Palius + O'Kelley LLP is a different kind of CPA firm. Just as a good fitness trainer can develop an exercise and diet plan to maximize his/her clients fitness, we help our business clients develop and implement strategies, systems, and training programs to take their businesses to the next level of profitability. We call this *Business Fitness Training and i*t is *a new paradigm to help your business grow.*

We use a variety of tools, technologies, seminars, and workshops to help our clients become models of *"business fitness." The Profit Book* is one example of how we do things a little differently. It illustrates the mindset we bring to all our business engagements, and will serve as an introduction to some of our methodologies.

As you already know, these are competitive times. Business customers have more choices than ever before. Many believe that to run lean and mean is the best way to survive. We agree, but only to a point.

Studies have shown re-engineering efforts that focus on cost reduction have been only marginally successful. Further, studies have shown that costs can only be reduced by a maximum of 20% and still allow the company to function. We believe that a re-engineering strategy and plan should focus on the revenue stream...and this booklet will show you why.

WHAT IS PROFIT?

Profit is what's left over after you've paid all your expenses. The important thing to note is that profit is "what's left over." In other words, profit is a residual. It is the consequence of what happens in and to your business.

Some of these things are within your control and some of them are outside your control. If you're going to have any effect on your profit, you have to focus on those things over which you have control…So, what are they?

To answer this question, it is helpful to understand that there are only four specific factors which determine your profit:

1. The ***price*** you charge for the products and/or services you sell.
2. The ***quantity*** (or volume) of products and/or services you sell.
3. The costs you directly incur by producing or buying the products and services you sell. (We call these ***variable costs*** because they increase or decrease as your sales increase or decrease.)
4. The costs you incur whether you make any sales or not. (These are best described as ***fixed costs*** because they do not change with changes in sales volume—at least not on a day-to-day basis.)

Let's put these four things together. And for simplicity, we'll assume you have only a single product. (The conclusions we come to will apply whether you have 1 or 1000 products.)

Suppose you sell a thing called a widget. It costs you $60, and you sell it for $100. What you sell the widget for is the price. What you pay for it is a variable cost.

If you sell 100 widgets, your total variable costs will be $6000. And if you sell 50 widgets, the total variable cost is only $3000. (It varies directly with your sales volume.)

Now, if you sell a widget for $100 and it costs you $60, you've made a profit of $40 on each sale. We call this the ***gross profit*** or ***gross margin.*** We use this term to remind us that we still have to meet our fixed costs before we end up with a net profit.

If you sell 100 widgets and make a gross margin on each one of $40, your total gross margin is $4000. And if your fixed costs for such things as rent, leases, wages, insurance, etc. amount to $3000, you end up with a "net profit" of $1000. On the other hand, if your fixed costs are more than $4000, you'll incur a loss.

HOW TO INCREASE PROFIT

If you're looking for ways to increase your profitability, you have to focus your attention on the four profit determining factors: price, volume, variable costs, and fixed costs.

Let's look at each of these four factors under three headings—the factor, the possible action you could take to enact change, and the required conditions that would have to occur to increase profits.

It's important to note that profitability can be increased by either taking action to increase or decrease any of the four factors, as long as some conditions are met.

The interesting thing to notice about the adjacent summary is that no single factor can be considered without considering its impact on, or the impact from, each of the other factors.

The second thing to remember is that a profit improvement strategy may involve either an increase or a decrease in each of the four factors. There is no standard formula for improving profitability; it depends entirely on the specific circumstances and the relative strengths and weaknesses of your business.

The third thing to notice is that a favorable change in price and/or your variable costs will improve your gross margin per dollar of sales. On the other hand, a favorable change in your sales volume and/or your fixed costs indicates greater productivity. Therefore, the overhead you incur in running your business involves lower costs per dollar of sales.

In other words, any profit improvement strategy must focus on either or both of two things:

1. achieving a higher gross margin per dollar of sales by increasing price and/or reducing variable costs.

and/or

2. achieving greater sales per dollar of fixed costs by increasing the productivity of those things which have a fixed cost.

