Keep Pointed Towards Profit

Written by WeBC

Why do some business owners hit the profit target more often than others? They do it because they keep their operation pointed in that direction. They never lose sight of the goal—to finish the year with a profit.

You can improve your company's performance by knowing your operation, by practicing the art of making timely, balanced judgments and by controlling the company's activities. In effect, you must control the activities of your company rather than being controlled by them.

This document gives suggestions that you can adapt to your situation to help you zero in on profit.

1. Know Your Business

The time-honored truth "Knowledge is Power" is especially pertinent to the owner of a small business. You must know how the company is doing before you can improve its operation. You must know its weak points before you can correct them. Some of the knowledge you need you pick up from day-to-day personal observation, but records should be your principal source of information about profits, costs, and sales.

2. Know Your Profit

The profit and loss statement (or income statement) prepared regularly each month or each quarter by your accountant is one of the most vital indicators of your business's worth and health. You should make sure that this statement contains all the facts you need for evaluating your profit. This statement must pinpoint each revenue and cost area. For example, it should show the profit and loss for each of your products and product lines as well as the profit and loss for your entire operation.

It's a good idea to have your profit and loss statement prepared so that it shows each item for the current period, for the same period last year, and for the current year-to-date. For example, a P & L statement for the month of November would show income and expenses for the current month, for November last year, and totals for the eleven months of the current year. Many corporations publish their annual reports with several previous years so stockholders can compare earnings.

Comparison is the key to using your P & L statement. If your accountant is not already furnishing figures that you can compare, you should discuss the possibility of having them provided. Financial ratios from your balance sheet also help you to know if your profit is what it should be. For example, the ratio of net worth (return on investment ratio) shows what the business earned on the equity capital invested.

3. Know Your Costs

You should know costs in detail. Then, you can compare your cost figures as a percentage of sales (operating ratio). Be certain that your costs are itemized so you can put your fingers on those that seem to be rising or falling according to your experience and the cost figures of your industry. When costs are itemized, you can spot the culprit when the overall figure is higher than you budgeted.

Take advertising costs, for example. You can catch the offender if you break out your advertising expenditures by product lines and by media. In addition, a thorough check of inquiry returns from advertising will help to avoid unproductive publications.

In knowing your costs, keep in mind the formula for profit: Profit = Sales - Costs.

4. Know Your Product Markup

Be certain that the pricing of your products provides a markup adequate for the kind of profit you expect to achieve. You must keep constantly informed on pricing because you have to adjust for rising costs and at the same time keep prices competitive. Knowledge about your markup also helps you to run closeouts with your eyes open.

Continuing to make a product that only a few customers want is an effective merchandising tool only when you use it on purpose—for example, to hold or attract buyers for other high markup products. Don't hesitate to drop a loser from your line.

5. Garbage-In, Garbage-Out

You should not fudge the records. The acronym GIGO that the computer industry uses is true with manually kept records as well as with machine-processed ones. If you allow “garbage” to go into the records, the reports will contain “garbage.” Reports need not be extensive, but they must be accurate.

6. Look For Trends

Try not to look at a single month's sales or profit picture by itself. The figures on your operating statements are meaningful only when you put the picture in the right frame—that is, look at your figures in the context of what has happened and what is likely to happen. In that manner, you catch a downward trend before it gets out of hand.

You should also concern yourself with the figures behind the dollars—for example, the number of units sold or the number of orders. Insist on cost-per-unit statistics. The fluctuation of the cost-per-unit can be much more meaningful than just looking at the dollar figures alone. Another idea is to display these comparative figures on graphs so that significant trends can be seen easily.

7. Predict Your Future

Don't use a crystal ball to make forecasts for your business. By carefully analyzing the historic trends of your business, as shown in your records for the past five years, you can forecast for the year ahead. Your record of sales, your experience with the markets in which you sell, and your general knowledge of the economy should enable you to forecast a sales figure for the next year.

When you have a sales forecast figure, make up a budget showing your costs as a percentage of that figure. In the next year, you can compare actual P & L figures to your budgeted figures. Thus, your budget is an important tool for determining the health of your business.

8. Make Timely Decisions

Without action, forecasts and decisions about the future are not worth the paper they’re written on. A decision that doesn’t result in action is a poor one. The pace of business demands timely as well as informed decision-making so, if you’re to stay ahead of competition, you must act to stay in control.

