# Business Financial Health Pays Off: Maximizing ROI through Improved Financial Health and Team Efficiency

## Executive Summary

CEOs and their leadership teams must improve the financial health of their organization to meet stakeholder objectives, providing a return on investment (ROI) in both the short and long term. The CEO accountability for and recognition of organizational financial health is a balancing act that has existed for thousands of years. Consider that pharaohs in ancient Egypt managed to control funding, taxation and production for 3,000 years through a structured approach to financial management and resource allocation. A business leader's role is to try and replicate that longevity for their business.

My purpose here is to explore the strong business investment rationale for continually improving financial health using two methods:

1. Generate a highly efficient finance and accounting function; and
2. Foster an organizational finance system that CEO's buy in to.

The return on investment made possible by the impacts of increasing business financial health is significant, which I identify in my supporting calculations. CEO's, stakeholders and leadership teams should be attracted to increasing the financial health of their business for improving profitability, liquidity, solvency, growth potential and operations efficiency.

The finance and accounting team, in particular, is often perceived by stakeholders as a necessary cost that contributes little to profit; one that is viewed with uncertainty to its performance and value-added impact on the business overall. One key reason is that many business founders navigated their own finance approaches without significant experience in the finance field, often experts in the sales or operational functions of their business, and as a result have created low-efficiency finance functions with stagnant performance and low value to the business.

I believe that healthy finance and accounting systems create value beyond their cost and may return short-term ROI from incremental improvements ranging from **57% to 106% annually** when led properly and supported by the full leadership of an organization from the bottom to the top.

# Introduction

**Overview of financial health in business**

This paper doesn't seek to prove the relevance and importance of financial health in business because it's been done many times by others. In short, a business can't achieve its potential without financial health.

I agree with a commonly held perspective that t*he health of a business relies on each of the functions being healthy*; and indeed the CEO and leadership roles include ensuring that happens.

For example, If the sales function is healthy and operations are healthy but finance is not healthy…the business might employ terrible pricing, or have a margin tower that erodes profit, or not be liquid enough to facilitate growth, or many other detrimental faults. However, the finance function is often the least cared-for, because most leadership groups under-value it and aren't experts in it. As a result, the financial return from improving it is greater than in any of the other key business functions.

I will measure that financial return derived from improving overall business financial health and team efficiency.

**Overview of finance team efficiency**

Team efficiency for my objective refers to the performance of people, processes, tools and vision employed by the Finance and Accounting function in an organization. It also considers the team's relationship with senior leaders, other key business functions, boards, investors and other stakeholders. Depending on the size of the organization, the finance team size will vary.

My focus is on small business finance and accounting teams, where the function has not yet developed from an owner-operator mentality to an entrepreneurial state.

## Section 1: Understanding Business Financial Health

Business financial health refers to the well-being of an organization's finances. When measured and assessed, it often includes a group of related and interdependent segments including liquidity, solvency, profitability, operational efficiency, growth potential and cash flow management. Let's look briefly at those.

**Liquidity**: This refers to a company's ability to meet its short-term obligations using its most liquid assets. It measures how quickly a company can convert its assets into cash to pay off its immediate liabilities.

*Healthy is: enough cash to make required payments.*

**Solvency**: Solvency is the ability of a company to meet its long-term debts and financial obligations. It indicates whether a company can sustain its operations and grow over the long term by managing its debt effectively.

*Healthy is: sustainable growth long-term.*

**Profitability**: Profitability is the ability of a business to generate more income than it expends in its operations. It is a key indicator of financial health, showing how well a company can convert its resources into profit.

*Healthy is: enough profit from operations to provide stakeholder value.*

**Operational Efficiency**: This measures how well a company uses its resources to produce goods and services. High operational efficiency means the company is maximizing output while minimizing costs, leading to better financial performance.

*Healthy is: well-balanced performance and resource allocation.*

**Growth Potential**: Growth potential refers to the capacity of a business to expand and increase its market share, revenue, and profitability over time. It involves assessing market opportunities, resource availability, and the ability to adapt to changing circumstances.

*Healthy is: high capacity for growth.*

**Cash Flow Management**: This involves monitoring, analyzing, and optimizing the net amount of cash receipts minus cash expenses. Effective cash flow management ensures that a company has enough liquidity to meet its obligations and invest in growth opportunities.

*Healthy is: predictable and sufficient cash flow.*

One key challenge facing business leaders is understanding each of these components of health, aligning them with organizational strategy and then communicating the status now and against future scenarios. This is the responsibility of the Chief Financial Officer (CFO) in many instances. Even if a business doesn't have a designated CFO, someone is inherently filling that role and is accountable to the business for addressing the challenge.

