

Business Reimagined #56

Simplicity and Honesty in Accounting with Greg Crabtree



Greg Crabtree is a speaker, author, entrepreneur and financial expert. Greg has used his entrepreneurial skills to develop Crabtree, Rowe & Berger, PC, a CPA firm focused solely on the needs of entrepreneurs, helping them build the economic engine of their businesses. Working with entrepreneurs all over the country in a broad range of industries, Greg has simplified financial reporting and empowered all entrepreneurs to take ownership of their finances. He has pioneered a revolutionary metric for driving business profitability: measuring labor efficiency and developing simple benchmarks for company, team and individual performance.

In 2011, Greg published his first book *Simple Numbers, Straight Talk, Big Profits*, in which he shares his core principles of how to turn your business into a wealth building engine.



Voiceover: This is Business Reimagined. Every week we talk with thought leaders and revolutionaries who are reimagining the way business is done in their industries, like today's guest, Greg Crabtree.

Greg: How big of a check you wrote to the Internal Revenue Service as a US-based business is your key indicator of true wealth creation because if you didn't write a big check to the IRS you either didn't make any money or you cheated. That's the only two possibilities.

Voiceover: This is Business Reimagined with Danny Iny.

Danny: What do you think of when I say accountant? Is it the person you visit once a year to look at your taxes? Maybe you share a few messages with him or her over the course of the year, but it's really just one more expense for your business. It's time to think again. Today's guest, Greg Crabtree, is a different sort of accountant. He has a new way of looking at the numbers, and making them more simple and applicable to everyday decisions. His entrepreneurial roots began on his family farm but there was something more lucrative calling his name, air-conditioning and respect.

Greg: I grew up on a chicken farm. We had laying hens, gathered around seven to eight thousand eggs a day from the time I was six years old till I went to college. My mom had of tax preparer a couple hours away that she would take her taxes to. I went with her when I was fourteen years old and I realized this guy worked in an air-conditioned office. I said, "Gee, my mom thinks highly of him, and so I think I want to be an accountant."

Danny: It was quite a departure from the chicken farm but Greg went to school and became an accountant. Instead of counting eggs he was managing companies nest eggs. Though he had an amazing mentor who began the transformation of Greg's way of thinking it wasn't until he was part of a forum entrepreneurs that he truly learned where CPAs fall short of the mark.

Greg: The last piece that they said was the damning indictment of the profession. They said, "You see hundreds of businesses most intimate details. You ought to have some idea of what works and what doesn't." When they said that, that hit me like a ton of bricks because here we are producing financial statements that are nice little blue binders, and we charge thousands and thousands of dollars for them, and you hand them to a client, and they say, "Thank you very much. Can you send a copy to the bank," and they take that binder and stick it in a drawer, and they don't even open it.

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They don't use it to run their business. Here, the most expensive thing we do as a profession, people don't even use it to run their business. Something's wrong with that.

Danny:

When he looked at the numbers that successful entrepreneurs were using to make business decisions, it was a far cry from what he'd been taught to do in school, so he studied them, and in trying to glean data from over fifty companies Greg has to develop a new framework for one simple reason.

Greg:

You get a group a hundred entrepreneurs in a room and say, "Everybody pull out your PNL and put it on the table." You realize there's a hundred different versions of a PNL and I go, that's just wrong. We have taught finance in such a pathetic way that you've got a hundred different versions of supposedly the same document? That's just insane. How can we have communication across businesses, or even financial understanding, if there's so many different ways to present it?

Danny:

Greg's new way of looking at accounting has paid off for his clients, so much so that he wrote a book about it called Simple Numbers, Straight Talk, Big Profits. From the very start you can tell it's not your typical accounting book, especially when you hear what Greg has to say about how you file your taxes.

Greg:

If you ask your accountant to pay as little tax as possible, I can help you do that by just not making any money. I can help you. When the first words out of my mouth as an accountant at the end of the year, as you're looking at a profit before the end of the year, then you come back and say, "Well, we need to spend some of that. What can you spend it on?"