Effective decision making in the small business requires several things. You must have as much accurate information as possible. With these facts, you should determine the consequences of all feasible courses of action and the time requirements. When you have made the judgment, you have set up your business so that the decisions you make can be transmitted into action.

9. Control Your Business

To be effective, you must be able to motivate key people to get the results planned for within the cost and time limits allowed. In working to achieve results, the small business owner has an advantage over big business. You can be fast and flexible while many large firms must await committee action before a decision is made. You do not have to get permission to act. And, equally important, bottlenecks to implementing new practices can receive your personal attention.

One of the secrets is in deciding which items to control. Even in a small company, you should not try to be all things to everyone. You should keep close control on people, products, money, and any other resources that you consider significant to keeping your operation pointed toward profit.

10. Manage Your People

Most businesses find that their largest expense is labour. Yet, because of the close contact with employees, some small business owners don't pay enough attention to direct and indirect labor costs. They tend to think of these costs in terms of individuals rather than relate them to profit in terms of dollars and cents.

Here are a few suggestions concerning personnel management:

- **Periodically review each position in your company.** Take a quarterly look at the job. Is work being duplicated? Is it structured so that it encourages the employee to become involved? Can the tasks be given to another employee or employees and a position eliminated? Can a part-time person fill the job?
- **Use compensation as a tool rather than viewing it as a necessary evil.** Reward quality work. Investigate using raises and bonuses as incentives for higher productivity. For example, can you schedule bonuses as morale boosters during seasonal slacks or other dull periods?
- **There are creative ways of controlling absenteeism through incentive compensation plans.** For example, the owner of one small company eliminated vacations and sick leave.

Instead, this owner gave each employee thirty days of annual leave to use as the employee saw fit. At the end of the year, the employees were paid at regular rates for the leave they didn't use. To qualify for the year-end pay, the employee had to prove that sick leave was taken only for that purpose. Non-sick leave had to be applied for in advance. As a result, unscheduled absences and overtime pay were reduced significantly. In addition, employees were happier and more productive than they were under the old system.

11. Control Your Inventory

Don't tie up all your money in inventory. Use a perpetual inventory system as a cost control rather than a system just for tax purposes. Establish use patterns or purchase patterns on the materials or items you must stock to keep the minimum number required to supply your customers or to maintain production. Excessive inventory, whether it's finished product or raw materials, ties up funds that could be used to better advantage, for example, to open up a new sales territory or to buy new machinery.

Centralize your purchases and avoid duplications. Be a comparative shopper. Confirm orders in writing. Get the price and amount straight right away. Check what you receive for condition and quality. Check bills from suppliers against quotations. You do not want to be the victim of their error. You should, however, keep one fact in mind when you set up your inventory control system: do not spend more on the control system than it will return in savings.

12. Control Your Products

Make sure that your sales people recognize the importance of selling the products that are the most profitable. Align your service policies with your markup in mind. Arrange your goods so that low markup items require the least handling.

13. Control Your Money

It is good policy to handle cash as though they were perishable commodities. They are. Money in your safe earns no return, and it can be stolen. Bank promptly.

Use credit wisely and take advantage of discounts. One of the hallmarks of a successful business entrepreneur is knowing how much credit you can afford to extend over any period and how much you have already extended.

Grant credit willingly, but keep it on a systematic basis. Insist on a written credit application and see that the credit application contains a promise to pay according to the credit practices in your industry. Get your monthly bills out to customers on time, and be certain that bills show date of purchases, what was purchased, how much it cost, and how much was paid, if anything, and then how much is owed. The statement should also show your customer any overdue balance and for how long it has been overdue.

Every account will not pay promptly, but keep in mind that a slow paying customer can be profitable, especially if the customer buys large amounts of your high markup items. The danger is in letting such a customer get in beyond their ability to pay.

Set up a system for collecting from late and slow-paying accounts, but in reminding them to pay up, your objective is to get your money without losing their business.

14. Get Help When You Need It

It’s good practice to use your outside advisors as you go along rather than calling on them only in emergencies. For example, your accountant can help you analyze the financial position of your business to help you avoid problems rather than to get you out of them.

Sometimes a business owner needs to call in a management consultant. Help may be needed in isolating and solving a problem that you can sense but can't quite put a finger on. In other instances, the consultant may be needed to supply skills that do not exist in the company—for example, the capability for doing market research or for setting up an inventory control system. In many cases, the management consultant can provide the time that you lack to implement a solution.

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