## Section 2: The Role of Team Efficiency in Financial Health

Team efficiency plays a crucial role in business financial health by directly impacting productivity, cost management, and overall performance along with the key finance components described above. Here are some key areas about the impact of team efficiency to clarify my subject:

**Increased Productivity**: Efficient teams can accomplish more in less time, leading to higher output and better use of resources. This boosts the company's ability to generate revenue and meet market demands.

*Efficient is: increasing output relative to the cost of resources.*

**Cost Management**: When teams work efficiently, they minimize waste and reduce operational costs. This includes optimizing workflows, reducing errors, and avoiding unnecessary expenses.

*Efficient is: low error rate, low redundancy, high value from resources.*

**Enhanced Collaboration**: Efficient teams communicate easily and collaborate effectively. This leads to improved organizational predictability, sound decision-making, improved problem-solving, and fosters both collective and individual innovation.

*Efficient is: highly performing cross-functional people and processes.*

**Employee Morale and Retention**: High team efficiency often correlates with higher job satisfaction and morale, especially among employees who share the drive to perform individually and as a group. Engaged employees are more likely to stay with the organization, reducing turnover costs and increasing growth potential.

*Efficient is: great people doing great things for longer tenure.*

**Adaptability and Resilience**: Efficient teams are better equipped to handle changes and challenges. Their ability to adapt both quickly and appropriately to new situations ensures that the business remains resilient, sustainable and high-performing.

*Efficient is: successful adaptation at a low frequency of failure.*

Without employing a measurement of efficiency, which happens often in business, CEOs and other senior leaders often describe their beliefs about the team by how they "feel". A leadership gut-instinct has value depending on their experience level, but is prone to error and emotional response.

The table below highlights my assessed range of efficiencies (low, average, high) along with what the organizational leadership is experiencing from its people, processes, tools and vision.

| | Efficiency Measure | People | Processes | Tools | Vision |
|---|---|---|---|---|---|
| **Low** | < 60% | Wasting time, redundancy, high error rates | Inconsistent with high variability | Unsophisticated and stand-alone or missing | Don't get it, or not available |
| **Average** | 60-80% | Increasing accuracy, some errors, reliant on others for data | Still manual but gaining consistency | Developing but still stand-alone | See glimpses |
| **High** | > 80% | High functioning, low error rates, quick to action | Highly automated, quick turnaround, integrated | Highly developed, strong integration | Easy to see, shared by all |

The gap in performance from low to high efficiencies is significant. Strong business leaders will recognize naturally that low team efficiency also corresponds with low financial health. A business cannot be financially healthy without high team efficiency. This is a core assumption in the return on investment calculation below.

## Section 3: Impact of Improving Financial Health

The specific impact from improving financial health and team efficiency will vary between organizations. Here are 15 example areas of a business that can be positively impacted by increasing financial health, along with the potential impact on profit margin as a result:

**Interest Expenses:** Lower interest rates due to better creditworthiness can reduce interest expenses, directly improving profit margin.

**Supplier Terms:** More favorable payment terms with suppliers, reducing costs.

**Operational Efficiency:** Investments in technology and processes that enhance operational efficiency.

**Employee Morale and Productivity:** Financial stability can improve employee morale, leading to higher productivity and lower turnover costs.

**Marketing and Sales:** More effective marketing and sales strategies, potentially increasing revenue.

**Inventory Management:** More efficient inventory management, reducing holding costs and waste.

**Research and Development:** Fund R&D, leading to innovation and competitive advantage.

**Customer Credit Terms:** More flexible credit terms for customers, potentially increasing sales.

**Risk Management:** Improve risk management practices, reducing unexpected costs.

**Expansion Opportunities:** Enable strategic expansions, increasing market share and revenue.

**Supplier Relationships:** Improve relationships with suppliers, leading to better pricing and terms.

**Debt Management:** Better debt management, reducing interest and principal payments.

**Capital Expenditures:** Strategic capital expenditures that can improve efficiency and productivity.

**Cost of Sales:** Bulk purchasing and better pricing, reducing costs.

**Legal and Compliance Costs:** Better compliance and lower legal costs.

While each business area identified on its own may only experience a small impact from improving financial health, which is how I've designed my model, in aggregate the impact becomes significant.This list is certainly not exhaustive, nor does each item apply to each business. My hope is that you see how the impact crosses each of the business functions to generate a holistic improvement.

## Section 4: Measuring ROI from Improved Financial Health and Team Efficiency

My method for evaluating ROI considered two end measures, *net profit and business valuation*. I built a sample income statement from a business running at low financial health, and made incremental increases or decreases to the revenue and expense components as the business moved toward high financial health using the impact areas listed above.

