



Bucks County

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Practical Steps to Improve Profitability

Introductions and Objectives

- Understand the key profit drivers of your business
- Learn practical ways to monitor your financial performance and improve profitability
- Define the key steps in establishing a profitability improvement program

AGENDA

introduction

financial controls

strategies for growth

financial management

financial improvement planning

summary

Small Business facts

Small business is a major engine of US economy. On average about 450,000 new companies created every year.

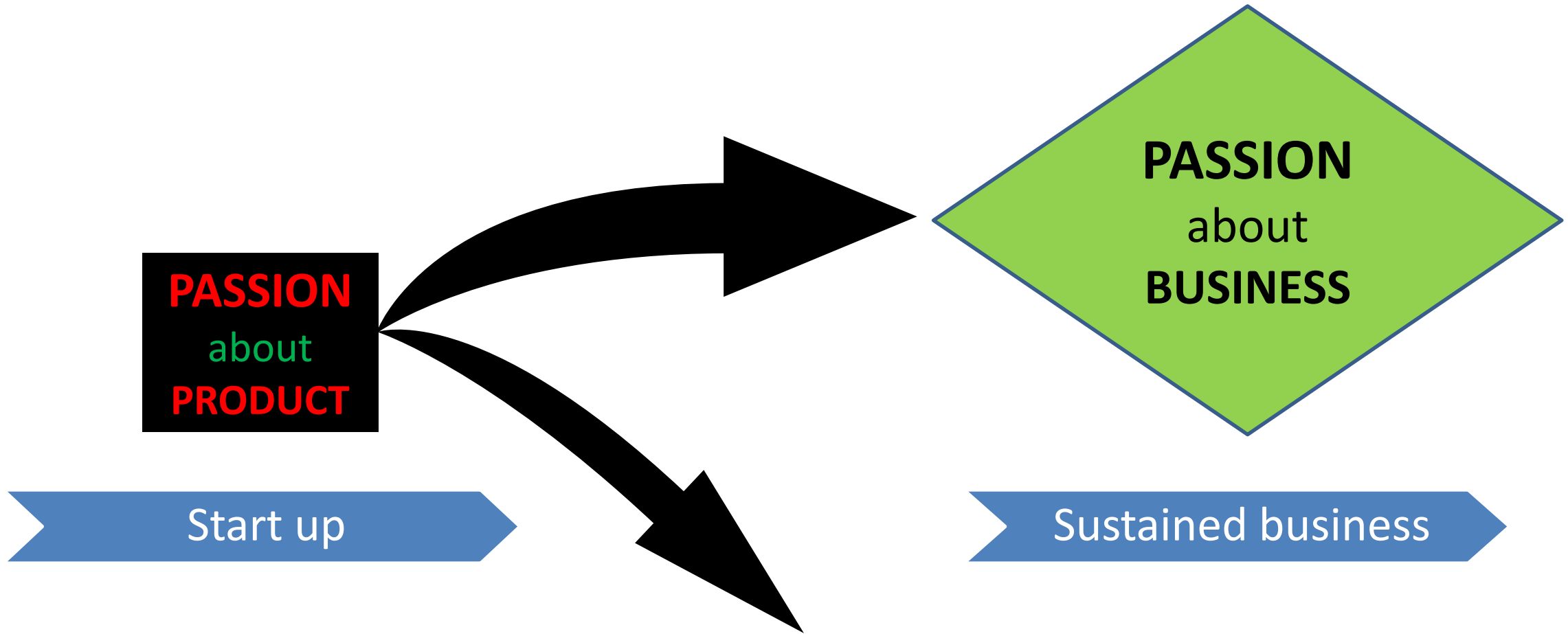
80% survive the first year

50% survive 5 years

30% operate past 10 years

WHY??

Mind set and focus must evolve



Realities of business today....

- Need to manage closely with prevention in mind
- Act quickly in case of unplanned events to avoid crises
- Pay attention to performance and trends and re-invent yourself as needed
- Like chess, you need to think a couple of moves ahead!!

financial controls

Key Financial Terms

Profit

financial gain obtained when the revenue generated from the business operations exceed the expenses and costs incurred in carrying out the business activity (\$)

Profitability

the degree to which a business or activity yields profit or financial gain (% of sales)



Essential Financial Statements for your business

Balance Sheet

It reports a company's assets, liabilities, and equity at a single moment in time.

