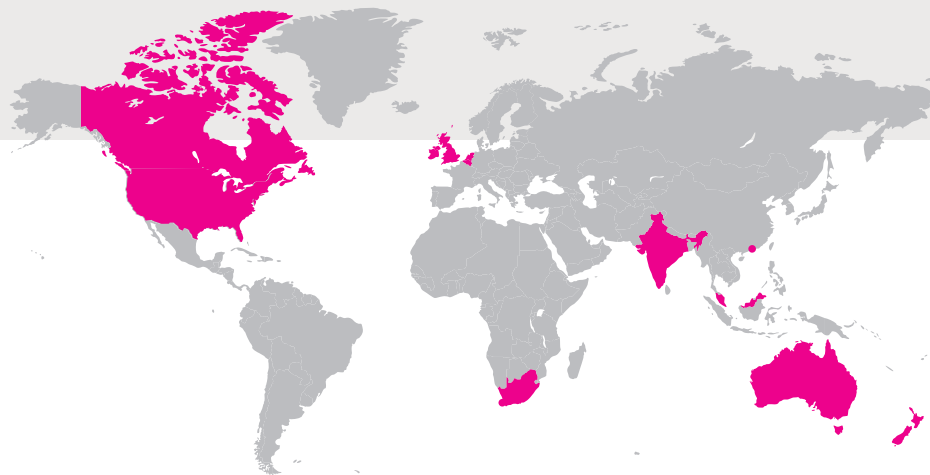




DRIVING PROFITABLE
GROWTH

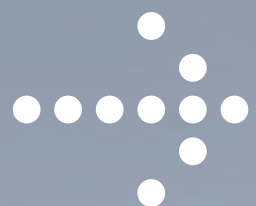
Profit
Improvement





“Without an understanding of profitability, every business, no matter how successful is a house of cards”

Mike Michalowicz, Entrepreneur and Author.



Executive summary

There are only four ways you can improve your profits: sell more, get customers to buy more frequently, increase prices and reduce costs. If you can do all four at once, your profits will increase dramatically. Even changing one of these four factors will boost your profits.

Highlights

- The main reasons for low profits
- How a part-time CFO will help you to boost your profits



Introduction

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Profits are vital for your company's growth for the following reasons:

- They provide a return on your investment capital.
- They provide opportunities to reward staff.
- They make it easier to attract investors and customers
- They make it easier to borrow money and negotiate a lower interest rate on the money it secures.
- They can be reinvested in the business to expand into new markets, products and locations.
- They provide a buffer against economic downturns and changes in market conditions.
- They make it possible to hire more people.
- They allow you to develop and test new products or services.

While many business owners experience a decline in their net profit margin (the percentage of total revenue that's profit) at one time or another, they are usually able to continue to trade, albeit with the aid of a short-term loan and some heavy duty cost-cutting.

Sadly, unless you identify and address what's causing your profits to shrink, the problems are likely to get worse. For it often follows that poor profitability leads to reduced cash flow. When profits are low and cash flow is weak, businesses can slip into a downward spiral.

Your profits tell you how well or how poorly your business is performing.

For example:

- Gross profit (the total amount your business makes minus the cost of goods sold (COGS) indicates how efficiently your business uses resources to produce your products or services.
- Operating profit (gross profit minus operating expenses, depreciation, and amortisation) indicates how efficiently you produce and sell your product or service.
- Net profit (the amount of money left after paying all the business' expenses including interest, taxation, depreciation, etc.) indicates how well your business is generating healthy results.

These figures alone won't give you the whole picture. You'll need to compare them with previous annual and monthly profit results. That's where ratios come in, which can be used as a benchmark against which you can measure your business' performance.

Profitability ratios help you evaluate your company's ability to generate profits.

They include **gross profit margin**; **operating profit margin**; and **net profit margin**.

- **Gross profit margin** your gross profit divided by your sales is a useful indicator of your company's financial health. It shows how efficiently your business is using its materials and labour in the production process and gives an indication of the pricing, cost structure and production efficiency of your business.


