



## How to Detect and Prevent Profit Leaks in Your Company

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**There are many different situations in every business where a "misuse" of resources may be detected, resulting in leaking profits. *People, culture, decision making and processes are the four most common contributors to the consistent misuse of resources.***

Just keep in mind that a 'misuse' of resources is different than a 'waste' of resources - because the distinction is much more than a language nuance. When resources are misused, it means they are not being managed efficiently or effectively. Wasted resources, though, are frittered away and lost. Water leaking out of a bucket is wasted and lost – but a bucket that is either too big or too small for the amount of water poured into it is being misused. In this situation, the wrong size bucket can be exchanged as needed for one that is more effectively proportioned for the job. The distinction is worth noting as this article will focus on first identifying, and then preventing, the *misuse* of resources.

Whether caused by people, culture, decision making or poor operations and processes, profit leaks can be identified and corrected.

***People*** – When the people involved in decision making have the right tools, they can be expected to make more informed choices. Performance standards that are well known and mandatory, application of consistent measurements and a culture that places a value on productivity can help people do their jobs more efficiently. Training and sharing best practices are also critical components for improving the "people" part of the company's profit leaks program. In other words, expected behaviors need to be clearly spelled out, managed and rewarded. When people are not held accountable for their results or when they do not know what appropriate behavior is, communication needs to be improved quickly for leaks to be detected and reported. People who understand their obligations, and the impact they have on the bottom line, are more likely to step up and contribute to the company's well-being – especially when they are recognized and rewarded. Instead of replicating inefficient processes and procedures, employees who are motivated are more likely to be innovative and thoughtful, willing to try going down a new path rather than sticking to the path of least resistance.



Example: When you are buying dinner at an upscale restaurant, you may be very conscious of the menu selections and the costs. But if you are someone's guest, and the sky is the limit, you may consider ordering an appetizer, dessert and wine with your meal. That is the exact same situation you face when employees do not feel responsible for the company's success, most especially where it involves managing costs. Without an ownership mentality, they most likely say, "It's their money; I can be careless or careful and prudent. They will probably not even notice and they don't seem to care when I am frugal and conservative in an attempt to carefully manage our budget."

To build a culture filled with people who regularly contribute to the company's well-being, the leaders must pay attention to performance metrics, using the data when evaluating and promoting their people. When employees think leaders don't care or notice what they do, it trickles down and impacts their sense of commitment.

***Culture*** – The norms and philosophy of the company greatly impact its efficiencies. Studies indicate that companies that have a poor attitude end up with a culture that causes, or hides, major sources of profit leaks. This happens most often when leaders do not define or reinforce values and employees quickly become disheartened. When morale is low it is usually because priorities are not defined or adhered to, there is talk but no action regarding customer service and employees are not treated fairly.

If the culture discourages employees from feeling valued by not recognizing or rewarding their efforts, they may turn a blind eye to inefficiencies and profit leaks that cause financial losses for the business - even though they clearly recognize them. Their "I don't care" attitude is a symptom of a poorly functioning and mismanaged culture, and the company suffers greatly because of it. Leaders at cutting edge companies are obligated today to create a positive culture if they want employees to have a positive attitude. There are volumes that have been written on how to be a good leader, an inspiring leader, and one who builds a strong corporate culture. The tone starts at the top!

Example: At a local manufacturing company, the CEO rings a bell every time someone in customer service is complimented by a prospect or returning customer. Her goal is to remind everyone how important it is to build strong relationships. The bell is also rung when a new customer comes on board or a returning customer renews a contract. Again, the bell signals how proud the CEO is, and the sales staff and customer service people on the front line see the immediate impact of their initiative and their attitude. In addition, something good always happens when the bell rings.



Employees' efforts are recognized and they are honored for their efforts. To really make a difference, employees need to know their efforts matter and they have to see the impact – as well as the tangible results. While some employees like a gift certificate for lunch or dinner, movie passes or a designated employee of the month parking space. Some are thrilled to have their names added to the "Employee of the Week" list posted in all common areas. The end result is that everyone wins when the culture is nurturing and supportive of the employees' efforts.