Profit and Loss Statement (Income Statement)

summarizes the revenues, costs and expenses incurred during a specified period of time

Cash Flow Statement

It tracks the inflow and outflow of **cash** resulting from operating, investing and financing activities during a given time period



Strategies for growth

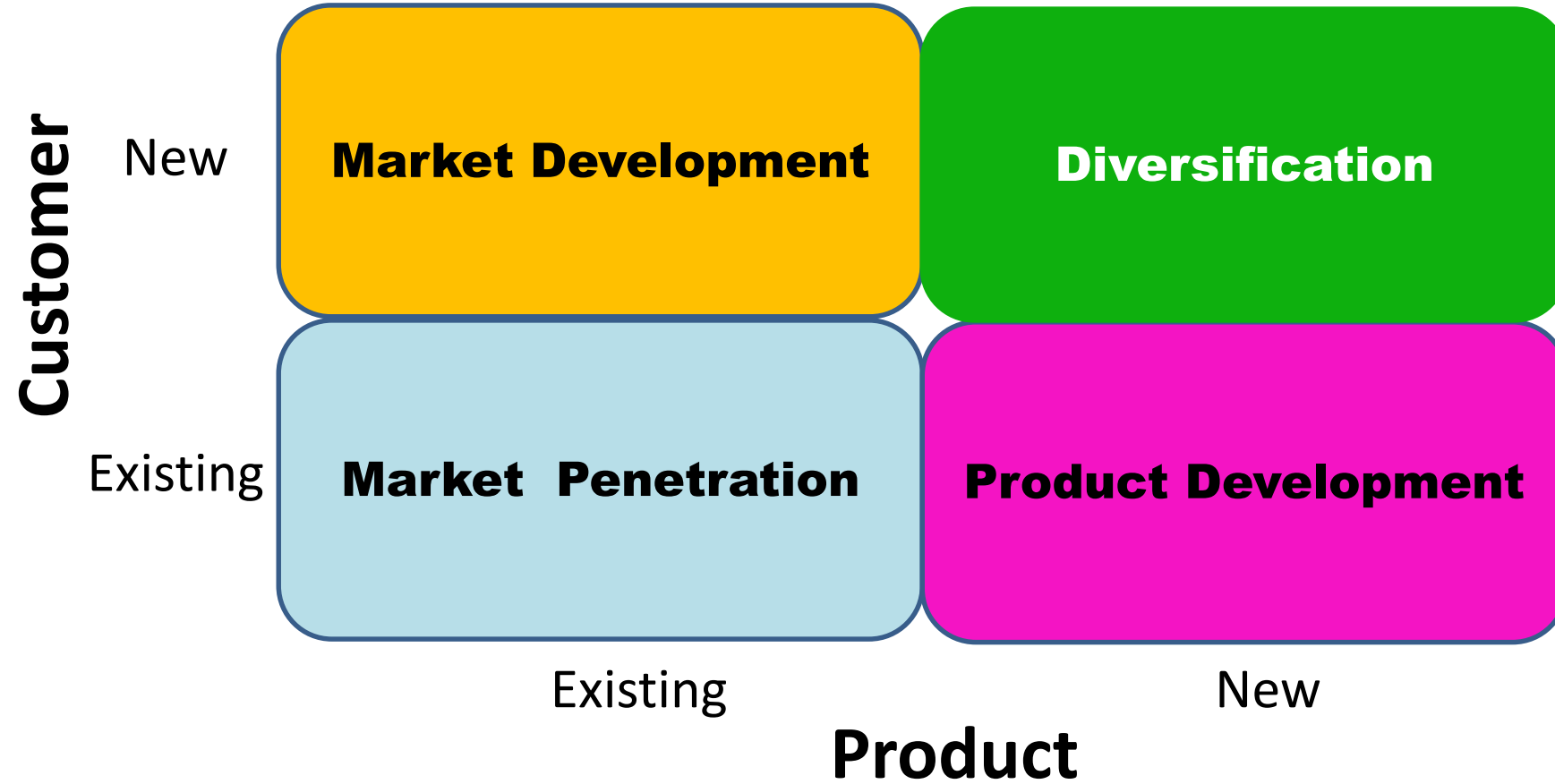
Several approaches to grow your business with increasing levels of complexity and difficulty

Market penetration/expansion

Product expansion

Diversification

Penetrating new markets and/or new product very challenging



Improvement in business performance requires management changes

- Large transformations offer the potential for significant growth in revenue ...
but they are slow, expensive and riskier
- Small changes offer potential for small improvements
but they are easier to implement with less risk

Simplest approach for short term financial performance improvement

Optimize your operations

Review your Financial reports, understand and systematically challenge all line items

- **Revenue**
- **Costs**
- **Cash Flow**

to determine potential to changes that can lead to higher profitability

Smart cost reduction only

Any cost improvement should be focused on eliminating waste and inefficiency and not be made at the expense of:

- Customer satisfaction
- Product quality and performance
- Safety – product, employees
- Compliance with laws and/or ethics standards

Financial Management

Keep business separate from your personal finances

Why should you keep business and personal finances separate?



The illustration shows two men on either side of a central area. The man on the left is dressed in a white t-shirt and blue jeans, representing personal finances. The man on the right is in a white shirt, tie, and black pants, representing business finances. Both are holding large blue and red magnets. In the center, several gold coins with dollar signs are being pulled towards the magnets by orange lightning bolts, illustrating the flow of money between the two domains.

