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SME Decision support: Faster and more relevant

SME business decisions must be made quickly, and without being sure of everything. A finance team must help management know what uncertainties are worth focus, and what the likely range of financial outcomes is: bringing simple 'what-if' modelling to SMEs. This article has ideas for improving decisions with tools already available. It covers a strong process for SME decision making, and uses a simple Excel model to highlight key points. The Excel spreadsheet is freely downloadable.

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SMEs are different

Most ideas about better decision support come from the world of large companies. SMEs owners and managers are different.

- they are more likely to be genuine entrepreneurs rather than professional managers,

- they have deep expertise in their market

- they are more likely to be owners or part-owners

- they are more likely to be involved in the execution of the decision

- they and are much more inclined to fast decision making, as are their customers

What finance brings to decision making

GrowthPath believes the existing Finance team, be it only a handful of people, can provide much better support without significant

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investment in new systems or people. Your existing finance team is a great resource just waiting to be used more effectively.

Here is a list of strong points true of nearly all finance teams.

- **Finance people like numbers and estimates**: ultimately, finance sees a business as cash flows. Converting ideas and plans into numbers requires estimates and assumptions.

- **Timing counts**: finance people are drilled in the time value of money concept: expecting an income of $100,000 is not enough information: when is it coming? Finance will ask what investment is needed now to get benefits later, and finance knows that you can only spend a dollar once, so spend it well.

- **Sensitivity analysis**: Converting ideas and plans into numbers is very powerful, but it only works because it takes the complex real world and simplifies. Simplicity has dangers. For example, a business plan may make a simple assumption about gross margin development over three years. In reality, gross margin will depend on product mix and customer mix. A good finance person doesn't fix this by adding complexity back into the model. Instead, they model a range of gross margin values to see what effect inaccuracy in the assumption has. This is "sensitivity analysis". It's a key tool: a decision about how much to bid for a tender may crucially depend on inflation assumptions as well as gross margin assumptions. We can use sensitivity analysis to show how different inflation outcomes affect tender profit. The model can't tell us what inflation will be, but it shows what are the most important unknowns or uncertainties to master for confident decision making.

- **Risk**: Finance people look for risks and opportunities, and how to measure them. When finance builds models it finds key drivers of the outcome. This forces finance to focus on the important risks and opportunities. Another tradition of finance is business control, which means processes to

eliminate certain types of risk, and an audit mentality, where proof ifs required. Combined, it means that finance people will probe and prioritise uncertainties. This leads to a systematic investigation and ranking of upside and downside risks.

- **Truly understanding relevant consequences**: Cash flow analysis is about "relevant cost", which can be a difficult concept. An experienced business leader once complained about a staff member who wanted to replace traditional light bulbs with energy savers. The MD wanted to wait until the existing light bulbs burnt out; throwing them away seemed wasteful. Relevant cost analysis shows us that this is wrong. Delaying the use of the energy savers is a poor decision because they save money as soon as they are installed. The old light bulbs have already been bought; keeping them in use saves nothing; rather, it costs. The discipline of relevant costs forces a focus on what the real decision is, and what the real consequences are.

The process is vital

The process that a finance team uses to arrive at a recommendation is vital ... if the process is collaborative. The process involves smart questions and a focus on what really matters.

However, the integrity of the process depends entirely on delivering and standing behind the conclusion, so the outcome is not simply a by-product of the process.

A strong financially-oriented decision-making process will involve all members of the management team, leading to agreements on timing, key assumptions, the true decision being faced and what is needed to make the project happen and stay on track. Even before the numbers are crunched, the analytical and focused approach of Finance will have already contributed enormously.

Most literature about management accounting comes from the world of large companies. How are SMEs different? The differences

are that SME managers are less likely to have MBAs, are more likely to be genuine entrepreneurs rather than professional managers, have more expertise in their market, are more likely to have skin in the game, are more likely to be involved in the execution of the decision, and are much more inclined to fast decision making.

An example

I'm not going to produce an example which goes through all the points above; that would be overwhelming. Instead, I want to give a simple practical example of how finance techniques can be used to support an SME management team. The biggest challenge is keeping things clear, to use decision support tools to keep focus on important points, and to get involvement and buy-in to the financial decision making process.

I'll show a model with is simple and easy to use, encouraging participation and ownership. I've chosen a generic example; it's an EBIT model designed to show a few key drivers of the business result, and come to a break-even sales level. This model should leave the management team very clear about what type of fixed cost level the business can support.

The model concentrates on a few key drivers. The spreadsheet can be downloaded here (Excel 2007): **http://tinyurl.com/excelModel1**

Such simple models can be used often, so they're worth getting good at. Simple models are perhaps not very technically satisfying (I learn programming languages as a hobby and I'm strong at maths, so I enjoy technical challenge, but I try not to inflict it on my colleagues). Simple models are satisfying because they help other members of your management team quickly move to a deeper understanding of where they should be focusing, and how the management team should be co-ordinating efforts. Focus and co-ordination are great outcomes of a process.

