Planning for PROFIT

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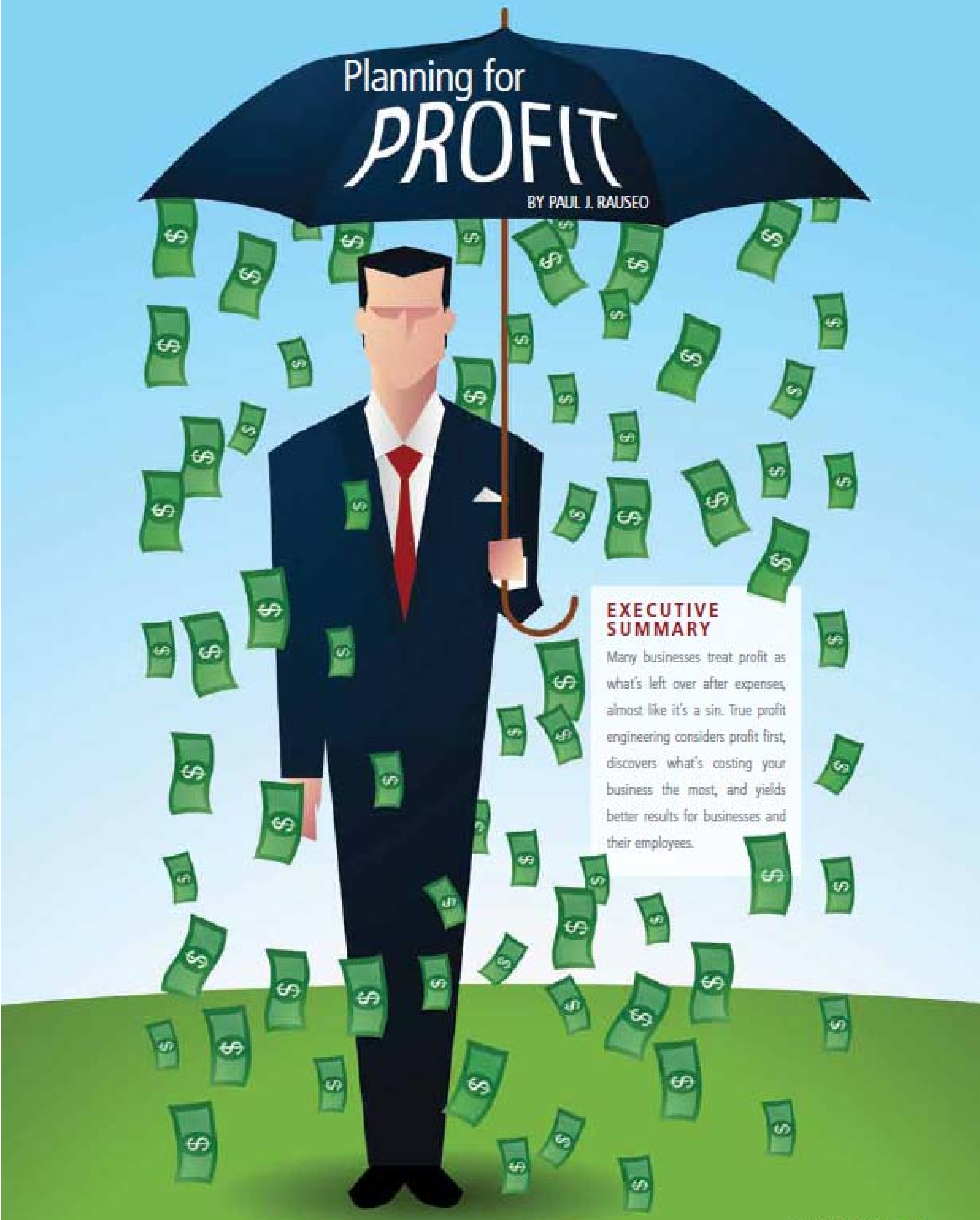

EXECUTIVE SUMMARY

Many businesses treat profit as what's left over after expenses, almost like it's a sin. True profit engineering considers profit first, discovers what's costing your business the most, and yields better results for businesses and their employees.