TAXES
Helps ensure you pay the right amount of tax. Not too little, not too much.

TRACKING
Saves you time figuring out what your business expenses are.

TRANSPARENCY
You'll be ready when an accountant, potential investor, or lender asks to see your finances.

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Tools used for Financial Management

Financial statements provided by your Accountant, QuickBooks, or your own monitoring spreadsheet

- Profit and Loss (or Income) Statement
- Cash Flow

Profit & Loss or Income Statement

summarizes the revenues, costs and expenses incurred during a specified period of time

Income Statement – Example

Company Business performance in 2018

- Sold 10,000 units at an avg price of \$ 25/unit
- Product cost: \$ 14/unit
- Other expenses for the year:
 - Lease: \$20,000
 - Marketing: \$15,000
 - Payroll: \$50,000

Income Statement

Sales		250,000
Direct Cost (COGS)		140,000
Gross Profit		110,000 (44%)
Fixed costs		
- Marketing:	15,000	
- Rent:	20,000	
- Payroll:	50,000	
	Total Indirect	85,000
Net Profit		25,000 (10%)

Income Statement - Revenue/Sales

Sales

250,000

0 price

Two important classes of costs in pricing setting

DIRECT COSTS (variable)

- Costs associated with production and delivery of product/services:
Labor, material, shipping,...
- Vary with level of sales – “good costs”

INDIRECT COSTS (fixed)

- Costs associated with the operation of the business:
Admin payroll, rental, insurance, telecommunications
- Need to be recovered regardless of sales
- Not dependent on volume (limits)

Price views – internal vs external

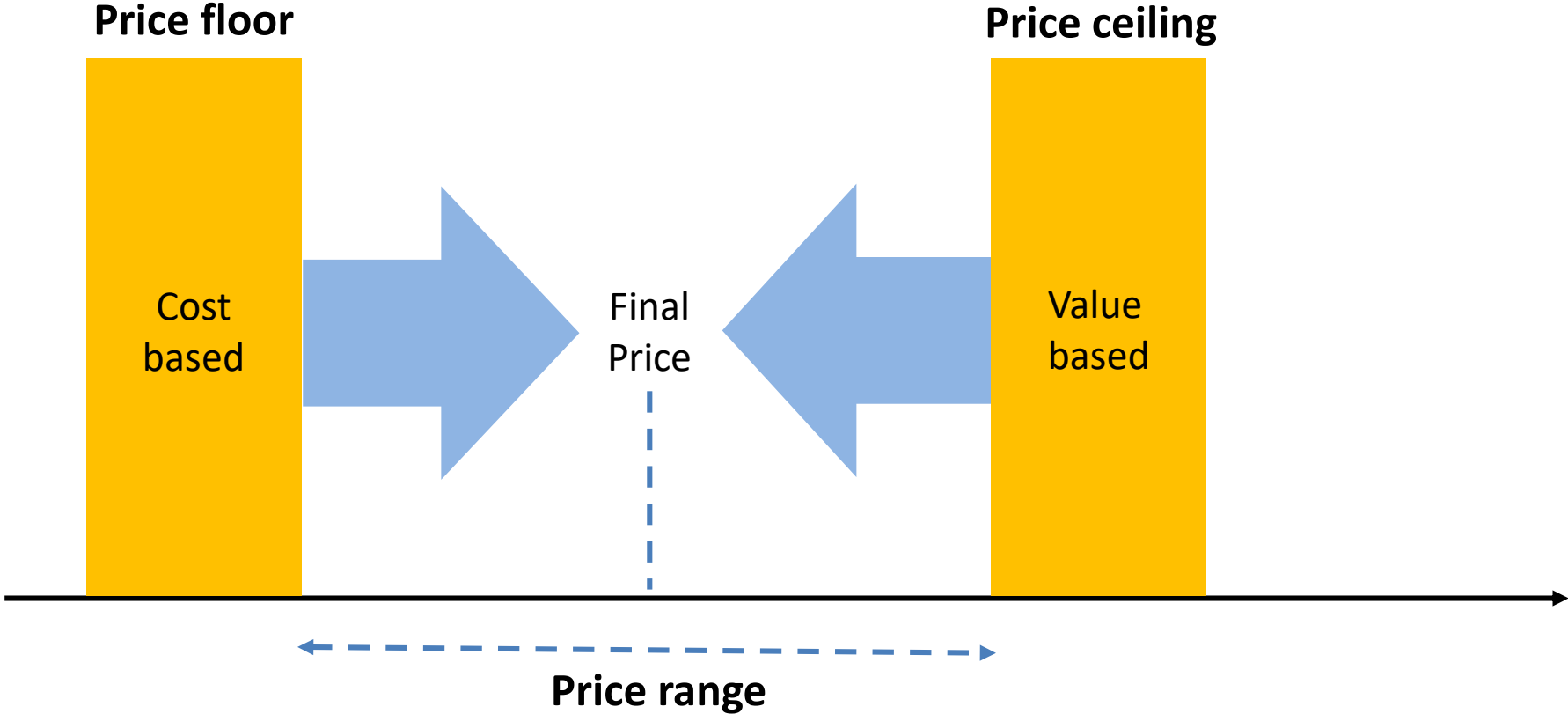
Cost-based (*Internal view*)