INCREASING PROFIT FACTORS

FACTOR	ACTION	REQUIRED CONDITIONS
Price	Increase	Sales volume could either remain unchanged or decline. If sales volume declined, the decline would have to be less than the offset created by the price and resulting profit increases.
	Decrease	The sales volume would have to increase sufficiently to compensate for the decline in price. If sales volume was to increase, as a result of the decrease in price, there is a possibility of a decrease in the per unit fixed and variable costs because of increased economies of scale.
Variable Costs	Increase	The increased variable costs should lead to or be a result of improved product or service quality. The market would have to accept a higher price, or the heightened quality would have to attract enough new buyers to offset the increase in variable costs.
	Decrease	The sales volume would have to remain unchanged. The decrease in variable costs could not be allowed to affect product or service quality—which would have a consequential effect on sales. If they did decline, the fall in gross profit would have to be less than the decrease in variable costs.
Sales Volume	Increase	The price could either remain unchanged or decline. If the price was reduced, the reduction would have to be less than the offset created by the volume and resulting profit increases. Another possibility is to achieve a reduction in per unit fixed and variable costs due to an increase in economies of scale.
	Decrease	A savings in fixed costs would have to be achieved by reducing the size of the business or production levels would have to be evaluated to find variable cost economies of scale. This savings would have to be greater than the reduction in gross profit due to the decreased sales volume.
Fixed Costs	Increase	The increase in fixed costs should lead to or be a result of improved product or service quality. The market would have to accept a higher price, or the heightened quality would have to attract enough new buyers to offset the increase in fixed costs.
	Decrease	Sales volume would have to remain unchanged. The decrease in fixed costs could not be allowed to affect product or service quality—which would have a consequential effect on sales. If they did decline, the fall in gross profit would have to be less than the decrease in fixed costs.

We'll begin with the figures previously given as an example and use them as a base. To demonstrate the powerful effect of small changes, a 5% improvement in each of the four factors are made.

		BASE	% CHANGE		RESULT
Price		100	5% increase		105
Sales Volume		100	5% increase		105
Total Revenue		10,000			11,025
Variable Costs	($60)	6,000	5% decrease	($57)	5,985
Gross Margin		4,000			5,040
Fixed Costs		3,000	5% decrease		2,850
Net Profit		$1,000			$2,190

It can be seen that a 5% favorable change in each of the four factors, without a consequential unfavorable impact on each of the other three, would more than double your profit from $1,000 to $2,190. This is a 119% improvement.

You may want to take issue with the assumption that there are no consequential impacts. However, it is a fact that small improvements made to each of the four factors that determine your profit will combine to give a staggering overall impact.

And of course, the reverse is also true. If you discount your price, allow your sales volume to fall, fail to control your overhead costs, or let your variable costs get away from you, then you can destroy a potentially profitable business. This can happen very quickly.

You see it's all about what we call ***leverage***—it's a concept that can make or break a business. If you get all the little things right, the big picture looks after itself. But if you get all the little things wrong, you're going to be in real trouble (and its likely, you'll never know why).

DEVELOPING A PROFIT IMPROVEMENT STRATEGY

You'll recall that to improve your profitability you must either make a larger gross margin on each dollar of sales or sell more without increasing your fixed costs. It goes without saying that the biggest improvement will occur if you can achieve both simultaneously.

IMPROVING YOUR GROSS MARGIN

Remember, your gross margin is the difference between the price of your product and what it costs you to buy or make it. Therefore, the only way to increase your gross margin is to sell at a higher price or buy/make at a lower price.

In most instances (but not all!) you will have limited scope to buy at a lower price. For this reason, your selling price is the critical variable.

Without doubt, the biggest single barrier preventing small business managers from making an acceptable profit is their refusal to charge a price which will enable them to achieve it. ***You are not in business to match the price your competitors set; you are there to service your customers.***

In fact, studies of the factors people regard as influencing their decision to deal with a particular business indicate that product and price are relevant in only 15% of cases—we'll say more about that in the discussion on sales productivity.

