

Setpoint Systems, Inc.

Authored By:

Joe Knight

Are You Faking it When it Comes to Financial Intelligence?



S E T P O I N T TM

www.setpointusa.com

info@setpointusa.com

801-621-4117



SETPOINT

Setpoint provides industrial automation equipment customized for specific manufacturing processes.

Are You Faking it When it Comes to Financial Intelligence?

Are you financially savvy? If someone asked what EBITDA is, would you be able to answer, “Earnings Before Interest, Taxes, Depreciation and Amortization”? My name is Joe Knight and for the last seven years I have been teaching people how to read and make sense of financial statements. Over that time, I’ve trained some of the largest corporations in the world such as GE, with over \$180 billion in sales, to some of the smallest like Setpoint Systems, a lean automation company, where I work as CFO, with 25 employees.

After teaching financial literacy to thousands of managers and leaders, I believe that corporate America’s general understanding of finance and accounting is fairly low. Yet, when I start a new project, the client usually assumes that his or her employees already understand finance and accounting basics. This assumption is dangerous. If your management team doesn’t know how to read and interpret business numbers, it’s as if they are playing a game where they don’t know the score. Can you imagine an NBA team playing a game where neither team knows the score as the game progresses?

Recently, my partner and I met with a potential new client—a large publicly traded company with annual revenues of nearly \$3 billion. After making our training proposal, we had lunch with the COO. He liked our proposal and had read our book *Financial Intelligence*. He looked me in the eye and said, “Joe, I’ve read your book and I really like your approach to training. The only issue I have is my direct reports all know the numbers fairly well. I don’t think we need to cover the basics with this group.” I smiled and said, “Really? I think you might be assuming they know more than they do. Most good business managers and leaders are not going to ask their boss, the COO, what EBITDA means in a business review meeting with their peers.” This COO laughed and said “You might be right about that, but I’m pretty sure they can define EBITDA.”

As you might imagine, my training business partner, Karen Berman, was a

bit nervous with me challenging the COO of a potentially large new client. Karen and I have been in the financial training business at our Business Literacy Institute for quite a while and she knew that I was probably right, but also that it was a risky thing to say to the COO.

After our earlier exchange, I suggested to the COO that we get 10 to 15 of his direct reports together and Karen and I would provide a two-day course on finance basics. I invited the COO to attend the first day and see what kind of questions his leaders were asking about the statements. He agreed to give it a shot.

On the appointed day, I started the training with basic income statement concepts. When I started talking about EBITDA, one of the COO's lead managers asked, "All I hear is EBITDA, EBITDA, EBITDA. What exactly is that and why is it important?" This was followed by several basic finance questions as we worked through the material. At the break on that first training day, the COO pulled me into the hall and said, "Joe, I can see we really need this training. Let's get this training done for this group and roll out a comprehensive training course for all of our managers at a certain level."

This was the beginning of a great relationship with this client. We ended up with a five-day course and spent two years rolling it out to the company leaders. We have continued to work on financial literacy with this company; the COO and others have acknowledged that the company has benefited greatly by having increased financial intelligence.

How Can We Solve the Problem of Financial Illiteracy?

After this experience and several others like it, Karen and I started to wonder why there was such a gap between what managers understood and what their company executives thought they knew. I believe that most good managers are smart enough and politically careful enough to fake it when it comes to finance. At the Business Literacy Institute, we always wondered what we could do to solve this problem.

I developed my approach to training finance while working at Setpoint. The two company founders, both engineers, wanted to start Setpoint with an

open philosophy, which included opening the financials to employees. When I got involved as a business partner, we found that it was fairly easy to share financial reports with employees, but that sharing reports without some training as to what they meant was fairly useless. I found a way to teach basic finance to the Setpoint employees, and I have learned over time that as people start to understand what is going on financially where they work, they become better employees who find ways to help make their companies more profitable. They think—and sometimes even act—like owners.

These two themes led Karen and me to investigate a way to assess the financial intelligence of an organization. First, we realized that most managers have a fairly low financial IQ. Second, we knew that if we could raise that level, they would perform significantly better. This led us to develop a Financial IQ or FIQ test.

Karen and I have collaborated with Breck England, an executive at Franklin Covey, and Brad Angus, Setpoint's current CEO, to develop this assessment. The FIQ is a 21 question true/false and multiple-choice test that measures a person's financial literacy level in many critical areas. The assessment tests a subject's understanding of the income statement, balance sheet, cash flow statement, and several critical ratios and financial concepts.

The FIQ was recently validated statistically for business managers of companies with over 150 employees in the United States by the Center for Innovation and Change, Marshall Goldsmith School of Business, Alliant International University. The mean score on the national validation study was 38% correct. If a typical manager were taking this test as a collage final, he or she would be given an F. This outcome is not surprising to us at the Business Literacy Institute.

When you consider the financial problems that have beset United States businesses since the turn of the century, it is no surprise that our collective financial IQ is so low. Better financial intelligence might not have allowed us to avoid all of the problems we have seen with corporate malfeasance since 2000, but a higher financial IQ would certainly have helped us discover problems sooner. Corporate failures such as Enron and WorldCom and Ponzi scheme fraudsters such as Bernie Madoff and R. Allen Stanford are examples of a

financially illiterate populace getting tricked by dishonest business leaders. The current banking crisis is related to this problem where people did not understand the financial consequences of sub-prime loans and mortgages. Also, if U.S. managers scored 38% on this test, I wonder what members of the U.S. Congress would score. My guess is significantly lower than 38%.

Are You Ready to Take our Sample Financial Test?

We plan to offer this test to our clients at the Business Literacy Institute. There is a sample of it online at www.testmyfinancialiq.com with the full version coming soon at www.financedog.com. We hope that this assessment tool will better educate U.S. managers on financial issues. With the sample test, you will get your score; with the full version, there will be downloadable trainings that will be available. Please visit us; we'd like to help you raise your financial IQ.

THINK: You should take this test and see how you do.

FEEL: Understanding finance is important.

DO: Go take the test. It takes about 10-15 minutes.

Setpoint is the leader in lean automation equipment from concept to functioning completion. Following the Toyota Production System, Setpoint has successfully created custom solutions for a broad variety of industries for over 18 years.