To spend a dollar to save forty cents in tax is about the dumbest advice that a so-called professional could ever give you. It's just ridiculous. We'll talk about investing here in a moment but generally, most of these advice scenarios that accounts are getting are really just a wasting of the profits. To me, you can't build wealth that way. The only way you build wealth is after tax profit. I'll put this in the book and I'll stand by it still today. How big of a check you wrote to the Internal Revenue Service as a US-based business is your key indicator of true wealth creation, because if you didn't write a big check to the IRS you either didn't make any money or you cheated. That's the only two possibilities, and I'm sorry.

People have pushed back and said, "Oh well that's not true." That's hogwash. Nobody's been able to prove it yet. Now, you can kick it down the road. You can play these games of deferrals

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and all that kind of stuff. No, no, no. Until you pay the tax on it you don't have the money, and that's just the way it is. There's other countries that may have different tax systems, but even that, we do a lot of work in Canada as well, and I'm telling you, you got to make a profit to build wealth.

You may be building a company that has supposedly value even though it doesn't have profit. Well, just go watch the Saturday Night Live skit called the First National Change Bank, and they talk about for quarters for a dollar. How do you make profit? Volume. It's dumb. It's just dumb, and it's just old, wrongheaded thinking.

What we've had as great success in people finding, all the sudden we give people permission to go be profitable. The key behind it is making sure that first and foremost, they're looking at financial truth. That comes into the scenario of what you pay yourself as an owner. We have a scenario where we've had clients that were paying themselves thirty thousand dollars a year, taking a hundred-and-fifty thousand in distributions. Really they needed a hundred-and-eighty thousand dollar salary and that was the appropriate salary, but for years that's all that they made. Then all of a sudden we give them permission to be profitable and they make two eighty, and then four fifty, and then seven fifty, and then a million two, and then a million seven, and then three point two million.

It's all because of the change of a mindset. I'm telling you three point two million six years after making nothing is a pretty big shift in income producing capacity. If you had taken that approach as the traditional accountant to say every time you have profit at the end of the year what can you spend it on, you would build no wealth.

Danny:

I want to dig into this because, when you say it's a shift in mindset, it could easily sound like this is a law of attraction, power of positive thinking kind of thing, but your accountant so clearly it's not.

Greg:

It's actually behavioral economics is what it is. It's one of the most fascinating area of studies that I've really paid a lot of attention to in the last couple years is this idea of how can you take data, and present it in a compelling way, that causes people to behave differently? That's really, at the end of it, what I'm trying to accomplish. If you look at the core premise of behavioral economics, a loss feels twice as bad as a game feels good. That's kind of the original premise of behavioral economics.

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There's a few rare people that are driven through looking at the positive side, but in reality, if I left you off the hook and distort profitability to where you look more profitable than you really are, you're not motivated to act correctly. If I show you the harsh, bitter truth of you're losing money, or you're not profitable at all, all the sudden your entrepreneur juices kick in and you change the dynamics of what happens.

It's just amazing. We see it time and time. and time, and time again. It's just amazing what the human capacity is for change once you give them truth. You mentioned sweat equity a while ago. Granted, I'm not asking someone to take a salary that they're using as a capital contribution, but I darn well want to record it in the books that way. I want them to see the brutal truth of them not taking a wage and putting capital in that business.

Part of it is, is therefore how long are you willing to put up with that? It sounds easy for a while but there's so many entrepreneurs that do not really put enough speed on development of their business because they're giving themselves a pass on how profitable they are. When I show them the truth of it they change.

Danny:

I can vouch for that. I was sharing with you before we started recording, I heard the back story of you coming on the show was I heard you speak at a conference a few months ago, and your presentation, and subsequently your book, really hit home. That led to some changes to what we're doing internally in the business and our profitability has improved dramatically. We're talking about just a few months. It's not a very big length of time.

It comes down to the fact that entrepreneurs are great problem solvers. This is what we do. We see a problem in front of us and we fix it. The challenge is that people aren't aiming at nothing, they're aiming at the wrong thing. As an entrepreneur for the longest time, and I've spoken with tons of entrepreneurs, the target the entrepreneurs shoot for is break even, it's a cash positive. You talk in your book at length about why that is such a dangerous target. Can you explain that?