Trying to hold or win market share on the basis of price discounting is the lazy manager's competitive strategy. It is applicable in only one situation and that is where you have a definite cost advantage (either variable or fixed) over your competitors and your product or service is one where customers are very price sensitive.

The following table indicates the increase in sales that is required to compensate for a price discounting policy. If your gross margin is 30% and you reduce price by 10%, you need sales volume to increase by 50% to maintain your initial profit. Rarely has such a strategy worked in the past, and it's unlikely that it will work in the future.

And you reduce price by:	*If your present margin is:* 20%	25%	30%	35%	40%	45%	50%	55%	60%
	To produce the same exact profit, your sales volume must increase by:								
2%	11%	9%	7%	6%	5%	5%	4%	4%	3%
4%	25%	19%	15%	13%	11%	10%	9%	8%	7%
6%	43%	32%	25%	21%	18%	15%	14%	12%	11%
8%	67%	47%	36%	30%	25%	22%	19%	17%	15%
10%	100%	67%	50%	40%	33%	29%	25%	22%	20%
12%	150%	92%	67%	52%	43%	36%	32%	28%	25%
14%	233%	127%	88%	67%	54%	45%	39%	34%	30%
16%	400%	178%	114%	84%	67%	55%	47%	41%	36%
18%	900%	257%	150%	106%	82%	67%	56%	49%	43%
20%	-	400%	200%	133%	100%	80%	67%	57%	50%
25%	-	-	500%	250%	167%	125%	100%	83%	71%
30%	-	-	-	600%	300%	200%	150%	120%	100%

On the other hand, the next table shows the amount by which your sales would have to decline following a price increase before your gross profit is reduced below its initial level. At a 30% margin and a 10% increase in price, you could sustain a 25% reduction in sales volume before your profit is reduced to the initial level …you would have to lose 1 out of every 4 customers!

And you increase price by:	*If your present margin is:* 20%	25%	30%	35%	40%	45%	50%	55%	60%
	To produce the same exact profit, your sales volume must be reduced by:								
2%	9%	7%	6%	5%	5%	4%	4%	4%	3%
4%	17%	14%	12%	10%	9%	8%	7%	7%	6%
6%	23%	19%	17%	15%	13%	12%	11%	10%	9%
8%	29%	24%	21%	19%	17%	15%	14%	13%	12%
10%	33%	29%	25%	22%	20%	18%	17%	15%	14%
12%	38%	32%	29%	26%	23%	21%	19%	18%	17%
14%	41%	36%	32%	29%	26%	24%	22%	20%	19%
16%	44%	39%	35%	31%	29%	26%	24%	23%	21%
18%	47%	42%	38%	34%	31%	29%	26%	25%	23%
20%	50%	44%	40%	36%	33%	31%	29%	27%	25%
25%	56%	50%	45%	42%	38%	36%	33%	31%	29%
30%	60%	55%	50%	46%	43%	40%	38%	35%	33%

If you're like many small business people who regard price as the only factor influencing the buying decision of their customers, you will undoubtedly reject the proposition that a high price strategy (and by implication, high value) will work.

You may believe that it's right for some businesses, but it sure doesn't apply to your business.

There is ***no*** business that does not have the potential to command a premium price for its products or services ***if***—and this is the crunch—it is able to market those products or services in such a way that ***the customer perceives added value.***

If all of your marketing effort, all of your advertising, and all of your sales dialogues focus on price, then you will be beaten on price every time a competitor comes along with a lower one. In other words, if you focus your customers on price as a critical factor, it will be one.

The only way to get out of the price trap is to promote other features and benefits that you can offer your customers (for example, better quality, longer warranty, satisfaction guarantees, 24-hour accessibility, more convenient location, greater resale value, etc.).

It may be that your competitors already offer all of these things...but unless they also emphasize this in their marketing, how will the customer ever know?

Think about this for a moment.

Your job as a marketer is to create the ***perception of value*** and then to back up what you sell with superb service. The thing to remember is that price is only important when all other things are equal. Some customers only think in terms of price. They are better left to your competitors. What you should be doing is working with those people who are happy to pay for value.

This means two things. First, you have to deliver value (embody service). And second, you have to educate your customers to be aware that they are receiving value. One without the other will leave you exposed.