**Decision making** – Cost overruns and spiraling expenses can be caused by poor decisions. Wise decisions are educated decisions and require fact-finding and knowledge gathering. This means understanding all the implications when deciding on a purchase, a new hire, a new product line or even expanding the company's footprint – and incorporating lessons learned from past experiences in these areas. Metrics can be applied to every situation – from simple to complex – to assess and measure outcomes, looking beyond the numbers to understand the circumstances around the decision. Using financial analysis can provide key performance indicators, projections and estimates of what is expected to occur as well as offer feedback and wave red flags regarding the reality of the decision once implemented.

Example: The executives at a local auto repair company tired of seeing mounting costs. Since they had never talked to employees, they decided to put the word out and see where the problem was. Once they were alerted to the problem and they were told their help was needed, employees began to be much more aware of how they were using resources all around them. This led to changes in several areas, including the most obvious which ranged from efficient lighting fixtures to keeping the bay door closed when working on cars – thus managing all the utilities more efficiently. It was a simple thing, but keeping their eyes open saved the company thousands of dollars. But if essential conversations do not take place, employees can take the easy way out, making unwise decisions that lead to profit leaks.

When asked how they arrive at critical decisions, many will probably defend themselves with excuses that they "didn't know" there was a problem (and they may not!).

**Processes** - Knowing how effective a process is, and understanding how the process adds value for the company and the customer, are two important characteristics of any profit leaks program. Employees are trained to use a process, that is they follow a sequence of steps necessary to do their jobs and create a product or service, whether that is to conduct an audit, manage a distribution facility or manufacture consumer



goods. But the current process in place may not be the most efficient way of accomplishing the company's goals.

All processes should be reviewed by multiple disciplines across the company with regularity, looking for both efficiencies and redundancies or inconsistencies. All processes need improvement over time, from minor tweaking to major overhauls as business models, technology and cultures evolve. Knowing where bottlenecks or breakdowns frequently occur can help the company be preemptive, leaner and more productive. Employees who are on the front lines are often in the best position to observe inefficient, leaky processes and should be asked for suggestions on ways to improve!

Example: A manufacturer was losing money during production but was struggling with identifying the reason. After reviewing every process, and following the flow of paper around the office, they realized there was an old process in place that had originated before their IT network and their 'paperless' commitment which required personal sign off from three different managers for every invoice. Once they realized that the process was redundant, inefficient and not even necessary because of the new technology capabilities, it was refined and profits turned around.

### **Profit Leaks Prevention Program**

To bring about the critical changes needed to detect and manage leaks, it is obvious that employees must see the impact of their decisions. They must be consistently and continually engaged by the leadership to perform in a *watch dog* role. This requires re-education at every level; it means giving employees permission to influence decisions and to generate new ideas; and above all else it means explaining the big picture to everyone. To do this requires a shift in mindset from the common "top down" management style that reinforces a mentality that only the leaders or senior managers need to understand all the implications of decision-making. Instead, a more contemporary "flat" approach, with less emphasis on hierarchical decision-making, is likely to encourage all employees to take ownership and responsibility for thinking about ways they can enhance profitability and reduce costs.

Asking employees to help the company be more efficient is simply not enough to create the significant behavior change that is essential. Owners and senior managers must work closely with employees to keep them involved and invested in any leaks prevention program for it to succeed. Employees must be sincerely respected by management, entrusted with real authority and rewarded for their efforts. In return,



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they need to embrace their expanded role and assist management in creating sustainable efficiencies that lead to a profitable organization.

In this way the company will begin to build and embed a cultural approach that gets everyone on board and committed to preventing leaks before they begin to drain away profits.

*Some of the information cited here was gathered through research provided by New jersey CPA Society, continuing Professional Education Seminar, "Plug Your profit Leaks: Exploring Ideas to Significantly save Time and Money" presented on July 14, 2014.*