent for it. But these same managers may not spend much time managing the financial side of the business, especially when faced with unfamiliar ideas and concepts.



The success of any business venture requires attention to forecasts and results, as well as clever leadership to manage available resources. The strategic profitability model is one financial tool that can help manage these resources.

As a business manager, you should use financial statements in conjunction with other tools such as your company's marketing plan. Don't consider financial statements as the sole indicator of your success or failure! Although the balance sheet, income statement and cash flow statement are the most frequently used financial tools, we will discuss in this article how the strategic profitability model helps to increase sustainability.

The Strategic Profitability Model

Managers who examine financial records to determine profitability can use the Strategic Profitability Model, also known as the DuPont Model, to relate financial ratios to everyday aspects of the business.

The SPM illustrates how a business earns money (margin management), turns money (asset management) and to what extent they leverage or borrow money. The ratios are generated from information provided on the income statement (IS) and balance sheet (BS). Because the information is presented in a model format, the ratios help the manager understand the entire business by illustrating how the functions are related. The margin management section focuses on sales, with key numbers showing net profit and the net profit margin generated from sales, expenses, and cost of goods sold (COGS), which are provided by the income statement. This area of the model shows whether sufficient sales are generated.

Asset management examines sales and total assets to show the correlation between assets and revenue generation. This is similar to understanding how well inventory and equipment are used to generate sales or a measure of a company's efficiency in using its assets. The major ratio for this section is asset turnover (AT), which indicates how many times per year the company turns over every dollar in assets. For example, an AT of 2.5 indicates the company turns its assets into sales 2.5 times a year. Industry benchmarks for the ideal AT (based on firm size and other characteristics) can be used as a comparison with your company's AT. For example, if the industry benchmark is 3.6 and your company has an AT of 2.5, you are turning assets into sales slower than the average company within the industry. This information is helpful in understanding how to become more efficient when buying equipment or inventory and whether the inventory you purchase is relevant to and in demand by the consumer. This information should also help in your marketing plan.

The leverage section shows the ratio of the funds the company manages (from borrowing) to the dollars the owner has invested in the company. Leverage is usually a number equal to or greater than 1. A leverage of 1 indicates the owner has borrowed nothing. Again, industry benchmarks can help you to determine whether your leverage numbers are in line with others.

> It's important to understand how different financial factors affect your business' overall sustainability. The Strategic Profitability Model can help growers understand this with simple ratios that describe how each number relates.

The Big Idea

The margin management, asset management and leverage sections are constructed to determine the return on net worth (RONW) of the company. RONW is the final ratio of the SPM and is the percentage return for every dollar invested in the business or the amount the company makes for every dollar it invests. Using the three sections of the SPM help to pinpoint which section most contributes to the profitability of the business — and where the company should improve.

Using the SPM can help you, as a business manager, understand cash-flow needs based on what is being earned and turned, and evaluate your ability to maintain and grow equity based on the return on net worth ratio or the total percentage generated by the business from assets and leverage.

There are many financial analysis tools available to help you measure progress toward your company's financial goals. Using benchmarks to track industry averages and understanding how financial data are related to your day-to-day business are two ways to decrease financial risk and ensure sustainability. GPN

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