Greg:

Yeah. The idea is you're stopping it way short. It would be like, think of if the water is calm and you stop at break even. That means your mouth is half under water and half above water. I mean you still drown. It's almost like that in business in the sense that the reality is there's certain things that you have to have cash for that is beyond break even. If you have any debt, the only way I can repay debt is to use after tax profits. If I'm going to break even, that means for every dollar that I repay in debt, I got to turn around and reborrowed it back, so that's making no progress.

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Most of the models that we see from what banks will probably generally allow people to borrow against, you got to have a minimum five percent profit just to tread water, and turn over the debt, and repay that. Realistically until you get past, that's why we call five percent is really the new zero, so really we say ten percent is the new break even. It's what you should be aiming for because you don't have any oxygen to work with until you're at ten percent in that business.

The other thing that you have to look at from a distortion standpoint too though, is if I convince you about the compensation piece, there's still one other aspect, and that's revenue. In today's world, more likely than ever, there's a lot of business schemes to where revenue is really just a fake number. It's just a beginning point, but it's all about the second line, cost of goods sold or direct costs as we call it, that are pass throughs. We want people to look at those direct costs as being, those are costs that are going outside the business, so we want people to really focus on gross margin.

Danny:

Clearly you know this stuff inside and out. I'm fairly financially literate and as you zip through all that I could follow, and I was thinking it's a really good thing I've got a CFO who can do all this for me and just give me a report. I guess I have, it's a set of questions, but help me understand, for an entrepreneur who's not financially literate, someone who does not have an MBA, has never taken a finance class or an accounting class, how much of a learning curve have you seen for people to get their heads around this and be able to start doing it? Then when it comes to actual implementation, this is only useful if you're looking at the numbers with some frequency, so if you understand it in theory and once a year you do a little analysis, it's not going to help too much.

How much time do people have to dedicate? How often should they be compiling a report, and looking at it, and talking about it? How does this fit into day-to-day operations in a business?

Greg:

I think the idea is you can have too much of a frequency, as much as you can have too less of one. The key is breaking it down into the critical elements that you need to know. I'll just share with you my rhythm.

In my rhythm the one thing I look at every day is I get an email from our office admin, of here's the bank balance, not the bank balance that the bank says we have because there's things that the bank doesn't know, but we trust that our accounting system, we use QuickBooks for our back office accounting, so our QuickBooks cash balance is the real truthful bank balance. In that same email of here's the cash in the bank, it tells me who paid us, who came in. If you have a lot

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of activity, that may be too much. Yyou just want to know here's today's deposit and here's today's cash. I get that every day.

On Friday I get to things. On Friday I get a two week cash flow forecast. If you go to simplenumbers.me, that's the book website, there's a free profit tool section. The spreadsheet, the exact spreadsheet that I get in my email, there's a template of that, that's a free download spreadsheet from the website. You can download that example.

All I'm looking for is here's the cash in the bank, here's the aged receivables and totals, and here's the major bill categories for the next two weeks. I can look at it and say do I need to freak out and do something immediate to manage cash in the next two weeks, or is everything looking pretty good? That comes every Friday between two and three o'clock in my inbox, as a cut and pasted into a body of an email. There's a secret to that one.

Danny:

I want to just jump in with a question because we do very much the same thing but we're looking at a two month cash forecast. We look at it weekly. You mention, do I need to jump in and do something drastic with cash. Two weeks doesn't give you a lot of time to do something drastic so can you explain the rationale for that time frame?

Greg:

The idea is our cash flow model tells us the longer term and I only need to look at that once a month.

Danny:

Got it. Okay.

Greg:

Yeah. That's why I'm focused on near term of a pulse but then at the end of the month- we've had clients that have tried to look at the two month. The problem is you're probably trying to chew up way too much in that weekly pulse of things. I want to get that longer term picture, so we believe in the great game of business concept of constant re-forecasting. The idea is at the end of each month we constantly re-forecast where we're at in the future. Sometimes we don't change it because we're on pace, we're doing what we think we're going to do, so we don't need to change it. But we're willing to change our forecast at any point we see a significant change in our business model. That model is predicting profit and loss statement first, then it's predicting the balance sheet second, which then predicts cash.

We think that's the ultimate rhythm that everybody should fall into. Smaller businesses don't have the skill set to be able to do that forecasting piece, but that's where we've developed a

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service that does that for them, that's very inexpensive. At least we think it is. We've made it affordable and accessible. It's just, unfortunately, my peers don't think that way. There's a few that are coming around. We've actually been contacted by several CPAs that we're teaching that methodology to.