The higher the gross profit margin, the better. That is because the higher the percentage, the more your business retains of each pound of sales, which means more money for other operating expenses and net profit.

- **Operating profit margin** calculated by dividing your operating income by your net sales during a period reveals how much revenues are left over after all your company's variable or operating costs have been paid. It also shows what proportion of revenues is available to cover non-operating costs like tax, interest, and distribution to your company's owner.

It is useful because it shows you whether your operating costs are too high.

- **Net profit margin** calculated by dividing your after-tax net income (net profits) by your sales (revenue) shows the amount of each sales pound left over after all expenses have been paid.

The higher your net profit margin, the better because that shows your company is more efficient at converting sales into actual profit. A low net profit margin might mean that your business is not generating enough sales, your gross profit margin is too low or that your operating expenses are too high.



The higher the
gross profit margin,
the better

The main reasons for low profits

Falling revenue

Your sales or turnover slump could be due to internal and external factors such as:

- > Inadequate marketing programmes. To be effective, your marketing needs to convey the right message to the right target audience and convince them to take a desired action like call your company or purchase a product or book your service.
- > Poor pricing strategies.
- > Increased competition.
- > An inability to keep up with market changes.

Excessive expenses

Budget overruns or unexpected costs will chip away at your net profit.



The higher your variable costs, the lower your net profit margin will be. High production costs or purchase costs can result in insufficient funds to cover expenses. When variable costs rise to the point that there are not enough funds left to support all expenses for the period, a net loss will occur.

How a part-time CFO will help to boost your profits

The CFO Centre will provide you with a highly experienced senior CFO with 'big business experience' for a fraction of the cost of a full-time CFO.



This means you will have:

- > One of Australia's leading CFOs, working with you on a part-time basis
- > A local support team of the highest calibre CFOs
- > A national and international collaborative team of the top CFOs sharing best practice (the power of hundreds)
- > Access to our national and international network of clients and partners

With all that support and expertise at your fingertips, you will achieve better results, faster. It means you'll have more confidence and clarity when it comes to decision-making. After all, you'll have access to expert help and advice whenever you need it.

In particular, your part-time CFO will help you to boost profits.

There are only four things you can do to increase your company's profitability:



If you can do all four at once, your profits will increase dramatically. Even changing one of these four factors will boost your profits.

Your CFO will help you to identify the ways in which you can sell more, sell more frequently, increase prices (without losing customers) and cut your costs.

Selling more and selling more frequently

Driven by a need to make more sales, most business owners will chase new customers.

This can be a costly exercise since it will often involve more expenditure on marketing and advertising. Acquiring new customers can cost as much as five times more than satisfying and retaining current customers, according to Management Consultants Emmett Murphy and Mark Murphy.

That's because convincing people to buy from you for the first time is difficult. Prospective clients are scared of making a mistake; of choosing the wrong supplier and wasting their money.

If your sales are low, it's better to focus attention on your existing and previous customers and find ways to encourage those people or companies to buy more and to do so more often.

Your existing and previous clients do not have the prospective clients' fears and objections to doing business with you. You've already demonstrated that you can deliver the benefits they want from your products or services.

On average, loyal customers are worth up to 10 times as much as their first purchase.¹

There are other benefits to selling to existing and past clients too: it cuts your refund rate, raises the likelihood of positive word-of-mouth, and lessens the risk of your clients buying from your competitors.

¹ Source: White House Office of Consumer Affairs, '75 Customer Service Facts, Quotes & Statistics: How Your Business Can Deliver With the Best of the Best', Help Scout, www.helpscout.net

² 'Leading on the Edge of Chaos: The 10 Critical Elements for Success in Volatile Times', Murphy, PH.D., Emmett C., Murphy, MBA, Mark A., Prentice Hall Press, June 15, 2002

A **2%** increase in customer retention has the same effect as decreasing costs by **10%**.

