



Business Solutions

### Three Bottom Lines Are Better Than One

*Where performance is measured, performance improves. Where performance is measured and reported, the rate of improvement accelerates.*

–Thomas S. Monson

With the recent Fortune 500 accounting scandals and an increased focus on overall economic indicators, company financials have once again taken center stage as the primary focus of the savvy business owner. Terms like performance measurement (PM) are being tossed about boardrooms and executive offices nationwide, in businesses of all sizes. Consultants are brought in. Accountants, once relegated to musty back offices, are now being moved to the top of the agenda at staff meetings.

However, in our desire to focus on the nitty-gritty details of every dollar saved and spent, many of us are missing the big picture. Performance measurement is a valuable tool that, used correctly, directly links activities with outcomes, enabling business owners to make better, more informed decisions. As a business owner, it is a safe bet that you are currently engaging in some form of PM. Most likely, you are paying greater attention to the financial statements presented to you on a weekly, monthly or annual basis. But how do you know that you are being presented with the *whole* picture?

John Madden, during his commentary at a football game, mentioned that the whole nature of statistics in football has changed dramatically over the years. In the early days, he said, we only kept track of the offensive statistics in order to measure the performance of the entire team. It wasn't until we also began looking at the defensive statistics that the whole nature of coaching changed in the game. Many of us are running our businesses this same way – just based on *half* of the information, which creates a lop-sided view of what's really going on in the business.

So how do you get the whole view of the business? The answer lies within a proper interpretation of your company's financial statements. A well-run business has a bottom line for each of the three financial statements; Income Statement, Cash-Flow Statement, and Balance Sheet. Each bottom line has its own advantages and disadvantages. Only by looking at all three collectively with a tool like the Financial Scoreboard\*, can you obtain a complete view of your company's performance.

**Bottom Line #1: Net profit**, derived from the income statement, shows whether your company's sales in any given time span exceed its costs. As a performance measurement, net profit is an excellent bottom line. The business world understands it and it shows whether you're "making money." But net profit also has many drawbacks. If you keep an eye only on net profit, you may be able to keep expenses from exceeding sales, but you won't know how much cash is actually going into your back account. Net profit also is susceptible to various accounting distortions, depending on which accounting methodology is used. It is only one measure of a business's financial performance and should not be considered by itself.

**Bottom Line #2: Operating cash flow (OCF)** is the second bottom line that should be considered and is found on the cash-flow statement. It shows how much net cash is flowing into your company, independent of what you may receive from lenders and investors and independent of what you spend on fixed assets or other investments. Unlike net profit, OCF is based on real

events and not on accounting theory. If your OCF is consistently positive, you know you are generating enough cash from operations to meet your regular obligations. However, OCF is also subject to external manipulation (for example, you can decide to pay your vendors late, temporarily increasing OCF) and also should not be considered alone as an indicator of overall business performance.

**Bottom Line #3: Return on assets (ROA)** is the third bottom line and is calculated by taking your business's net profit and dividing by its average assets. ROA is a great bottom line. Since it encompasses net profit, it helps you evaluate what's really happening when your profit moves in one direction or the other. It also allows a company to compare itself to competitors in the same industry. Profit levels and cash flow can differ widely from one company to another, but ROA is a universal solvent for companies in the same business. However, ROA is also an abstraction and is more complex than the other measures.

The truth is that you need all three of these bottom lines: net profit, OCF and ROA. Without them, you can't see the big picture. Your company can look good in terms of dollar profits but poor when you consider ROA. Your company can have a satisfactory ROA but flat or declining sales. Only with all three bottom lines can you get an accurate assessment of the status of your company.

Whatever the variations, every company needs to make a profit, generate cash and produce sufficient return on investment to be competitive. These three bottom lines give you a powerful tool for evaluating your business's performance. Together, they provide an executive summary and will highlight cause-and-effect relationships. You can now focus on your company's "offense" as well as its "defense," thereby avoiding the lop-sided management to which so many companies fall prey.

Article reference material: [Managing by the Numbers](#) by Chuck Kremer and John Case