Price = (Direct cost/unit + Fixed cost/unit) + Profit/unit

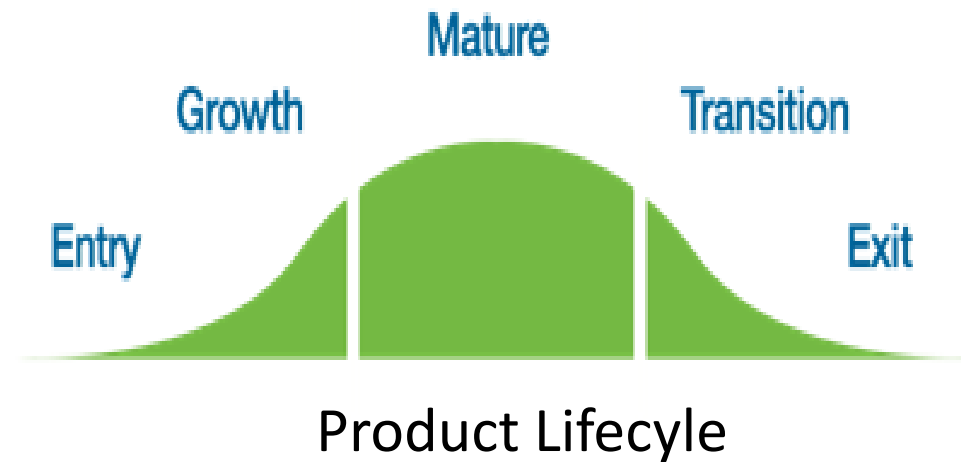
Value-based (*External view*)

Price derived based on the benefits the product provides

Pricing setting is a compromise of multiple factors - need to understand what is the PERCEIVED value by the customer!



Price varies significantly depending on the strategy



Income Statement - Revenue/Sales

Sales

250,000

① Increase price

- Where are you in the price range?
- Understand differentiators
- Marketing plan based on value and differentiators

Income Statement - Revenue/Sales

Sales

250,000

- 0 Increase price
- 1 Increase customer numbers
 - Expand channels
 - Increase market share

Income Statement - Revenue/Sales

Sales

250,000

- 0 Increase price
- 1 Increase customer numbers
- 2 Increase frequency they buy
 - Outstanding service
 - Nurture your customers
 - Ask them to return

Income Statement - Revenue/Sales

Sales

250,000

- 0 Increase price
- 1 Increase customer numbers
- 2 Increase frequency they buy
- 3 Increase avg sale value
 - Cross and up selling
 - Bundling

Income Statement - Direct Costs

Sales	250,000
Direct Cost (COGS)	140,000

- 0 Increase price
- 1 Increase customer numbers
- 2 Increase frequency they buy
- 3 Increase avg sale value
- 4 Increase margins
 - **Operational efficiencies**
 - **Reduce waste**
 - **Overtime**
 - **Automation**
 - **Avoid discounts**
 - **Better supplier agreements**
 - **Scope control (service)**

Income Statement - Indirect/Fixed Costs

Sales	250,000
Direct Cost (COGS)	140,000
Gross Profit	110,000 (44%)
Fixed costs	
- Marketing:	15,000
- Rent:	20,000
- Payroll:	50,000
Total:	85,000

- 0 Increase price
- 1 Increase customer numbers
- 2 Increase frequency they buy
- 3 Increase avg sale value
- 4 Increase margins
- 5 Reduce fixed costs
 - Marketing – determine cost/benefit
 - Renegotiate lease
 - Evaluate mix full time, part time support
 - Technology, automation. subcontracting

Income Statement - Profitability

Sales		250,000
Direct Cost (COGS)		140,000
Gross Profit		110,000 (44%)
Fixed costs		
- Marketing:	15,000	
- Rent:	20,000	
- Payroll:	50,000	
Total:		85,000
Net Profit		25,000 (10%)

- 0 Increase price
- 1 Increase customer numbers
- 2 Increase frequency they buy
- 3 Increase avg sale value
- 4 Increase margins
- 5 Reduce fixed costs
- 6 Profitability
 - Is this the right level \$ and %?
 - Consistent with your plan/goals?