A man named John Buskin once said,

"It's unwise to pay too much, but it's worse to pay too little.
When you pay too much, you lose a little money, that's all.
When you pay too little, you sometimes lose everything, because

the thing you bought was incapable of doing the thing it was bought to do.

The common law of business balance prohibits paying a little and getting a lot—it can't be done. If you deal with the lowest bidder, it is well to add something for the risk you run. And if you do that, you will have enough to pay for something better."

IMPROVING PRODUCTIVITY

This is all about getting more sales per dollar of fixed costs. It can be achieved by either or both increasing your sales at a faster rate than your fixed costs increase or reducing your fixed costs without affecting your sales.

Let's start by looking at your fixed costs.

These costs must be incurred for you to remain in business. In the short-run, they do not change as your volume of sales changes. Examples include rent, wages, advertising (to a large extent), interest, lease costs, and so on.

Some of these costs are discretionary in the sense that you can take a decision to reduce them simply by cutting back. Others, however, are committed, and you can't avoid them.

To determine the critical things about each fixed cost, ask yourself a few questions:

1. What service does this cost provide to my business? Can I obtain the same service from another source at a lower cost?
2. If so, is it feasible to switch to another supplier of that service? If I did switch to another supplier, would I get equivalent quality and would this affect the quality of my product or service?
3. If I were to spend more on this service, would it generate additional gross profit that exceeds the additional cost?

You'll notice that all of these questions are directed toward what you're getting for what you're spending. They are not simply concerned with whether or not you can eliminate or reduce the cost.

Take wages for example. In difficult times people will often think of dismissing team members. This may be an appropriate course of action,

but it should be considered carefully. More often than not, the appropriate strategy is to invest more in team training to show them how to improve customer service and how to sell more to your customers.

What about advertising? There is a standing joke in the industry that 50% of your advertising is wasted. The problem is identifying which 50% it is! In fact, the 50% estimate is being generous. It's probably closer to 100% that's wasted—and, at least you know which 100% it is...yours!

In a *Business Review Weekly* article, a manager of a major supermarket chain said, *"91% of readers took very little notice of price and item ads, and only 9% looked at them for shopping purposes."* If that's a fact, why do the major supermarkets still persist with this type of advertising?

The reason is that ***product suppliers pay*** for the ads and the supermarket gets to:

1. promote its name, and
2. create consumer perception that it's a price-competitive retailer.

The only organization that benefits—whether your advertising works or not—is the media company you use. They're always ready to invite you to participate in special deals and supplements. And they're pleased to give advice on how to structure your ads "to get results."

But ask them to do a deal where you pay an amount per inquiry, and you'll be met with stony silence. How many times have you been contacted by a newspaper or radio representative and asked how your advertisement worked?

This does not deny the value of advertising.

On the contrary, advertising is one of the best ways to increase your sales. What is a folly is spending on advertising that does not work. You can learn how to create advertising that does work, and you can test the results.

When we talk about productivity, we're talking about how to get the most out of your advertising dollar. This is unquestionably one of the major untapped areas of your potential profit growth.

Effective advertising is clearly one way to create new customers. This is a specialized area in itself, but there are four absolutely critical

things to get right:

1. ***Target*** your customers—never try to appeal to everyone. Focus specifically on those people you know will benefit from your product/services. How you word your headline will be the major factor in accurately targeting your offer.
2. Make your ***offer*** compelling and relevant to the market you target. Don't be cute or clever. Say it exactly as it is.
3. ***Graphics*** and layout will make your ad readable and noticeable. Don't try to make your ad look like an ad. Make it look like something worth reading.
4. Write your ***copy*** in terms that your readers can clearly understand. It must be specific and believable. If you have a clearly defined target market, and your offer is compelling and well stated, your copy can be poor—you'll still get a good response. But good copy writing will not sell a poor concept/offer.