Profit: *The return received on a business undertaking after all the expenses have been met*

Engineering: *The application of scientific principles to practical ends as the design, construction and operation of efficient and economical structures, equipment and systems*

Think you can solve your company's problems by increasing sales? Think again.

Controlling cost is the key to engineering greater profit. Many business people fall prey to the common misconception that more sales will solve any problem. And while increased sales add to the bottom line to a certain extent, to get the full benefit of increased sales you must control expenses.

Profit should be the first line item addressed, not the last line item accounted for. To succeed, profits must be pre-planned and tracked with daily, weekly and monthly monitoring.

Have you ever experienced a situation in which your sales increased but your bottom line decreased? This problem is a strong indication of uncontrolled expenses. At the same time, you can cut your way to profitability, but it must be engineered.

Profit: residual vs. planned

The current state of the economy continues to be the most common factor business owners blame for profit woes. According to a January survey of 715 small business owners across the United States by the George S. May International Co., 27 percent of small business owners do not have the financial resources to weather the next quarter. The survey also found that 41 percent of small business owners have not taken a salary in 2009 in order to stay in business, 20 percent have had to pull money from their personal 401K, and 80 percent said they reduced the number of employees, as shown in Figures 1 through 4.

Now is the time to act and take control of the business side of the business. The drastic measures business owners turn to are not always the answers. Business owners need to stop living on what is left over (residual profit model) and implement a business model that ensures profit.

What do I want to make and how can I get there? The answer is to plan for profit, which can be done with a planned profit model — a simple equation that ensures you act today but plan for tomorrow:

Revenue – Profit = Expenses

Profit should not be a result or an outcome. It needs to be considered ahead of time, as a fixed input variable, decided on and controlled in advance. Too many businesses use a model that places profit as the result and don't realize how much money they have generated (or lost) until the accounting period ends.

What do I want my profit to be? How much revenue will it require? And what expenses can I cut?

What does it cost you to get out of bed in the morning?

There are plenty of businesses making money in this economy, but a great strategy isn't enough. It's mandatory to understand the who, what, where, when, why and how of your expenses.

Who is costing my business money? Too many small businesses cut staff when they need to cut costs. The people that are costing you the most money are not your employees; they are your customers. Make the changes that will make the company better instead of damaging the very thing that made it successful in the first place — its employees.

One client who wanted to improve business performance didn't want to give out employee questionnaires. He feared the forms would upset his workers, and he said he liked to treat his employees like family.

We told him to tell his employees that because he ran the business like a family and lost $100,000, they could share the loss and give him back

Survey SAYS

The following four figures are from a January survey of 715 U.S. small business owners. The George S. May International Co. conducted the survey.

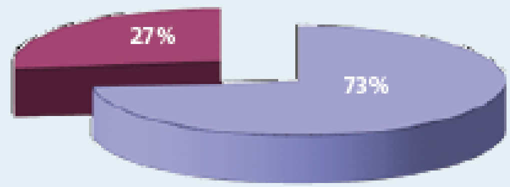

Figure 1. The survey revealed that 27 percent of small business owners don't have the finances to weather the next quarter.

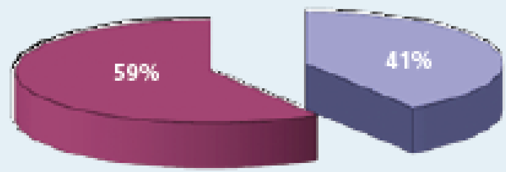

Figure 2. The survey found that, to stay in business, 41 percent of small business owners did not take a salary in 2009.

