industrial management

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contributors
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Bulletproof profit models

BY PAUL RAUSEO

EXECUTIVE SUMMARY

The economic crisis of 2008 has caused a heightened awareness about the need to take a hard look at business performance, cutting costs and being profitable. There are plenty of businesses making money today, but too often managers and executives get tied up handling the day-to-day demands of the business with little or no time to oversee the direction and efficiency of the daily operation. Profitability comes from cutting costs and increasing productivity, which is accomplished by having a planned profit model.

A planned profit model is a simple equation that ensures you act today, but plan for tomorrow: *revenue – profit = expenses*. The equation is a basic assessment of the three major components of any business: expenses, revenues and what's left over. In the past, this model placed profit as the outcome number, and many times it is negative or lower than expected. With profit as a fixed input variable, the amount is decided on and controlled in advance. Too many businesses use an old model, with profit as the result, and don't realize how much money they have generated (or lost) until the accounting period ends. The model is simple, but it can be the critical factor in whether or not a business is profitable.

Profit should be thoroughly targeted. What do you want your profit to be? Most managers and executives don't realize that profit is a number that can be decided upon. If your business is suffering, your profit should be adjusted for recovery. Set the mark so you are breaking even; pay down debts, cover operational costs and evaluate how you can further grow in future periods. If your business is thriving, you must be reasonable when planning your profit. It is important to keep in mind current and future debts, long-term and upcoming expenses and goals for future periods.

Sales figures and interest earned make up revenues. With deferred buying decisions, whether your business is successful or not, extending reach can increase sales. When extending reach, three key elements must be looked at and adjusted:

- **Extend your demographic reach.** What kinds of people or groups of people are using your product or service? What are the uses for your product or service? Commonly used demographics include race, age, income, disabilities, educational attainment, home ownership and employment status. Successfully targeting other demographics can increase revenues dramatically.
- **Extend your geographic reach.** No matter if your business is successful or suffering, extend your geographic reach in a cost-efficient manner. Look into untapped areas and evaluate how your business would succeed in those geographic regions.
- **Extend your product and service reach.** With a business that is suffering, extending the product reach can turn revenues 180 degrees. Think of what other products and services your organization can provide without changing operations. Many companies can make different products with the same inputs and operations at a lower cost and higher demand. For instance, when a Wisconsin-based contracted brick layer recognized a declining demand, it evaluated its options and saw the value in extending its reach. The company sent laborers to Chicago to lay glass block in million-dollar condominiums, which resulted in higher revenues. The demand for laying glass blocks is extremely higher than laying bricks for factories, and the company could do both at no additional cost.

Cutting cost is easier than most people think. The trick is finding which ones can be cut and how to do it. Looking into every cost your business has and identifying waste is mandatory. Many times, costs are connected to wasted efforts, resources, services, and operations. Waste itself is every organization's biggest competitor. To identify and eliminate waste and costs, review each issue separately. While issues vary from one business to another, common cost drivers and wastes include:

- Labor inefficiencies, such as too many employees, improper allocation of personnel for jobs and scheduling problems
- Material inefficiencies, including poor purchasing decisions, cost issues and wasted materials
- Service inefficiencies due to the business not serving customers effectively as well as vendors providing ineffective services such as marketing services that don't provide sufficient ROI
- Inventory control, which includes having too much inventory, not having inventory where it is needed and having too much cash tied up in inventory

Most managers and executives don't realize that profit is a number that can be decided upon.

Productivity and efficiency

Dashboards and metrics management are technologies that can be customized to overlay computerized database information for virtually any type of business. These technologies provide insight and understanding needed to make better and faster decisions by visually representing business data in real time. While the dashboard concept was created initially to focus on financial metrics of sales, income, liabilities and profits, new software can display and track any type of key performance indicators (KPIs) or data that a business can gather and place into a relational database.

Every business has certain critical measures of business performance. KPIs may be developed to measure a company's general business activity, such as the number of items produced, sales made and orders filled. In addition, KPIs may be used to track the activities of functional departments, such as sales and marketing, human resources and customer service. The "gut feeling" was the way some business owners in the past may have been able to sense how the business was doing. But those days are over.

In looking closely at the operations of your business, an important question to ask is how efficient are my employees? To measure efficiency, one must look at what is expected of the employee, what they accomplish in a given amount of time, what the variance is and how to narrow the variance.

Another proactive way to manage employee performance is called *catalytic coaching*, which is the opposite of a reactive response to past performance, such as the traditional performance review. Catalytic coaching provides a structure for a working partnership between a manager and employee based on frank, open and constructive feedback and a shared desire for each individual to achieve his or her ultimate potential.