One of world's leading small business advertising specialists has used "split-run" tests (where one ad is run in half of a publication and a slight variation is run in the other half) to evaluate the relative performance of these four variables. From the response, he concluded a number of things:

great copy	will give	50% response increase
great graphics	will give	150% response increase
great offer	will give	300% response increase
accurate target	will give	1000% response increase

A specific focused target (i.e. people in the market who are predisposed to buy) is 20 times more powerful than how you express your message. If you know exactly who will be interested in what you've got to offer, and you make an offer that is compelling, you don't have to be a brilliant copywriter to get a cost-effective response from your ads.

The only sure way to get customers to come back and act as advocates for your business is to give them absolutely superb service. They need to feel that you really care about them and that your goal in business is to delight them with the way you look after them. Most businesses fall short of this ideal, but it is an objective well worth striving to deliver.

Almost 70%, or seven out of ten customers, cease to patronize a business because of ***perceived indifference.*** When you (personally) interact with various businesses, aren't you inclined to deal with those who take the trouble to show they care about you? Do you "shop around" when you're already delighted with the service you get?

It is sobering to note that most businesses spend 6 times more trying to attract new customers than they do looking after the ones they already have. They believe they have to do this because their existing customers keep leaving, and new customers are needed to replace the old ones.

A leading stockbroker and financial planning company recently undertook a study on client satisfaction. They reported that just a 5% increase in customer retention produces a 25% to 100% improvement in profit. To put it another way, it pays to look after your customers.

Let's put some numbers on this.

Suppose you have 1,000 customers who spend an average of $250 per year with you. Suppose that you have a customer loss rate of just 10% each year, and a customer who stays with you deals with you for an average of 10 years.

Forgetting about inflation, each customer has a lifetime value to you of $2,500. Therefore, a 10% attrition rate is costing you $250,000 in potential future revenue each year.

Another thing which is overlooked by most businesses is the simple act of asking the customer to buy. It's no accident that McDonald's is one of the largest and most profitable businesses in the world. The reason for this certainly cannot be found by looking at the uniqueness of their product.

The fact is that at McDonald's, nothing is left to chance. Everything is done according to a plan.

Even the question, *"…and will you be having fries and a drink with your meal today?"* is part of a well-designed system. About 30% of the time people say *"yes,"* even though it may not have been in their mind. The effect is a 30% increase in sales of fries or drinks and an over 100% increase in profit contribution from those lines.

A restaurant owner used to ask guests at the end of the main course (without really thinking) *"Would you like anything else?"* The frequent

answer was, *"No, just some coffee thanks."*

He changed this to, *"Now, can I offer you a beautiful platter of European cheeses, or would you prefer to make a selection from our new dessert menu. The pies are absolutely delightful tonight!"*

The result was that he instantly tripled dessert and cheese platter sales and still got to make the coffee sale. It's all in what you say and how you say it.

Word of mouth referral is the best means of creating new customers. But satisfied customers do not become advocates for your business—***delighted*** customers do!

Most people don't fully appreciate the powerful dynamics of customer retention and frequency of contact. This potential is reflected in the table to follow.

This table demonstrates the powerful effect of a relatively small improvement in the critical variables—customer attrition rate, new customer attraction rate, frequency of customer purchasing, and the average value of each sale—on total sales revenue.

THE COMPONENT OF SALES	PRESENT RATE	PRESENT POSITION	POSSIBLE RATE	POSSIBLE POSITION
Number of Customers		1,000		1,000
Less Customers Lost	10%	100	5%	50
		900		950
Add New Customers	10%	100	12%	120
Total Customers		1,000		1,070
Sales Frequency	10	10	11	11
Number of Transactions		10,000		11,770
Average Sale ($)	$25	$25	$27.50	$27.50
Total Revenue		$250,000		$323,675

Perhaps the best kept secret in the business world is that it is very simple to improve the profitability of a business; but there's a catch. What to do is the easy part. Being willing to do it is the stumbling block.

In every case, business success stories have been associated with people who have had the courage to change their way of doing business. In the case of the failures, it has been their refusal to try something different. Have you ever said, *"That sounds okay in theory, but it won't work in my business"?*

There are no special tricks to make a business more profitable. Although we make a living helping people in business, we can't pull rabbits out of a hat. And there is one over-riding consideration that must be accepted:

If what you're doing now isn't working, then you must do something different!