**Net profit:** I chose net profit as the primary measure because it is readily available to compare with actual financial results and is relatively consistently reported across industries under generally accepted accounting principles. In addition, it remains a key measure for most stakeholders globally.

I calculated the incremental net profit gain resulting from an increase in financial health areas and the net profit loss from the cost to implement those improvements (including additional technology, professional and R&D costs).

The result here displays the increase to net profit compared to the investment (fully recovered in net profit) to highlight the ROI at each increment, ranging from 57% to 106% ROI in this model.

| | FINANCIAL HEALTH LEVELS | | | |
|---|---|---|---|---|
| | Low | Average | High | Very High |
| **Net Profit Change** | NA | 159,871 | 176,279 | 209,642 |
| **Investment** | NA | 277,594 | 234,955 | 196,992 |
| **Return on Investment** | NA | 57.59% | 75.03% | 106.42% |

A key reason for the increasing ROI as financial health increases is primarily due to economies of scale achieved because of the existing improvements already made. For example, when I considered "expansion opportunities" I recognized that greater overall expansion opportunities will be available in a Very High financial health environment relative to those available at only an Average health level because of the increased capacity to find and choose those opportunities. My experience in business supports this approach.

**Valuation:** The secondary measure I considered is the overall value of the business that changes as a result of measured financial health. I used a very simplistic method to calculate value based on net profit with no change in the weighted average cost of capital (although you could argue it would change). I also increased the expected growth rate achieved by greater financial health assuming that a business will experience a higher growth rate when it performs well. The result is an additional ROI, although likely not experienced until some form of M&A activity, share issuance, or other equity transaction.

| | FINANCIAL HEALTH LEVELS | | | |
|---|---|---|---|---|
| | Low | Average | High | Very High |
| **Valuation Change** | NA | 1,812,012 | 2,262,950 | 3,048,641 |
| **Growth rate** | 2.00% | 2.50% | 3.00% | 3.50% |
| **% increase** | NA | 65.14% | 49.26% | 44.46% |

Many assumptions go into a business valuation, along with other methodologies and considerations for non-quantifiable variables, and so this calculation was only done to highlight how increasing financial health improves net profit first and then has a correlating impact on the anticipated value to investors. The incremental results from 44% to 65% are very favorable to the investors.

## Section 5: Common Barriers to Improving Financial Health

In my experience, one of the most common barriers to improving organizational financial health is the lack of expertise at the leadership level. Many businesses begin with an undeveloped financial IQ and create habits and culture that displaces or undervalues financial health components. Without expertise, the team may not be aware of how increasing financial health not only helps the organization overall, but also enables them to perform better in their individual capacities.

*Break the barrier: include finance and accounting expertise on the leadership team.*

Another common barrier is the absence of a full financial health picture when setting key strategic initiatives. A role of the business' financial leader is to create a communication environment where leadership considers liquidity, solvency, profitability, operational efficiency, growth potential and cash flow management in an active and high-trust environment for the greater good of the company.

*Break the barrier: commit the leadership team to seeing the full financial picture*

A third barrier shows up as a lack of a highly integrated system (processes, tools, activities and culture of innovation and performance) in the finance and accounting team itself. Creating that high integration takes scarce resources (time, effort, money) from other areas of the business during its development. This team must own the ways it is adding more overall benefit than cost, often facilitated by the financial leader's performance both up and down the chain of accountability.

*Break the barrier: intentionally develop the finance and accounting "system"*

In my experience, when a business is unable to break these barriers it often shows symptoms of a large-scale unwillingness to drop old habits, remove ego and emotion from business leadership and to commit to open and growth-oriented thinking at some or all stakeholder levels.

## Conclusion

Maximizing the financial health of the organization is a prudent and required action for any leadership team; the business stakeholders should demand it. A business can improve its financial health by increasing finance and accounting team efficiency as well as by narrowing the gap in communication, reporting and financial results.

Investing in the areas I've highlighted is a great starting place for any leadership team, but most importantly for those who are entrepreneurial and accountable to perform. This will generate a return on this investment that pays for itself and adds to the business net profit while creating a long-lasting, sustainably healthy business to rival the pharaohs of old.