Let's examine the impact of small changes

- Assume that revenue increased by 5%
- Assume all costs – direct and fixed – reduced by 5%

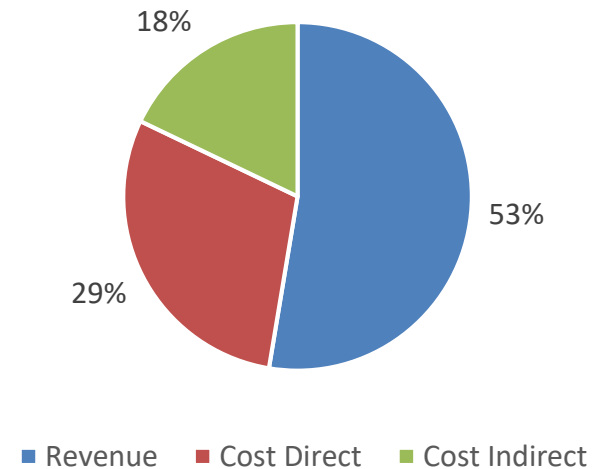
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Direct Cost (COGS)		140,000
Gross Profit		110,000 (44%)
Fixed costs		
- Marketing:	15,000	
- Rent:	20,000	
- Payroll:	50,000	
	Total:	85,000
Net Profit		25,000 (10%)

Guess an estimate of the improvement in net profit (\$)

Income Statement – changes +/- 5%

Sales		250,000		262,500
Direct Cost (COGS)		140,000		133,000
Gross Profit		110,000 (44%)		129,500 (49.3%)
Fixed costs				
- Marketing:	15,000		14,250	
- Rent:	20,000		19,000	
- Payroll:	50,000		47,500	
	Total:	85,000		80,750
Net Profit		25,000 (10%)	→	48,750 (20%)

Net Profit Improvement



Notes

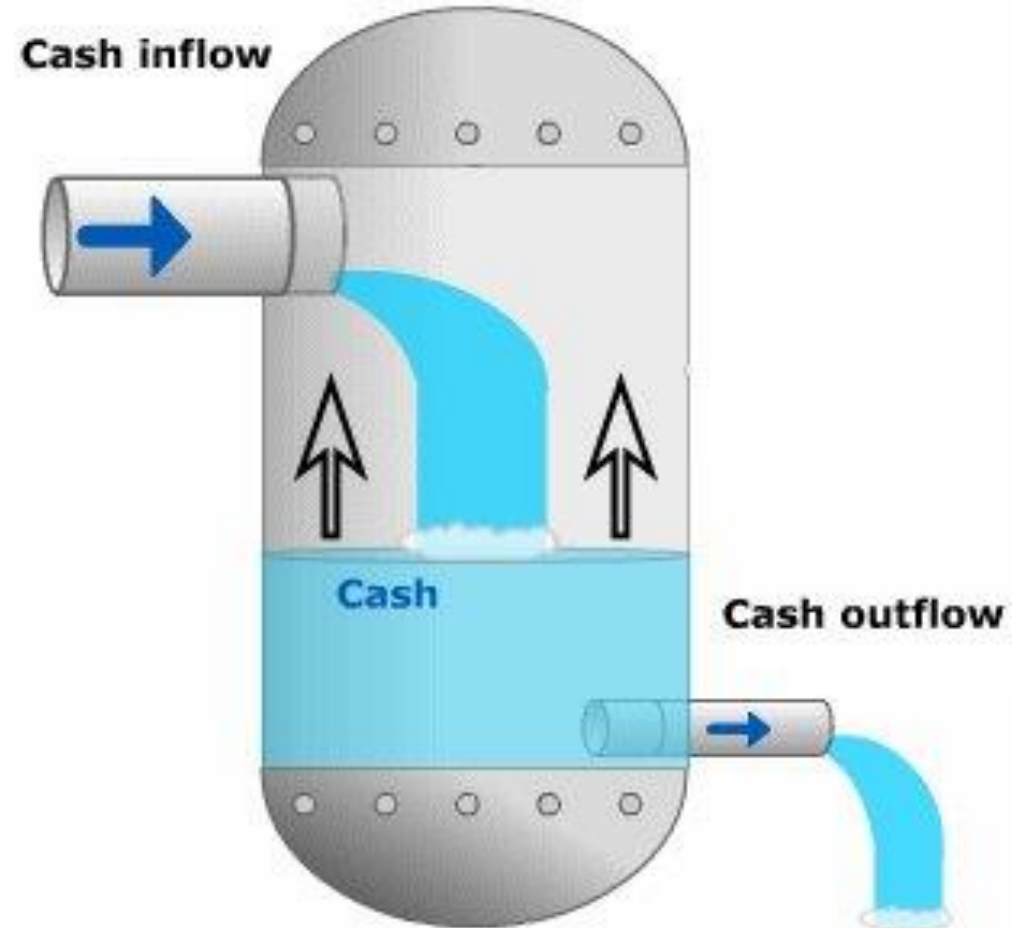
- The magnitude of the improvement is very dependent on the specific business financials
- Use your specific Profit & Loss Statement to determine what could be the impact for your business

Cash Flow Statement

It tracks the inflow and outflow of cash resulting from operating, investing and financing activities during a given time period

Why focus on Cash Flow

- Cash is critical for sustainability of the business
- Even profitable companies go bankrupt due to cash flow problems



Main causes of cash flow problems

- Low profits or (worse) losses
- Too much production capacity
- Excess inventories
- Allowing customer too much credit and/or too long to pay
- Seasonal demand

What can be done?