It's a slow grind for them but the ideas, the rhythm is, on that weekly basis I'm looking to weeks out on cash flow. The second thing I'm looking at is on that weekly basis, is some type of productivity metric. In our case I'm looking at our over or under to production target, so I know what we produce each week in terms of billable time production, and adjusted for what expected write-offs would be. As long as everybody's hitting their plan, our plan says we're going to be financially stable, life's good. Put your head back down and keep going.

It's when we start deviating from the plan is when you go into alternative processes and say, "Okay how do we fix it, and what's the problem?" You've got to have some type, like our marketing firms that we work with, we have them look at a weekly gross margin target. The reason why we say gross margin is what did you bill this week, what did we have to send out and pay freelancers who are not part of our staff, so what's left over is gross margin. They've got a gross margin target that they've got to hit week to week to week to fill up the bucket for the month, because they've got committed resources of productivity to cover their staff time and their basic overhead.

Every business should have some type of weekly target. Our online retail clients, they've got a weekly gross margin target of what they've got to sell week to week. Our restaurant clients have a weekly gross margin target of what they've got to hit week to week to week. You've got to have some kind of targeting there, and then once you get to the end of the month, then you do the full model.

Now, here's where behavioral economics becomes important. Remember a loss feels twice as bad as a gain feels good. You never look at him months worth of information first. You always look at the trailing twelve data, and trailing twelve across trend is the most preferred. We have a report in our model that shows you, here's this month's twelve month performance data compared to the previous twelve month performance data, compared to the previous month. It's just a series of columns and each column has twelve months of performance in it because that is truth. There's twelve months, four quarters, every holiday, every dog ate your homework excuse.

When you look at a month, a month has embedded variances from holidays, to seasons, to all kinds of issues. The idea is they did a study in one of these behavioral economics courses where they had two groups of people to where one group managed a stock portfolio where they only looked at monthly data of the performance to make buy sell decisions. The other group looked at annual data to make buy sell decisions. The group that looked at annual data traded less frequently, and had a higher yield than the group that looked at monthly data, because when your eyes are drawn to the monthly information first, you're going to make errors. You're not going to respond if the data looks good, when realistically there's some inherent weaknesses, and you're going to over respond when the data looks bad.

It's just normal. When I'm looking at rolling twelve I filtered out all of those seasonal variations.

Danny:

How well does this work in a situation where the business is not just seasonal but highly cyclical?

Greg:

I think from that standpoint think of it like this. Rolling twelve data is the moral equivalent of an Olympic athlete's personal best. An Olympic athlete does not measure themselves primarily by gold-medal performance, it is by personal best. Every one of them can tell you what their personal best is. As a golfer I can tell you I shot one under par twice in my life. That's my personal best and every time I tee it up I'm trying to break one under par because that would be a new personal best.

The idea is, the same equivalent for a business is the rolling twelve, because I could look back over a series of life of the business and say when were we at our best? I'm looking for patterns. Our simple number structure is much easier to grasp about the pattern of profitability that the business enjoyed. I can look back across time and say when was our company best rolling twelve revenue? Who cares about being January to December? That's some arbitrary twelve-month period of time. Last time I checked July to June is a twelve month period of time. It's just as valid if not sometimes more valid.

As I go through that process I can determine if company best revenue is in one month, but company best net profit is in a different month, I start to understand the quality of revenue. I also understand the potential of expenses that are not aligned to the revenue. For example, I may have a commission plan for my salespeople that's totally messed up to where it over compensates them for surges in revenue, that actually diminishes profitability. Trust me, that happens a lot. People just throw out commission plans willy-nilly thinking it sounds easy. It sounds easy and it's also taking money off your bottom line.



The idea is you look at each of these structural components. Sometimes here's my best grossed margin, but it's not my best contribution margin because I overspent in labor, or here's my best contribution margin percentage, but it's not my best dollars. You start to understand where is the market receptive point too? Sometimes I can try for a really great rate all the time, but there's only so many stupid customers that overpay for things. The idea is at some point I have to adjust price to get to that next level of business, but is it worth it?

