

Helping Clients through Better Benchmarking: *Becoming a Trusted Caddy to Your Business Clients*

By Brad Schaefer, Analyst, Sageworks, Inc.

A professional golfer, John, is approaching the 18th hole in a major PGA tournament. His performance on this hole could be the difference between claiming the trophy or being forgotten. He eagerly looks to his trusted caddy and asks how he is doing compared to the rest of the golfers. The caddy reviews the leaderboard, benchmarks John's score in the rankings, and tells him, "John, you are currently in 3rd place. If you improve your tee shot performance and birdie this hole, you can increase your ranking to 1st and win."

But, what if the caddy didn't have the necessary data to benchmark John's score against his competitors' scores? At best, he could have said, "I think you are doing just fine; you should be somewhere near the top." And John wouldn't have had an actionable plan to become 1st.

Helping your business clients with industry-specific, financial benchmarking is as important as John's caddy helping him when John needed data on his performance. The question, then, is how do you become the indispensable caddy?

To provide real value, you need industry data that is accurate, up to date, and relevant to your client's size and location. Here is a little more about each of these characteristics:

1) Accurate Data

Benchmarking John's performance to his competitors' performance is only meaningful if the scores on the leaderboard are reliable. Benchmarking ratios to inaccurate data provides no real value to the client.

2) Timely Data

The caddy wouldn't benchmark John's current score to his peers' scores from the previous year, or even the previous day. The same goes for your business clients. As most industries shift financially over the period of a year, it is important to compare your client's current performance to the industry's current performance to direct them through challenging financial environments.

3) Relevant Data

Another important characteristic of data is that it is relevant and pertinent. For example, it may seem obvious that John's caddy should be comparing John's performance to the performance of the players in the same tournament as John. It doesn't do John much good to have his score in Florida's sunny and calm tournament benchmarked against scores of amateur players at a windy Pebble Beach course. Think of the climate at the golf course as the geographical location of a business and the golfer's skill level as a company's revenue size. It is critical to compare your clients to other companies in the same geographic location (region or state) as well as in the same revenue bracket. Benchmarking your privately-held client in Florida with \$3 million in sales to a publicly-traded company in California with \$4 billion in sales—though they are in the same industry—doesn't particularly help your client.

According to Brian Hamilton, CEO of Sageworks, here are the most important financial metrics to focus on when looking at industry benchmark data with your business clients:

1) Net Profit Before Taxes Margin

Net profit margin is generally expressed as net profit before taxes in a given financial period divided by sales. Another helpful interpretation is how many cents of profit a business extracts from each dollar it earns in revenue. This is a basic financial metric, but it is the most important.

2) Liquidity Ratios

There are two fundamental liquidity ratios that should be analyzed jointly. Current Ratio is expressed as current assets divided by current liabilities. This metric shows the company's general liquidity, but it has some limitations. For example, by including inventory in the calculation, it may provide a distorted understanding of the company's very short-term cash flow. The second liquidity ratio is the Quick Ratio, which is typically expressed as cash plus accounts receivables divided by current liabilities. Again, the Quick Ratio may not be perfect for gauging liquidity, but it is a useful comparison to pair with the Current Ratio.

3) Turnover Ratios

There are three fundamental turnover ratios to calculate for your clients. Accounts Receivable Turnover, in days, is expressed as accounts receivable divided by sales multiplied by 365 days. It roughly measures the number of days a company takes to turn accounts receivable into cash. Lower numbers are more desirable. The second ratio, Accounts Payable Days, is expressed as accounts payable divided by cost of goods sold multiplied by 365 days. The Accounts Payable Days ratio indicates the number of days a company takes to pay its vendors. The third turnover ratio, Inventory Days ratio, is expressed as inventory divided by COGS multiplied by 365 days. The Inventory Days ratio measures the number of days it takes to sell inventory. Again, lower numbers are more desirable.

John's caddy helped him improve his game and increase his ranking by benchmarking John's performance to quality golf data. Clearly, John is made better by having the caddy as a trusted advisor, but the caddy benefits too as John wins more competitions and earns larger winnings. In the same manner, benchmarking your clients' performance to quality industry data and providing valuable recommendations for improvement will help your clients succeed. But, just like John's caddy, you will also benefit from their increased success as you continue to advise your clients while they grow.

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