INFLOW

- Invoice immediately upon product/service delivery
- Accept credit card payment
- Ask for pre-payment
- Reduce terms of payment
- Inventory control – stock turns, product mix
- Fire bad customers
- Have sale or liquidate inventory

OUTFLOW

- Negotiate with suppliers for extended payment terms
- Negotiate with suppliers on price or seek new suppliers
- Lease rather than buy assets
- Careful in acquiring assets that do not increase revenue

Financial Improvement Planning

Start by defining where do you want to go!

Vision - what do you want – sales, profits ?

Values - what is important for your business ?

Methods - how do you get there – road map ?

Metrics - how will you know when you get there ?

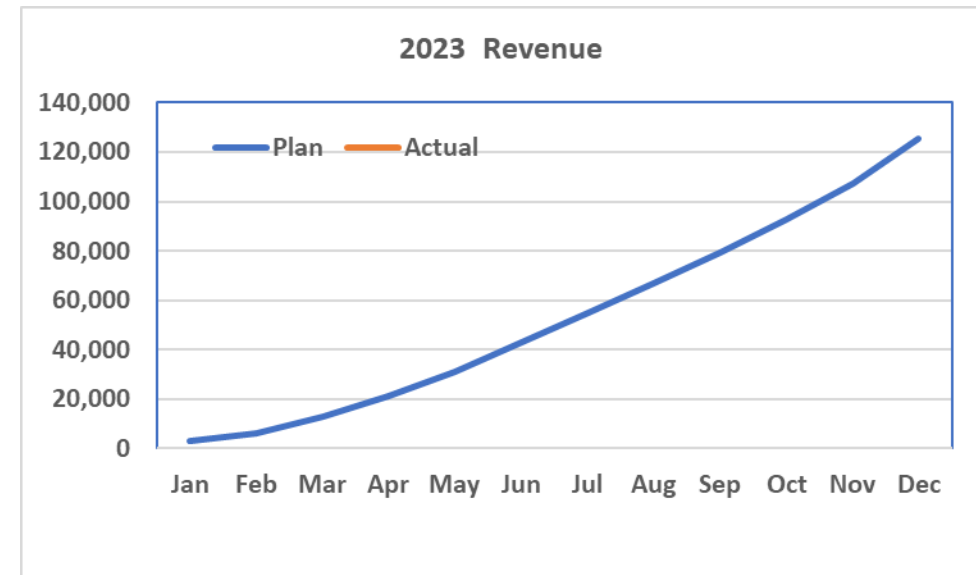
Improvement road map ... Set your goals for next year ...

1. Assessment of current operations
2. Define improvement goals and objectives
3. Prepare the Improved Financial Plan – forecast for upcoming year
4. Establish an Action Plan for improvement
5. Track the actual performance resulting from the actions implemented
6. Compare Key Metrics performance against the Financial Plan

Financial Plan – Yearly forecast of important parameters

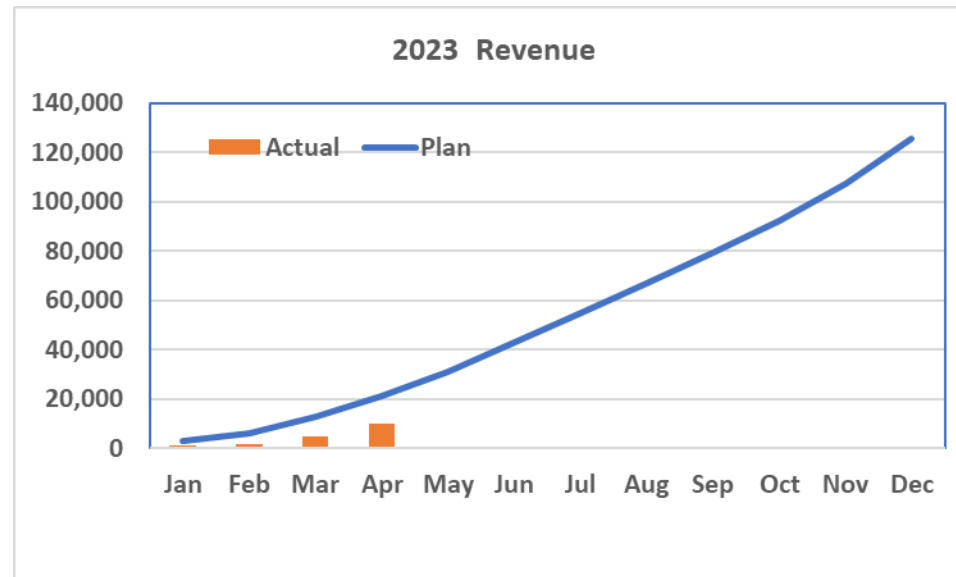
- Project your business performance for the upcoming year by creating forecasts for all lines of the Income Statement by month
 - ✓ Operating business - use previous period performance adjusted by the improvement goals
 - ✓ Start up - create a forecast, best guess of sales based on your understanding of the customer needs, market, product appeal, and your capacity of delivery