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Even better, a 2% increase in customer retention has the same effect as decreasing costs by 10%, according to Emmett and Mark Murphy. Cutting your customer defection rate by 5% can raise your profitability by between 25% and 125% depending on the industry, they say.²

Customer profitability tends to increase over the life of a retained customer, they say. In other words, the longer your clients are with you, the more they will spend.

Working with you and your management team your part-time CFO will investigate ways to get customers to return to you more often and buy more when they do make a purchase. The methods include:

- Using a strong follow-up sequence.
- Leveraging scarcity by using time-limited or limited availability offers.
- Using up-sells, down-sells and cross-sells

Raising prices

All too often, business owners believe their prices must be lower than their competition. They also believe if they increase their prices, they will lose customers. Both assumptions are false.

It all comes down to the perception of value. People will happily pay more for a product or service they perceive as having added value.

If your products or services are on par with your competitors, your prices should be similar or higher.

Even a small price rise will have a positive impact on your profit margins. After all, the larger the difference between the cost of a product or service and the price it sells for, the higher the profit.

Reducing costs

Companies that fail to control their costs are often forced to borrow but then find that servicing that debt erodes their profits still further.

The benefit of cutting your costs is that it will have a direct short-term impact on your bottom line since a dollar saved in expenses might mean an extra dollar in profit.

Your CFO will encourage you to consider the likely impact of any cost cutting on the quality of the products or services you provide before you take any action.

Your CFO will help you to identify the major cost centres in your company. These might be:



Your CFO will also help you to identify the profit drivers in your company.

Typically, profit drivers will be to increase sales, reduce the cost of sales and to reduce overhead expenses but they could be any of the following:

Financial drivers (which have a direct impact on your finances)

- > Pricing
- > Variable costs (Cost of Sales)
- > Sales volume (for example, generate more prospects, convert more prospects to customers, retain more past customers, increase the size of each purchase, increase the sales price, etc.)
- > Fixed costs (for example, overhead expenses)
- > Cost of debt (for example, interest rates on debt)
- > Stock

Non-Financial drivers

- > Staff training
- > Product innovation
- > Market share
- > Productivity
- > Customer satisfaction
- > Product/service quality
- > Analyse every area of gross profit to understand where the biggest opportunities lie and to determine how to reduce less profitable activities.
- > Find your most profitable customers (those who consistently spend more with you).
- > Find the customers who you are currently serving but who are loss making for you.
- > Analyse return on investment on capital and product development expenditure.
- > Ensure your management information is up to date and in a format that is useful and reliable.

- Educate the senior team about the importance of Critical Success Factors (CSFs). These are the activities that your business must do to survive. You can determine your CSFs by answering the following questions:
 - How is our business better than our competitors?
 - What do our customers like about our products or service and the way in which we operate?
 - What don't our customers like?
 - What would make our customers stop buying from us?

You measure your CSFs by using Key Performance Indicators (KPIs)