The word "catalytic" is used because it means an activity that causes a reaction between two or more people or forces. The idea of "coaching" comes from sports. Coaching focuses on the future and transfers responsibility for the development plan from management to the employee. Coaching also does not tie salary to the process. Catalytic coaching places emphasis on employee input rather than management review; the manager becomes a coach rather than a judge.

When performed properly, catalytic coaching turns the time used for the much-hated formal performance review into an activity that provides employees with value and empowerment. It helps individuals face their challenges at work and live up to their maximum potential. It can help the entire organization in its quest for growth and profitability.

Catalytic coaching revolutionizes performance reviews in three ways. First, the employee gives the manager written feedback. It is important for each employee to be able to make a case for her salary during review time. In this feedback, the employee lets management know what she has done for the company lately and where she aspires to be in the future. Management then gives the employee written feedback. Because it is important for all criticism to be constructive, management ranks the employees' top four strengths before listing improvements that need to be made. Additionally, suggestions are made in terms of what management can do to facilitate said improvements.

Based on discussions between staff and management, the employee creates a development plan that is reviewed and approved by the manager. Once implemented, this strategy should help assist in a smooth transition into improved productivity and employee-management relations.

Taking into account the cost of the actual sale of your product or service can also help your business be more profitable. If your business requires the use of a vendor or third-party provider, it is important to lock in prices or look at alternatives to see what can save money. Vendors located closer to your business may cost less in the end, as add-on and surcharges, such as fuel, are not listed on price tags.

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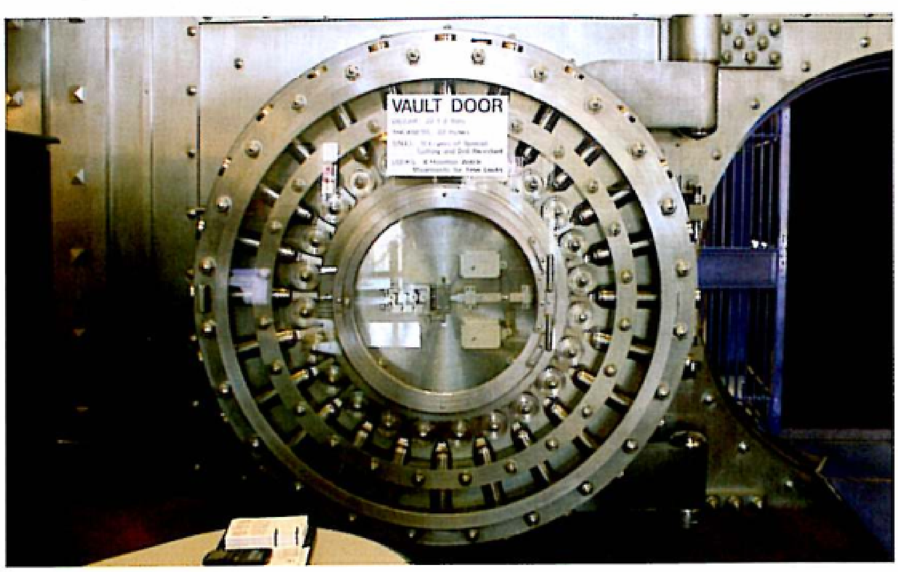

If the cost of service and sales is high, passing them along to the customer is completely acceptable, and the customer knows it. Many companies are passing their related costs, such as fuel prices, onto customers and moving the money saved right into their profits.

Don't become a bank

Many companies do not realize it, but they are, in effect, bankers to slow-paying customers. Not only is this unnoticed calamity causing cash flow problems for businesses, but many do not fully understand the impact this unacknowledged financing has on their companies. Compensating for slow-paying customers can dramatically affect the profitability of a business. Business owners talk themselves into allowing this for various reasons. Many do it as a favor to the customer, or perhaps they believe it will create a reciprocal bond to which they extend longer payment terms. Sadly, most owners discover their good intentions are never repaid.

Businesses also extend credit to their customers without credit checks. They believe the size of the clients company qualifies them for credit, but a big company doesn't always mean a secure one. At the same time, it is important to have a majority of clients with varying businesses. More small accounts are usually better than few large ones. Nonetheless, with any client, it is important to set high standards and keep them equal for everyone.

Prioritizing is the key concept. Every business owner is looking for ways to improve his operations. Many want to better position themselves for future growth. Meanwhile, others are looking for ideas to survive this economic downturn. The planned profit model is the only way to become and stay profitable while controlling your business.