This becomes your road map

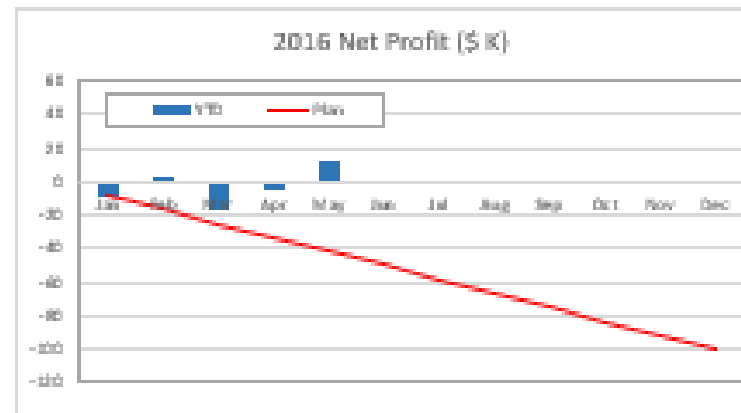
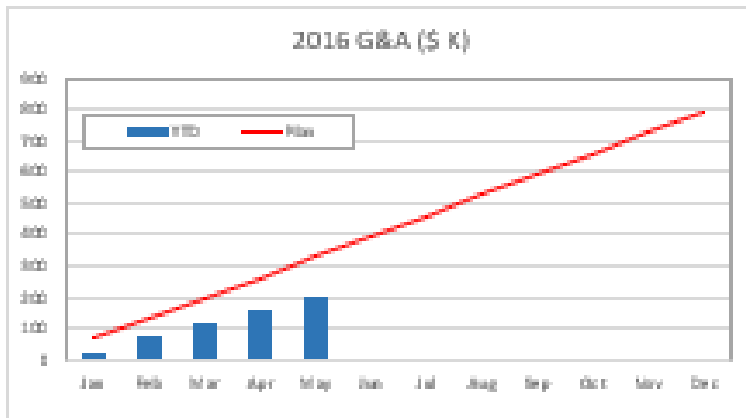
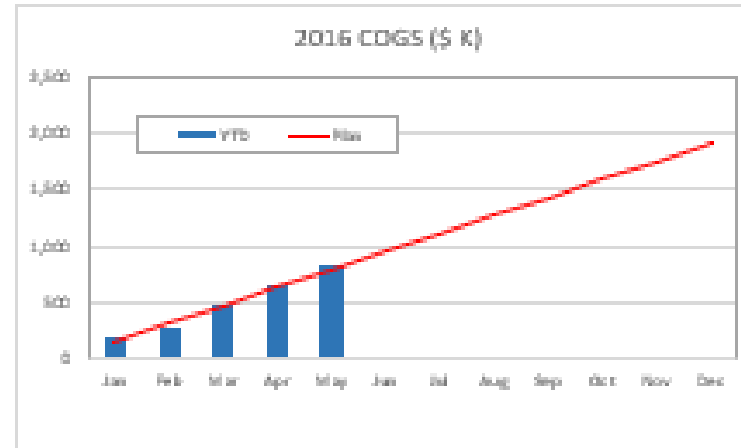
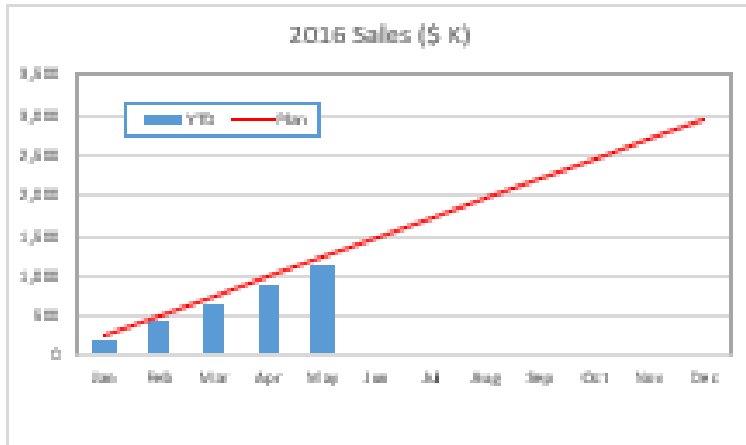