- Systematically analyse relevant KPIs and trends to identify potential hazards before they become a problem.
- Review arrangements with your main customers to see if there is a more profitable way to supply them.
- Review pricing arrangements with existing suppliers.
- Research alternative suppliers across all areas of the business.
- Research sources of grant funding.
- Determine your company's eligibility for Research and Development (R&D) tax credits. The tax relief will either reduce your tax bill or provide a cash sum. To receive R&D tax credits, you must show that your company is carrying on a project that seeks an advance in science or technology and how it will achieve it, according to ATO regulations. The advance being sought must constitute an advance in the overall knowledge or capability in a field of science or technology, not just your company's own state of knowledge or capability.
- Develop effective incentive schemes for staff to encourage productivity and to manage risk.
- Prepare customer surveys to understand what the market really wants (and then sell it to them).
- Analyse competitors to find out what is working well and what isn't and course correct accordingly.
- Review significant overheads and isolate opportunities to reduce expenditure.
- Investigate exchange rate hedging and planning.
- Create a realistic and achievable action plan then communicate it to all your employees.
- Increase prices.
- Explore online selling.
- Explore more cost-effective ways of marketing by forming strategic alliances and joint ventures with companies that deal with your prospective clients.
- Arrange for business mentors to give advice and share experiences with you.
- Review organisational structure and delegation procedures to maximise efficiency.
- Develop customer retention strategies to prevent loss of revenue.
- Evaluate business location and determine possible alternatives (to save costs on production, delivery, etc.).
- Outsource some functions (and so save on wages) or employ someone on a part-time rather than full-time basis.
- Look at the viability of redundancies. If you're making people redundant, you will need to fund redundancy payments. You will also need to ensure you meet current legislation and standards regarding consultations with employees, the grounds for redundancy and the selection of employees.
- Introduce an expense control programme. Your CFO will challenge expenses in all categories, large and small. Besides cost-cutting measures, your CFO will also ensure you tighten your control on costs. If you don't already have a purchase order approval policy, for example, you'll be encouraged to introduce one.
- Look at your bank charges. Your CFO will question all bank fees on your statements and compare them with what other banks charge.
- Check invoices from suppliers for overcharging (incorrect charges, missing discounts, double billing, etc.).
- Get rid of inefficient systems (for example, paper-based systems)
- Measure the return on all your advertising and stop using whatever hasn't worked in the past.
- Replace frequent small orders with bulk buy discount orders.

As you can see from this, profit improvement is not an emergency fix. It's something you and your organisation need to plan for and follow consistently. If you don't, there's a very real danger that once you return to growth, you'll get swept up with the day-to-day demands of running your business. That increases the risk you'll find yourself back in an unprofitable position.

As with many challenges facing growth businesses, the solution lies in good planning for profit improvement on the one hand and an ability to stick to the plan, month in, and month out, on the other.

Profit improvement should be seen as an ongoing project. It takes some time to establish systems, which enable your business to maximise its profitability, and then it takes focus and resource to maintain the monitoring process.

That's where part-time CFOs can help. They can take care of the finance function and the support systems within your business, which frees up your time to focus on growing your business.

A man with a shaved head and a goatee, wearing a dark suit jacket over a light-colored shirt, is shown in profile, looking towards the left. The background is a warm, out-of-focus interior with soft lighting. The overall tone is professional and contemplative.

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Conclusion

Most business owners say making a profit is the number one reason they are in business. Everything else (passion, purpose, mission) is subordinate.

Profit is an expression of getting the most out of your business for the least amount of effort. It is a reflection of your efficiency.

Building a large company and being able to cite impressive turnover figures are often the wrong drivers for business owners. Again, this is not to say that increasing sales is the wrong approach – on the contrary – it is merely to point out that selling lots of product without a full understanding of the profitability of the product can be a waste of valuable resource.

A compact, efficient business which operates under tight management procedures is nearly always a happier place to work than a chaotic business which is able to boast significant turnover figures.

Expanding overseas, taking on more staff and resourcing up may well be the right way for you to take your business. It could equally be the case that you may be able to enjoy increased profitability (and an improved lifestyle if this is an important driver) without expanding rapidly, but merely by improving profitability.

REAL
IMPACT
BETTER
RESULTS
FASTER
MONEY
CONFIDENCE

The path you follow will be determined by your objectives for the business and that's something your CFO will help you to clarify and then achieve.

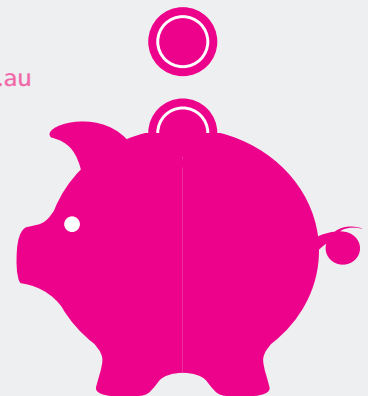
Increase your profits with the help of a part-time CFO

Don't miss this opportunity to talk to a part-time CFO about how you can improve your profits. To book your free one-to-one with one of our part-time CFOs:

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