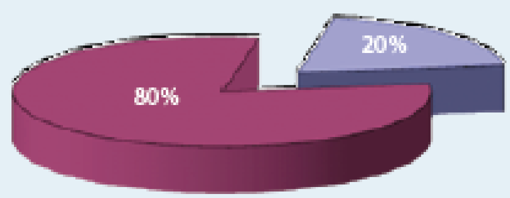

Figure 3. Twenty percent of small business owners pulled money from their personal 401K to stay in business last year, according to the survey.

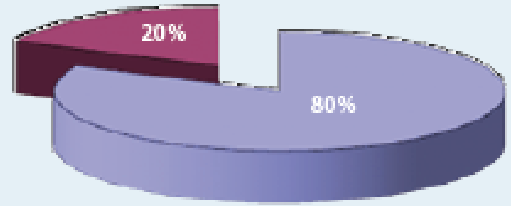

Figure 4. Eighty percent of respondents to the survey said they cut employment to stay in business last year.

$10,000 each. Of course, if he said that, they would have headed for the door to look for another job. If you really want to do the best for your employees, you have to be as profitable as possible. Otherwise you won't be around.

The actual cost to perform your service or sell your product adds up. Passing costs along to the customer is completely acceptable, and the customer knows it. For example, expenses like shipping and delivery charges should not be your responsibility, but your customers should understand what these amounts are and the itemized factors that make up these numbers.

What exactly is costing so much? Just as you would convey what your costs are when passing them along to customers, understand what makes up the expenses on your books. However, it's not about listing items, it's about understanding the price and determining if something can be done to lower it. 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-ons and surcharges such as fuel are not listed on price tags. There are many Web sites that actually calculate costs and compare them to competitors.

Where are my expenses coming from? Expenses come from everywhere, but where can you make the cuts? It comes down to your resources. There is a fine line between a necessity and luxury, quality and quantity, and in-house or outsourcing. While luxury items add convenience and many times improve the working environment, eliminating some of the basics can add real dollars to the bottom line. Quality and quantity go hand-in-hand. It's important to consider the quality or utilization of a resource versus the amount. For example, a business that uses delivery trucks might be able to eliminate the amount of deliveries or even trucks, waiting until one shipment is completely full. This ensures maximum capacity and fuel efficiency. Pre-planned driving routes will save time and energy as well. When it comes to outsourcing, many business owners are shocked to learn how inexpensive it is to bring a vendor's work in-house, or outsource a time-consuming, personnel-heavy job.

When will I get paid? 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.

If you really want to do the best for your employees, you have to be as profitable as possible. Otherwise you won't be around.

Businesses also extend credit to their customers without credit checks. They believe the size of the client's company qualifies it 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 businesses that vary. More small accounts usually are better than a few large ones. Nonetheless, with any size client, it is important to set high standards and keep them equal for everyone.

Why can't I get more from my staff? According to a survey of 1,000 small businesses in the United States conducted in August 2009 by George S. May International Co., 41 percent of owners pay their employees just to show up, and that model is killing profitability. The problem is that businesses still reward employees for being a warm body every day, when they should be paying workers based on performance related to specific, measurable goals.

You are setting the stage to destroy profits when employees come to expect compensation for participation in collaborative activities regardless of results.

The pay-for-performance concept has expanded rapidly over the past few years as companies look for ways to improve their operations. About 60 percent of small businesses claim to use the model, while not all (only about 55 percent) institute the specific, measurable employee goals needed to make the system work.

The relationship between the compensation and profitability data isn't a coincidence, and the similarity of those two numbers shows just how closely your compensation

Organization chart of WASTE INC.

