



## How to Determine if a Company is Profitable or Not

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The main reason most Los Angeles and Southern California business owners and entrepreneurs launch their companies is to earn a profit. Given this, it's surprising how many of these owners and entrepreneurs do not know how to accurately determine whether or not their businesses are profitable.

You might be working with one or more clients that fit this description — owners and entrepreneurs who realize the importance of profitability, but do not have the financial knowledge and expertise, or the right accounting systems in place, to accurately gauge profitability. Not having a good handle on profitability can lead to a number of different problems for these clients, including poor decisions, greater inefficiency, lost money, under-utilization of accounting systems, and the continuation of pre-existing management biases.

These problems, in turn, can result in companies simply maintaining the status quo, instead of going outside the box in search of new ways of doing things differently, both financially and operationally. And this can lead to stagnation and a lack of growth.

### Four Causes of Inaccurate Profitability Calculations

The main causes of companies not being able to accurately gauge profitability include:

- 1. Inadequate and/or outdated accounting systems** — Sometimes, small and mid-sized businesses take the “if it aint broke, don't fix it” mindset toward their accounting systems. If the systems are working fine, they reason, then why spend the money and manpower required to replace or upgrade them? The problem with this thinking is that while accounting systems might seem to be working well, in reality they are not providing the information a growing company needs to accurately determine its true level of profitability.
- 2. Poor or improper accounting practices** — This is another example of companies under-investing in their accounting and finance function. Accounting practices that were fine when the company was smaller may no longer be adequate once the company has grown to a certain level. However, the company has failed to update its practices and to provide more advanced training for finance and accounting employees.
- 3. Inability to properly use accounting data** — Undertrained finance and accounting employees will be unable to take the numbers and data generated by the accounting systems and apply them properly to determine what is truly happening from an operational perspective. The accounting records can tell the wrong story, which makes it difficult, if not impossible, to accurately gauge company profitability.
- 4. Inherent management biases** — Inherent biases exist in most companies when it comes to determining optimum spending and staffing levels. These biases tend to be reinforced when the accounting system is not providing accurate information, leading to faulty profitability calculations.

## How An Outsourced CFO Can Help

One solution to this problem is for your clients to hire an outsourced CFO services provider to help them improve their profitability calculations. Such a services provider will possess a depth of understanding of accounting and finance principles and guidelines that most bookkeepers simply do not have. The potential benefits to your clients of hiring an outsourced CFO to help in this area include:

**Enhanced reporting accuracy** — This will make it harder for “sacred cows” to flourish in the business. Instead, management decisions will be made based on data, not on inaccurate assumptions or simply maintaining the status quo.

**More transparency** — The deeper level of accounting and financial expertise brought by an outsourced CFO will result in more financial transparency. This, in turn, will lead to a better understanding of cost structures, which is the key to accurately determining profitability.

**Improved operational performance** — The outsourced CFO will work directly with your client company’s CEO and top management to ensure that the accounting records properly capture and reflect all financial transactions. In addition, he or she will help ensure that financial reporting is used as an integral tool in improving the company’s operational performance.

**Improved management understanding and decision making** — With more accurate, transparent and clear financial reporting, management will have a better understanding of current business conditions — and thus be able to make better, more data-driven decisions focused on boosting profitability.

Finally, creating a value-added financial and accounting team headed by an outsourced CFO services provider will help your clients identify areas where financial and operational opportunities exist. As the management team becomes more data driven, both internal and external biases driven by inaccurate and/or irrelevant data will slowly be eliminated, boosting operational performance and overall profitability.

## Concluding Thoughts

Given the importance of profitability, it’s surprising how many business owners and entrepreneurs don’t know how to accurately determine whether or not their companies are profitable. Not having a good handle on profitability can lead to a number of different problems for businesses, including stagnation. If you are working with clients that are dealing with this problem, you might suggest that they consider hiring an outsourced CFO services provider to help them improve their profitability calculations. Doing so may help your clients boost operational performance and overall profitability.

## About CFO Edge

CFO Edge, LLC delivers enterprise-class financial and operational performance solutions to executives throughout Southern California. Based in Los Angeles, our formerly-seated chief financial officers engage on demand as part-time CFOs, single-project CFOs, and interim CFOs to help business leaders successfully resolve pressing challenges and realize their financial and operational goals. At CFO Edge, we are passionate about helping our clients create, grow and sustain value. For more information, visit [www.cfoedge.com](http://www.cfoedge.com) or call 800.276.1750 Ext 101.

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