You have to ask yourself that question because it may not be. It may be that I'm better off being more profitable year at this size. I'm a huge fan of growing businesses, but sometimes there's a point that you grow and give up optimization. What are you aiming for at the end of the day?

Danny:

I want to come back to the question of implementability because to someone who, and I'm sure a lot of this comes with scale of business, but let's say a lot of the examples we were talking about, we're thinking about businesses that are on a million to ten, twenty million range. What if someone's much earlier on? They're just getting started. They're making a few tens of thousands of dollars a year or maybe high five figures or something. They're doing it all themselves. They don't have a financial background. How practical is this? Is there a minimum viable version that they can get in the book and get their head around, and it's going to be manageable, or is this just wait till your bigger?

Greg:

No. We think it's manageable from the very beginning because we've launched several businesses with this concept from the very beginning. A couple of things we've done, and we're in the process of, we've just completed an embedded app for the bookkeeping system Xero, online accounting system that's really competing very nicely with QuickBooks online.

Danny:

That's Xero with an X right? X-E-R-O.

Greg:

X-E-R-O, correct. We have an embedded app that'll allow you to bucket your data exactly, and create reports exactly the way we were talking about, so you can print a PNL and you can toggle between rolling twelve, rolling six, rolling threes, or monthly. The idea is we would have you, once you bucket the data, you would look at it, and you would look at the rolling twelve first because that's the more truthful trends of your business, the real mega data of it. Then you'd look at rolling sixes next, and then you'd look at rolling threes next, and then you look at monthly last.



It also produces a more condensed balance sheet and a cash flow report as well. Then we have something we call the simple numbers balance sheet. We've kind of taking an adaptation of the balance sheet, which is that statement that no entrepreneur ever reads, but it's where all the dead bodies are. We want you to pay attention to it and so we've created a version of it that's linear so it's not assets on the left, and liabilities and capital on the right. It is a single column version that's really designed to be very similar to the structure of a cash flow report, so that you've got your net working assets up top. That's current assets minus current liabilities but you see them all grouped together.

The goal of what you're really trying to do there is just to make sure that as cash moves around between AR, cash, AP, and all the various inventory, all of those accounts, you can see that it's really about growing your net working assets, or net working capital in that regard, because you can feel bad about cash being down, but if all your money's in AR then you just used a lot of cash to pay down accounts payable, you're in good condition. It'll fill back up so don't worry about it, but when you see that you're starting to consume your working capital by decisions, which generally comes from either taking money out of the business as an owner, as a distribution, when the business really couldn't afford it. That's a common error most probably all businesses do, or you're losing money.

Those are the two primary reasons that cause it to go down, and so it helps people understand a simple concept, plus it also has our core capital target concept built into it so that you can actually know when it's safe to take money out of the business versus when does the business need to have all profits left in. I think that's probably one of the more significant concepts, that we've been able to teach entrepreneurs what the picture of health looks like from the capitalization standpoint so that they don't just willy-nilly reached into the business and grab money when they want it. They have a target that they must attain to in cash, and only take out money when it's above that target.

Audra:

And that was Greg Crabtree reminding you to be truthful with yourself when it comes to your business accounting. Don't fall into the trap of mind games with taxes, your salary, and owner distributions. And most importantly allow yourself to make a profit because like Greg says, profit is like oxygen. Your business can't hold its breath very long without it, and profit is the key to real wealth creation.

To learn more about Greg picked up his book Simple Numbers, Straight Talk, Big Profits, or go to his website at simplenumbers.me where you can get the app mentioned in this episode and more.

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This has been business reimagined with Danny Iny. Join us next time as we talk with Anthony Trucks.

Anthony: That's the best advice I can give somebody right now is we're all great at planning because we have ideas, but life happens between our plans. It's always going to go off a little bit but the goal is not to be going through this plan saying if this doesn't work out exactly how it's planned, it's going south, it's to say, hey I got to have a plan to start moving. It's not a perfect plan. I'm going to follow it perfectly based on what I know but as I go I'm going to learn stuff. As I learn stuff I can modify and perfect it as I go, and then now you start seeing yourself moving. You start seeing stuff unfold and more and more things happen positively.

Voiceover: Learn more about us at Mirasee.com.

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