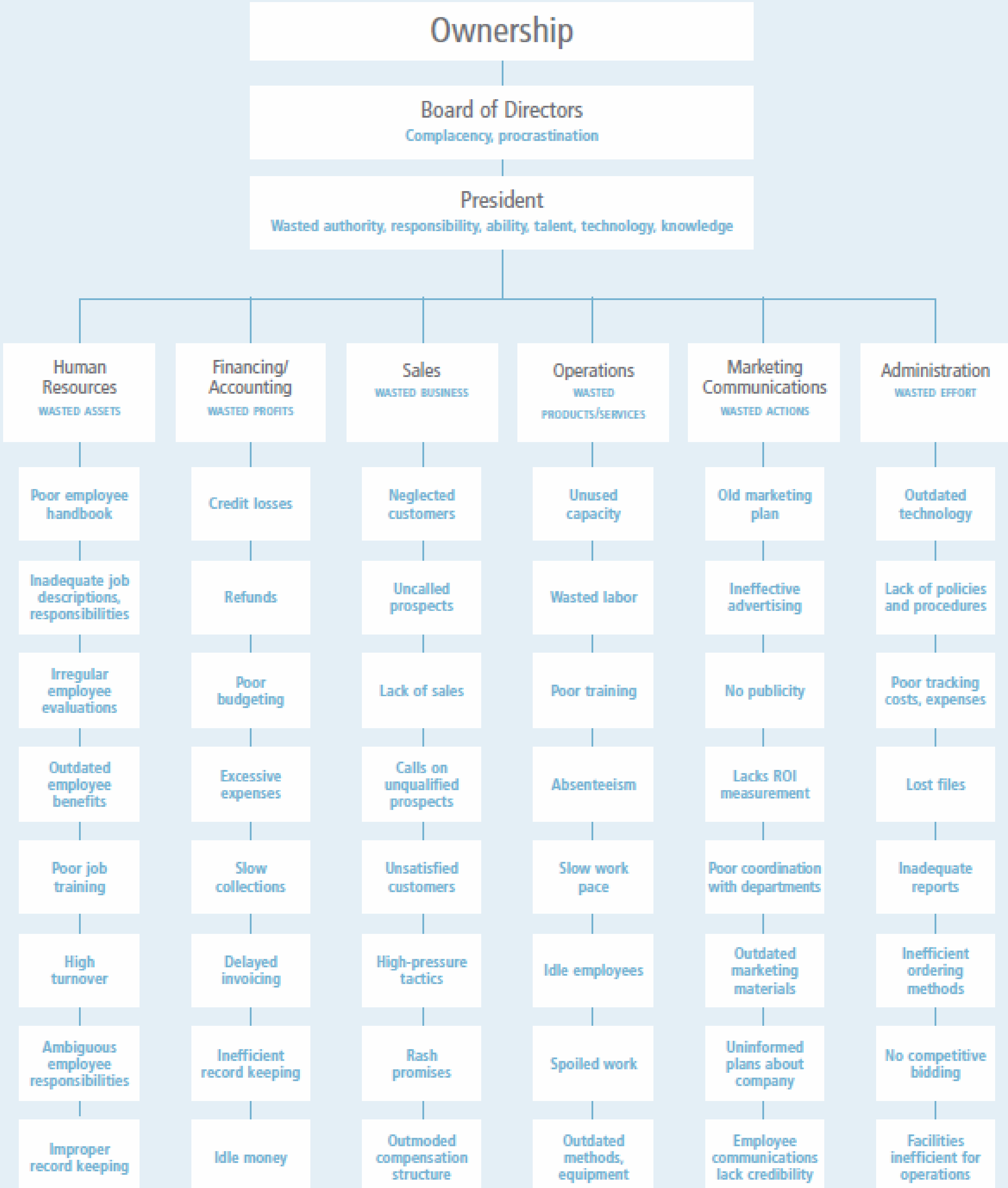

Figure 5. Waste is every organization's largest competitor.

style and profitability are linked. Pay for performance doesn't guarantee profitability, but it has advantages in a down economy.

How much is my staff costing? We recently found that even though 77 percent of small business owners don't plan to give raises in 2010, most aren't even talking to employees about their "hidden paycheck." This mistake costs talent and productivity because pay is just one aspect of employee compensation. Other employee benefits essentially make up a hidden paycheck that many people easily forget, although it can add as much as 37 percent to their compensation.