# Appendix 1: Income Statement Under Incremental Financial Health

Simplified income statement under each incremental set of assumptions.

| | FINANCIAL HEALTH LEVELS | | | |
|---|---|---|---|---|
| | Low | Average | High | Very High |
| **Sales** | | | | |
| Revenue stream | 5,000,000 | 5,287,500 | 5,594,175 | 6,061,289 |
| Total | 5,000,000 | 5,287,500 | 5,594,175 | 6,061,289 |
| **Cost of Sales** | | | | |
| Costs | 3,900,000 | 3,912,750 | 3,921,517 | 4,006,512 |
| Total | 3,900,000 | 3,912,750 | 3,921,517 | 4,006,512 |
| **Gross Margin** | 1,100,000 | 1,374,750 | 1,672,658 | 2,054,777 |
| % | 22.00% | 26.00% | 29.90% | 33.90% |
| **SG&A** | | | | |
| Existing | 800,000 | 904,163 | 1,006,952 | 1,145,584 |
| Total | 800,000 | 904,163 | 1,006,952 | 1,145,584 |
| **EBITDA** | 300,000 | 470,588 | 665,707 | 909,193 |
| % | 6.00% | 8.90% | 11.90% | 15.00% |
| Depreciation | 100,000 | 79,313 | 61,536 | 48,490 |
| **EBIT** | 200,000 | 391,275 | 604,171 | 860,703 |
| Interest | 150,000 | 133,650 | 117,612 | 101,881 |
| **EBT** | 50,000 | 257,625 | 486,559 | 758,822 |
| Taxes | 11,500 | 59,254 | 111,909 | 174,529 |
| **Net profit** | **38,500** | **198,371** | **374,650** | **584,293** |
| % | 0.77% | 3.75% | 6.70% | 9.64% |
| **Valuation** | 2,781,818 | 4,593,830 | 6,856,780 | 9,905,422 |
| WACC | 13.00% | 13.00% | 13.00% | 13.00% |
| Growth rate | 2.00% | 2.50% | 3.00% | 3.50% |

# Appendix 2: Income Statement Incremental Impact Drivers

A positive % indicates an improvement in each area (positive impact), while a negative % indicates a decline or cost.

| | FINANCIAL HEALTH LEVELS | | | |
|---|---|---|---|---|
| | Low | Average | High | Very High |
| **Revenue** | **5,000,000** | **5,287,500** | **5,594,175** | **6,061,289** |
| Targeted marketing | | 1.00% | 0.80% | 0.60% |
| Better sales price | | 3.00% | 1.50% | 1.00% |
| Better sales terms | | 1.00% | 1.00% | 1.00% |
| Improvement from R&D | | 0.25% | 0.50% | 0.75% |
| Expansion opportunities | | 0.50% | 2.00% | 5.00% |
| Adjusted incremental revenue | | 5.75% | 5.80% | 8.35% |
| | | | | |
| **Interest Expense** | | | | |
| Loan balance | 1,500,000 | 1,485,000 | 1,470,150 | 1,455,449 |
| Interest rate | 10.00% | 9.00% | 8.00% | 7.00% |
| Interest cost | **150,000** | **133,650** | **117,612** | **101,881** |
| | | | | |
| **Cost of Sales** | **78%** | **74%** | **70%** | **66%** |
| Pricing and terms | | 1.00% | 1.00% | 1.00% |
| Tech new spend | | -1.00% | -0.50% | -0.10% |
| Inventory management | | 0.75% | 0.50% | 0.40% |
| Improved reporting | | 0.50% | 0.25% | 0.15% |
| Error reduction | | 1.25% | 1.15% | 1.05% |
| Operating efficiency | | 1.50% | 1.50% | 1.50% |
| | | 4.00% | 3.90% | 4.00% |
| | | | | |
| **SG&A** | **16%** | **17%** | **18%** | **19%** |
| Pricing and terms | | 0.50% | 0.50% | 0.25% |
| R&D new spend | | -1.00% | -0.75% | -0.50% |
| Tech new spend | | -0.25% | -0.20% | -0.15% |
| New FnA spend | | -3.00% | -2.75% | -2.50% |
| Legal and compliance | | 0.30% | 0.15% | 0.05% |
| Error reduction | | 1.25% | 1.15% | 1.05% |
| Operating efficiency | | 1.10% | 1.00% | 0.90% |
| | | -1.10% | -0.90% | -0.90% |
| | | | | |
| **Depreciation** | **2.0%** | **1.5%** | **1.1%** | **0.8%** |
| Strategic capex | | 0.50% | 0.40% | 0.30% |
| | | 0.50% | 0.40% | 0.30% |

## About the Author

Everett Duerksen is a CPA by profession, entrepreneur, teacher, coach and creator passionate about helping CEOs orchestrate their finance and accounting (F&A) teams and systems. The teams he works with discover clarity, gain confidence and have the opportunity to grow their businesses in a healthy way.

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