CPA Practice Advisor

against the competition, but it's difficult for accountants to find quality data on comparable, private companies.

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Business owners are often interested in learning how their company performs as compared to their competition; unfortunately it can be difficult to find reliable data from private company competitors. CPAs who are able to effectively provide this service can be invaluable resource for their clients, which is a valuable asset when trying to transition from quarterly CPA to trusted business advisor. When providing this kind of analysis, it is important to seek out data with the following

strengths and weaknesses. Data sources, definitions, sample size, and boundaries tend to vary. It is therefore important to be mindful of data being as accurate as possible in order to avoid apples-to-oranges comparisons.

- **Timeliness:** Unfortunately financial data isn't always published in real-time; however, businesses oftentimes must makes quick decisions in response to rapidly changing industry trends. When available, make sure that your benchmark data is from the same year as the company data. Otherwise the resulting analysis has the potential to be ineffective or altogether misleading.

Prioritizing Benchmarks

After ensuring that your data is relevant, accurate, and current the question turns to which metrics deserve analysis and can be used to identify business strengths and weaknesses. This can be deceptively difficult, as different companies and industries will have their own unique metrics for measuring successes and shortcomings. While industry-specific performance indicators can provide highly specialized information, the following financial metrics are almost universally important to businesses and should allow you to give your client a high-level snapshot of their company's comparative performance.

Net Profit Margin

One of the most basic and fundamentally important financial metrics, net profit margin, measures how many cents of profit a business earns from each dollar it generates in revenue. Although raw financial data or the formula used by the data source are not always available, seek out these metrics and use them whenever possible to validate that they are consistent with the company's calculations. Verification is especially important for this metric, as other firms may make their own adjustments to assist in their analyses. For example, at Sageworks, net profit margin is adjusted to exclude taxes and include owner compensation in excess of their market-rate salaries — adjustments commonly made to private company

This problem is resolved by examining the Quick Ratio – cash plus accounts receivables divided by current liabilities – which provides a shorter term view of the cash situation.

Turnover Ratios

There are three fundamental turnover ratios to calculate:

- Accounts Receivable (AR) Days (accounts receivable divided by sales, multiplied by 365 days) can help your client see roughly the number of days a company takes to turn accounts receivable into cash. Help your client understand that lower numbers are more desirable, since it is better to have cash in the bank than extra receivables on the books.
- Accounts Payable (AP) Days (accounts payable divided by cost of goods sold, multiplied by 365 days) helps clients assess how quickly they are paying their own vendors. Here, higher numbers are better because it means the company is able to hold onto cash longer.
- Inventory Days (inventory divided by cost of goods sold, multiplied by 365 days) measures the number of days it takes to sell off inventory, but it is very specific to the industry. Imagine how long wine is stored at a winery compared to how long eggs are on grocery stores shelves. The key takeaway for clients is that generally, lower numbers are better.

Benchmarking Mistakes To Avoid

Benchmarking is an incredibly useful tool, but there are a few easy-to-make mistakes that can lead your analysis astray. Be aware of the following pitfalls of successful benchmarking to ensure that you don't fall for these commonly seen mistakes:

Comparing Company A to Company B is something that we see all the time. Comparison to a similar group can be useful so long as the group is relevant to the industry, but when analysis becomes focused on specific business to business

Finally, it is important to remember that a benchmark report is not the conclusion of your analysis, but rather the beginning. Once you have created a report that can clearly display these metrics as compared to the industry at large, you can begin to create a plan of action. Try to frame problematic areas as opportunities to improve the business, and point out in which areas the business is really excelling. Encourage the client to take pride in their strengths, and work with them to try to replicate the winning strategy in other areas of the company.

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