BENCHMARKING 101

An Introductory Guide & Case Study

Presented by:

CRR's Client Accounting & Advisory Services Team

Nick Sampson, Manager
Wendy Li, Manager

BENCHMARKING 101

What is Benchmarking?

"Benchmarking" is the process of measuring the products, services, processes, and financial performance of one company against those of similar companies that are known to be leaders in one or more aspects of their operations. Benchmarking provides necessary insights to help you understand your company's position and performance within the industry and even across industries, and further helps you identify specific areas, systems, or processes in which your company can improve.

In this guide, we will discuss in detail the process of benchmarking, as illustrated through an example from the Staffing industry.

Method and Example

CRR works with clients in various industries such as construction, employment services, food service, manufacturing, and so on. Because we have a broad client base and research tools, we are able to compare our clients to others in the same industry, using standard industry benchmarks. This comparison helps clients understand their specific situation, diagnose problem areas, and strategize problem-solving.

For example, we recently chose four staffing companies from clients in the employment services industry. We first compared them to each other by calculating their 2020 KPI/financial metrics, and then we compared them all to the industry benchmark. These four companies were medium size by revenue ($5M-50M).

Key Findings/Results

Comparison can be the thief of joy, but when you are trying to grow your company, comparison with competitors and industry benchmarks can be illuminating and essential. Here are benchmarks analyses that we performed for our client staffing company:

- **Quick Ratio.** This ratio measures a company's ability to meet short-term obligations with liquid assets. The higher the ratio, the better; a number below 1 signals financial distress. The employment service industry benchmark was 1.3. Four companies all performed better than the benchmark with quick ratios between 1.43 and 1.99.

- **Current Ratio.** A ratio between 1.5 and 3 is generally considered healthy. A ratio value lower than 1 may indicate liquidity problems for the company. A ratio over 3 may indicate that the company is not using its current assets efficiently or is not managing its working capital properly. The industry had a ratio 1.57. Four companies had ratios between 1.48 and 2.02, indicating a healthy condition.

- **Current Liabilities to Net Worth.** This benchmark ratio is also called current liabilities to equity, indicating the amount due creditors within a year as a percentage of stockholders' equity in a company. A high ratio (above 80 percent) can indicate trouble. The whole industry had a high benchmark 0.97. Four companies even had higher ratios between 1 and 2.04, indicating their equity couldn't cover their current liabilities due in a year.

- **Days Accounts Receivable or Days sales outstanding (DSO).** This is a measure of the average number of days that it takes a company to collect payment for a sale. The fewer the days, the faster the collection. Four companies all took much longer (between 53 and 83 days) than the benchmark (50 days) to collect sales payment. This is an area they all need to improve.

- **Working Capital Turnover.** This benchmark is also known as working capital to sales, a measure of how efficiently a company uses its capital to generate sales and support growth. The higher, the better. The industry benchmark was 11.9, meaning $1 of working capital produces $11.9 in revenue. Four companies had ratios between 5.83 and 10.85, indicating low efficiency of using short-term assets and liabilities to generate sales.

- **Total Assets to Sales.** This ratio helps to determine the efficiency of a company in managing its assets to generate enough sales. The benchmark ratio is 36.1%. Three companies performed very well and had ratios between 28.43% and 31.49%, but one company had a very high ratio of 45.34%, indicating a low efficiency in asset management.

- **Pre-Tax Return on Sales.** This is also called pretax profit margin, a financial accounting tool used to measure the operating efficiency of a company. It is a ratio that tells us the percentage of sales that has turned into profits before deducting taxes. While the whole industry had a very low ratio 0.8%, four companies surpassed the benchmark and had great performance with ratios between 4.6% and 8.88%.

- **EBITDA to sales ratio.** Also known as EBITDA margin, this is a financial metric used to assess a company's profitability. A higher value indicates that the company is able to produce earnings more efficiently by keeping costs low. Given the industry benchmark 5.5%, three out of four were doing very well with ratios between 7.07% and 9.05%. The company that underperformed still had a ratio 4.95%, almost the industry level.

- **Interest Coverage.** This is a debt and profitability ratio used to determine how easily a company can pay interest on its outstanding debt. The higher the ratio, the better prepared it is to pay its debts. A lower ratio may be unattractive to investors because it may mean the company is not poised for growth. The industry had 2.63 interest coverage. Four companies overperformed with ratios between 10.44 and 89.55.

- **Glassdoor Recommendations/Stars.** This is a free inside look at company reviews and salaries posted anonymously by employees. 5 is the perfect score. One company had a five-star review, while the other three got between 3.7 and 4.8 stars.

With these key findings in place, we can begin to think clearly about how to improve performance.

Solutions

Based on benchmark analysis, we find that all companies had the ability to meet their short-term obligations and utilize their current assets efficiently and properly. Some KPI/metrics indicate red flags in areas that need to improve.

- Current Liabilities to Net Worth. None of the four companies can use equities to pay off current liabilities due in a year with a ratio above 1. This affects the company's ability to borrow, since current liabilities to net worth is a key ratio that banks use to evaluate risk. In order to improve financing ability, companies should try to pay off vendors earlier and generate more profits down the road.

- **Days Accounts Receivable or Days sales outstanding (DSO).** In order to speed up the collection of accounts receivable, companies should consider the following: first, standardize procedures for product or service quotation and order management; second, get electronic invoices out fast; third, outsource collections; fourth, adjust credit terms based on customer history.

- **Working Capital Turnover.** Four companies didn't manage their working capital efficiently to support revenue. Ways to help improve can be: first, shorten operating cycles; second, cut unnecessary expenses; third, reduce bad debt; fourth, generate more revenue; fifth, balance cash reserves against accounts payable.

Our Client Accounting & Advisory Services (CAAS) team is helping businesses of all sizes gain a competitive advantage by focusing on specific practices and operations that are centered around your needs and goals. We offer insight and support to help you make critical business decisions that lead to improved profitability.

MEET THE TEAM

Our Client Acounting & Advisory Services (CAAS) team is lead by Nicholas Sampson and Wendy Li, and supported by multi-level members of our team, from Staff Accountants to Partners. Our CAAS team works with clients in various industries, helping them to understand their specific situation and provide solutions to streamline their accounting processes.

For more information, visit our CAAS page on our website at:
www.crrcpa.com/client-advisory-services.

NICHOLAS SAMPSON

MANAGER
CRR, LLP

direct dial: 781.835.2312
main: 781.279.7788
nick.sampson@crrcpa.com

WENDY LI

MANAGER, CPA, MBA
CRR, LLP

direct dial: 781.835.2314
main: 781.279.7788
wendy.li@crrcpa.com