Financial Tracking – On going review of actual performance

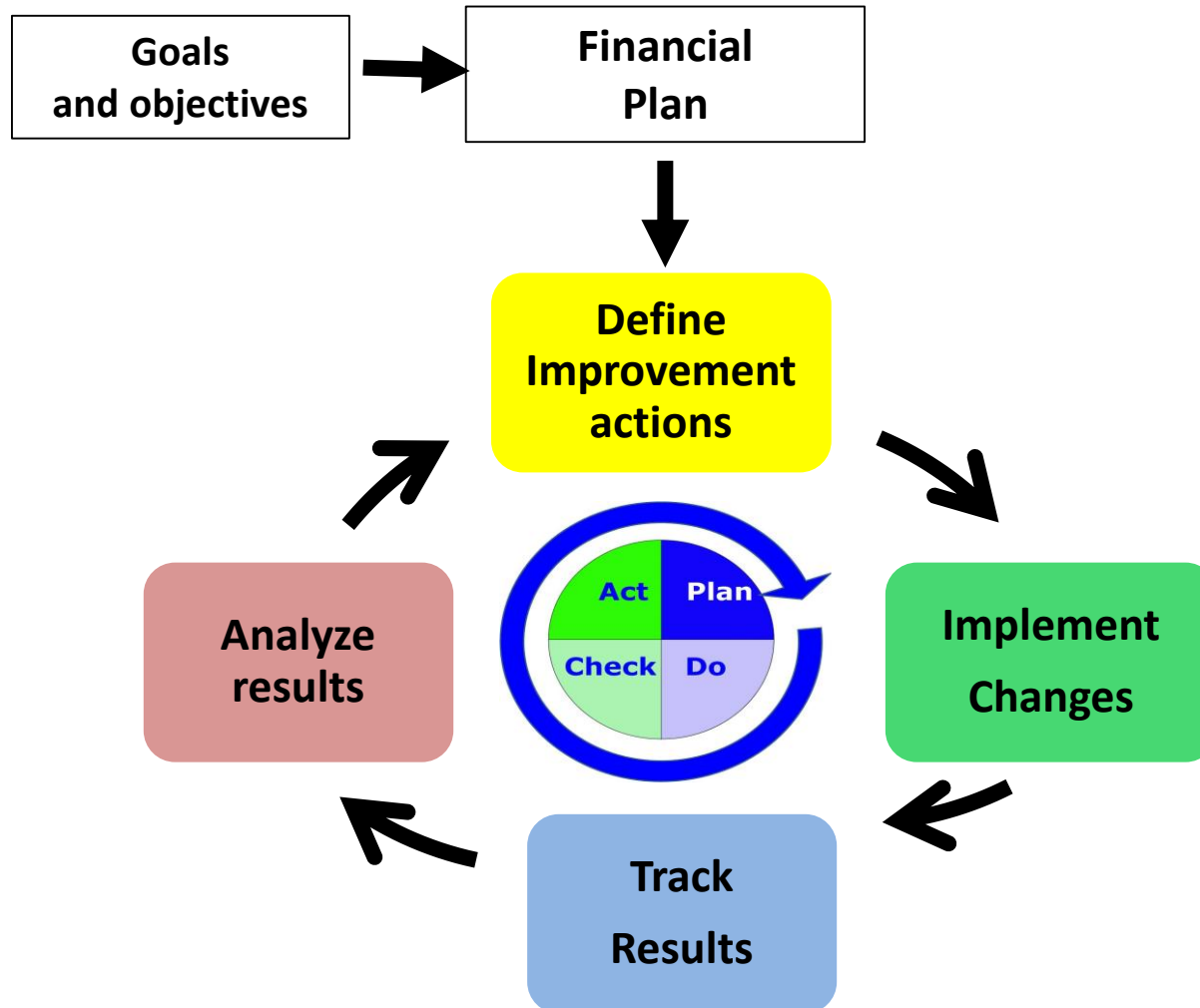
- Review all relevant Performance Indicators of interest, systematically on a monthly basis to follow what is happening
 - ✓ Understand the causes for significant deviations and define appropriate corrective actions
- Cash flow may need weekly review depending on the particular business



Typical Financial Monitoring dashboard



Implement with discipline monthly reviews and make it continuous



KAIZEN

- Japanese approach for Quality improvement,
- Continuous small improvements

Summary

Optimizing your operations can bring short term improvements

- Small improvement easy to implement
- Decisions based on data - use simple financial models
- Establish Performance Metrics
- Net profitability greater than 15% goals
- Manage financials with discipline - monthly



Small changes can have a significant impact

Ready to start your program?

- A mentor can provide guidance and help bring direct experiences
- Start your mentoring program today



Thank you !

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