Know Your Numbers, One Transaction at a Time

Gone are the days when you could open your company checkbook, note the balance and decide whether to write yourself a $100,000 bonus. The balance in the checkbook is not profit, and you have an obligation to your shareholders to produce profit—even if the only shareholder is yourself.

This obligation is no different than the SEC's post-Enron/Worldcom/Tyco mandate to publicly traded companies that CEOs must certify the accuracy of their financial statements. And taking a lesson from that mandate will lead you to greater profitability.

It's a lesson I personally failed to heed until the day in the mid-1990s when I had to scramble to avoid bankruptcy. That close call was the risk I exposed myself to for not having a firm grasp on running my company through a profit and loss (P&L) statement. I wasn't running on cash flow from the checkbook; I had just distanced myself from the obligation of a CEO to financially manage my company.

In such cases, the extreme risk is that you'll end up, as congressional testimony claims, like Enron's Kenneth Lay—duped by the people running your financials and signing your checks. To reassert my obligation to financial management, I first had to resolve a conflict I was having with my accountants.

If you're like a lot of mortgage brokers, you probably began your career originating loans for someone else's company, and then decided to start your own operation. But you may have never received any business training. So now you're still originating loans, but also trying to be the CEO of your company. And there's never any time to learn the business side. So instead you entrust the numbers to others, and focus on what you're best and most comfortable at doing—sales.

When I first started Majestic Mortgage Corp., in a suburb north of Chicago 15 years ago, I was learning the business day by day, through trial and error. One big problem was that I didn't really understand my financial statements. Of course I was reluctant to admit that, so I would fake it during accounting meetings. While they reviewed the financials, I would just nod my head. The accountants would reach into their vast 55-gallon drum of numbers and draw out information, but it never made any sense to me.

They wouldn't provide my P&L statements until they had precise numbers down to the last penny—usually 45 to 75 days after the month had ended. Of course, by then it was far too late for me to make timely adjustments based on those figures. Worse, the 19-page statements were written in arcane accountant language that I couldn't quickly or easily comprehend.

The accounting brain is different from the entrepreneur brain: Accountants think in precise numbers. To them, it's okay to provide a P&L statement 45 to 75 days after the month has ended. But the entrepreneur, who thinks in approximates, realizes that even right now might be too late for those numbers.

Trouble was, the accountants were trying to teach me from an accountant's perspective. And their way of looking at things is simply not in my DNA. I should have said, "Listen, I'm a business owner, not an accountant, and you've got to translate this information for me."

By Tom Ward

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The light bulb finally popped on when I realized that the P&L was meaningless unless it was viewed in the context of productivity, divided by the number of loans closed. Whereas accountants think only in terms of financials, I needed to think in terms of both financials and productivity. So I had my CFO combine a monthly closed-loan report with the P&L, breaking down revenues and expenses per transaction.

By combining productivity reports on closed loans with my P&L, "One Transaction Thinking" lets me accurately assess my revenue and expense per loan. Instantly assessing the productivity of my company expenses, I can make more informed decisions that are sometimes the opposite of what a financial statement by itself would suggest.

Let's say you had $18,591 in processing costs in March, and $24,377 in April. An accountant would look at that increase and say, "Whoa, your costs are starting to rise—you'd better be careful. Cut back those expenses. Maybe you should lay off some employees."

Let's look at my entrepreneur's view of these expenses, side-by-side with the accountant's view.

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It's all about getting to know your numbers. If your total processing costs are $18,000 one month, $24,000 the next month and then $28,000 the month after that, you might ask yourself, "Which is right?" Without a basis to interrelate the numbers, you won't have a clue. But with "One Transaction Thinking," you discover your average processing costs per loan during those months were $119, $131 and $107—all in the same general ballpark. Over time, you develop a benchmark. You learn what's par for any particular expense. If processing costs suddenly jump to $500 per closed loan, you'll know there's a problem—and you can take steps to correct it.

In the end, I made my accountants adapt to the way I think, not the other way around.

Closed	Production	Processing Costs/ Entrepreneur	Processing Costs/ Accountant
March	112	$166	$18,591
April	274	$89	$24,377

Which column is right? Clearly, your processing expenses went down, not up—the opposite of what the accountant would have concluded. That's because the accountants don't typically ask how many loans you've closed. Instead of thinking, "Maybe I should lay off some employees," now you're telling yourself, "My people are probably getting too stressed—I'd better hire some more staff!"

As an originator, you always know how much revenue is coming in the door. You price a loan and determine what you'll make on it. With "One Transaction Thinking," you apply that same concept to the expense side of the transaction, to determine your processing costs per loan. This unit-cost approach is very common in other businesses: assessing costs per widget or per pizza or sandwich made.

"One Transaction Thinking" reconnected me to my financials and revolutionized my business, allowing me to simplify my statements in a format I can instantly understand. I've trimmed them from 19 pages down to only one page, so now I can read my P&L in minutes.

The OTT reporting I use to manage my company with real time information doesn't replace audited P&Ls. What it does is translate the P&L information as it's being gathered, so I can make the right productivity and profit decisions in an ever-shifting business climate. My audited P&Ls now simply provide affirmation of what I already know.

To make this work, pick a date in the month to produce your OTT report and stick with it consistently, every month. You might not be balanced to the penny—your audited P&L will be, but much later. Build a record and track your revenue and expenses line by line, until you know par for each. In my company, par for processing costs is around $130 (23 month average).

Your OTT report can also be used to compare branches of your company, regardless of the gross production numbers. You can even take OTT down to the finite loan-officer level: Which loan officers are low maintenance and which are high?

If you'd like to receive a free template for combining your P&L and productivity report on one 8.5-inch by 11-inch piece of paper, just e-mail me at Tom@majesticconsulting.com, and I'll be happy to send you one. •