A useful model for non-financial people should allow the user to understand how one or two key drivers affects the business. Then

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it should lead to what-if questions. It should do this in five minutes. You know you have the model right when people start joining dots like never before, when they're having fun using the model and when they use it after you've left the room

Here are some tips, most of which ensure simplicity because this is the best way to get ownership and involvement (as Captain Barbossa said in Pirates of the Caribbean, these are more guidelines than actual rules).

1. One screen and printable

2. Use spinners, avoid keyboard entry of numbers and use Excel protection to avoid accidental breakage of formulas.

3. Provide tips about sensible ranges of inputs

4. Make the model tactical, not strategic, short term focus not long term focus. Long term models are too exposed to assumptions. Make the inputs things which can be influenced, or which are likely to change.

5. Make the model narrow in focus: it's a simple model, focus on one thing.

6. Don't make it too much of black box: help the user with "signposts". If you base your model on monthly figures, show the annualised value of certain key lines to help the user do reality checks. Show interim formula calculations

7. Use consistent terms and link the terms back to other reporting. Don't say "wage bill" if your P&L says "Employment costs". Don't say "margin" when you mean "gross margin".

8. SME managers may not have MBAs, but they are good at numbers. Think hard before presenting answers as charts instead of numbers.

If a model looks like becoming something with a lifetime beyond a few weeks, congratulations. Keep what you have achieved; probably the only thing you need to add is a way to store and retrieve scenarios (with a few simple macros).

Illustrated example

The best way to view this is to download the attachment. You can download it here: **http://tinyurl.com/excelModel1**

This simple model shows a few important points. This is not a lesson in spreadsheets, but a lesson in how to make simple, engaging models that focus minds on a few key drivers and how they impact results.

This model was designed to allow management team members to quickly understand how gross margin, variable costs, fixed costs and sales lead to an operational result, and then to understand what level of fixed costs would be appropriate.
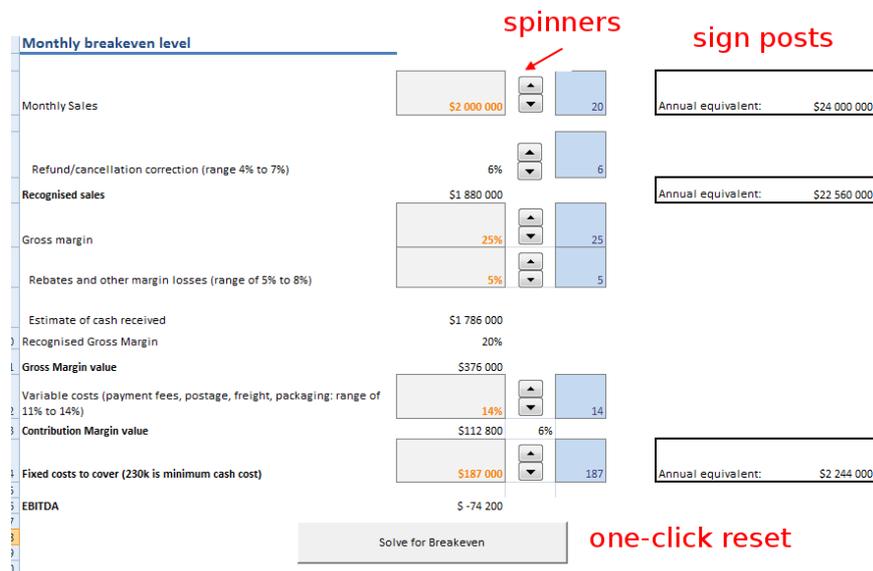
An example

This model is based on a real example, and it was highly effective. It may seem too simple, but this model kept discussions extremely focused on what really mattered. A key insight was the equivalence of fixed cost reductions to sales. If the contribution margin is 15%, then $1 of fixed cost reduction has the same EBITDA benefit as increasing sales by around $7. While this is simple arithmetic, the model made it concrete and real; it was an unforgettable insight.

The spinner controls (the up/down arrows) link to values in the blue cells. In Excel, the spinner controls can't drive negative values and they can only drive integers. So the percentage values are the integer divided by 100. To get negative percentages, you would make the value of 50 = 0 so that the percentage value = (the linked cell - 50) / 100.

Spinners seem to really encourage playing with different values.

This model is based on monthly figures because the idea was to take a short term focus. However, signposts to annual figures are shown, because the annualised numbers are very familiar.

A macro to reset the model to break-even sales is linked to a button at the bottom of the model. Having a reset is important if you want people to feel comfortable playing with values. The

model has notes suggesting reasonable ranges for the key drivers.

The temptation is to make the model more sophisticated. Questions will arise: for example, "what if the sales stay constant but channel X increases to 50% of total sales" or "what about exchange rate effects". You can ask questions all day. However, are they points which can be influenced? Are they important? And do they bear on the decision being faced? In this case, the decision was about fixed cost levels.

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