That hidden paycheck includes items such as medical and dental insurance; sick, personal and vacation days; education reimbursements; discount auto purchase plans; accidental death and personal loss insurance; workers' compensation; profit sharing; and Social Security and Medicare.

Nearly 70 percent of small business owners do not share the total value of the hidden paycheck with employees. But more surprisingly, more than 50 percent don't even know what that hidden paycheck is costing them.

A benefits statement or pay stub is more important than ever to communicate a company's true value to employees. Employees who move to another company to make another $2,000 a year may be losing $5,000 in benefits if they don't check, or know, the real numbers.

Know your company's biggest competitor

While business owners are experts in their particular industry, the reality of the day-to-day operations often overwhelms them. They get too caught up in the short-term details and lose sight of the big picture — the real role of a business owner.

This lack of management knowledge and feeling of being overwhelmed leads to the creation of every organization's largest competitor: Waste Inc., shown in Figure 5. And business owners are shocked to learn not only how much is wasted, but the real effect it has on the organization.

These characteristics are reminiscent of an owner who is nearly paralyzed from being overwhelmed:

This lack of management knowledge and feeling of being overwhelmed leads to the creation of every organization's largest competitor: Waste Inc.

- *Wasted assets:* Human resources can be wasted on a poor employee handbook or job training, inadequate job description/responsibilities, irregular employee evaluation, high turnover, improper record keeping, etc.
- *Wasted profits:* Finance/accounting can cause credit losses, refunds, poor budgeting, excessive expenses, slow collections, idle money, etc.
- *Wasted business:* Sales are wasted every day on neglected customers, uncalled prospects, lack of sales, unsatisfied customers, high-pressure tactics, rash promises, etc.
- *Wasted products/services:* Operations go underutilized with unused capacity, wasted labor, poor training and absenteeism, slow work pace, outdated methods/equipments, etc.
- *Wasted actions:* Marketing and communication wastes include old marketing plans, ineffective advertising, no publicity, lack of return on investment and measurement, uninformed plans about company, lack of employee communication credibility, etc.
- *Wasted effort:* Administration resources are wasted with outdated technology, lack of policies and procedures, poor tracking costs and expenses, lost files, inadequate reports, inefficient facilities, etc.

Ninety-five percent of George S. May's clients experience some form of inefficiency. To identify and eliminate waste and costs, businesses should address each issue separately.

Measurement is imperative

By employing some form of metrics, either with dashboards or metrics management technologies, critical insight and understanding can be obtained to make better and faster decisions by visually representing business data in real time. While managers can be involved in every area of the business at all times, it's important to measure performance and manage the business 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.

KPIs should be developed to measure a company's general business activity, such as the number of items produced, sales made and orders filled. Moreover, 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 employees, what they accomplish in a given amount of time, what the variance is, and how to narrow the variance. Technologies can help managers run the business in real time, by the hour, so nothing is wasted.

A strategically planned profit model and remembering three key ideas, stated in seven words, will help owners of any business perform better in the future. The three key ideas are business intelligence, data warehousing and the aforementioned key performance indicators. They are important for improved performance, and even survival, for business owners.

- **Business intelligence.** It's all about truly knowing and understanding your own business, your customers or clients, and their interests. Know the true value of your establishment.
- **Data warehousing.** Data warehousing is a fancy, computer-oriented term for something that smart owners have done for years: remembering past experience to improve current and future performance. The concept of data warehousing is a natural next step after starting to use business intelligence. Once you have the data, store it so it can be used to plan and compare against future work.
- **Key performance indicators.** KPIs include information such as the number of customers served per day, the amount of cash brought in per week and the quantity of widgets sold per period.

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Business intelligence, data warehousing and key performance indicators are seven simple words that when put into action can mean dramatically improved performance for a business. Without these metrics, business owners cannot know how well the business is doing. ◆