In every industry—and irrespective of the state of the economy—there are some businesses that consistently out-perform others in their industry, not by small amounts but by staggering amounts. This is called the margin of excellence. They have it right and the others have it wrong. It's as simple as that.

Close enough is ***never*** good enough. Improved business performance comes from a willingness to do something different and then getting the details right. If you get all the little things right…the big picture looks after itself.

The following example is an actual case in point. The result in the first year was a satisfactory 58% increase in profitability. The business itself increased in value by more than $75,000.

Today this business is generating well over $100,000 in net profit. It's a bigger business today than it was, but it is also much more profitable in terms of ***Return on Capital Employed*** and in absolute dollars earned for the owner.

A PROFIT IMPROVEMENT CASE STUDY

	BEFORE	AFTER	CHANGE	SEE NOTE #
Sales	$242,750	$279,462	15.1%	1
Gross Profit Margin	36%	39%	8.3%	2
Fixed Overheads	$61,358	$67,886	10.6%	3
Capital Employed	$194,885	$201,179	3.2%	4
Net Profit	$26,032	$41,104	57.9%	5
Return on Capital Employed	13.4%	20.4%	52.2%	

Analysis of the Profit Improvement:

Increased sales volume and prices	$14,317
Improved gross profit margin	7,283
	$21,600
Less Increased overheads	6,528
Increase in Profit	$15,072

Analysis Notes:

1. Sales

   Strategies:

   - More effective advertising: a budget was established, market was segmented and targeted, analysis of advertising effectiveness was undertaken, and ads that “pulled” more were developed.
   - Attention was devoted to team training (with respect to product knowledge, selling skills, and customer courtesy).
   - Performance standards and targets were established and closely monitored.

   Result:

   - 15.1% increase in dollar value of sales (some of which was due to selective price increases on key products).

2. Gross Profit Margin

   Strategies:

   - A detailed analysis of the major profit contributors was undertaken (with regard to both the product lines and customer segments).
   - Products which were not achieving required margins and/or which did not fit the business were dropped.
   - Team members were acquainted with the major profit contributors.
   - More selective purchasing was established, and greater attention was given to quantity discounts.
   - Selective price increases improved margins and enabled better service to be delivered at the point of sale.
   - Advertising and selling was directed to higher profit lines and targeted to properly qualified customers.

   Result:

   - 8.3% improvement in gross margin.

3. Fixed Overheads

   Strategies:

   - All costs were analyzed as a percentage of sales over the

last 3 years using available information—the major cost areas were identified.

- Each area of cost was examined on a cost/benefit basis to determine whether the same result could be achieved at a lower cost from an alternative source, or whether it was appropriate to increase costs to deliver more customer orientated service value.
- Detailed cost budgets were prepared on a cash flow basis.
- Actual costs were monitored against monthly budgets, and detailed reviews were undertaken quarterly.

Result:

- Fixed costs increased by 10.6% which was in line with normal inflation at the time—in real terms fixed costs remained constant (even though sales increased by about 5% in real terms and 15% in nominal terms).

4. Capital Employed

Strategies:

- A post-sale credit control was put in place. Customers who failed to pay within the prescribed term were politely brought into line. Some customers left, and that was an added bonus. (They were the ones that increased servicing costs.)
- As part of gross margin analysis (see #2, Gross Profit Margin) inventory lines that were not achieving turnover targets were evaluated, and some duplicate lines were dropped.
- Tighter control was instituted for inventory and the lead time for inventory purchasing orders.
- Old slow-moving inventory was disposed of quickly. (This released valuable space and increased cash flow.)

Result:

- Inventory levels and receivables were reduced relative to the increase in sales. This released cash that was then used to reduce bank loans and payables. Relationships with the bank and creditors improved significantly.
- Although actual capital employed increased by 3%, the

volume of sales it supported increased by 15%. In other words, a 3% increase in resources supported a 15% increase in sales volume.

5. Net Profit

   The Final Result

   - The net profit improved by $15,072—a 58% increase over the previous year. This example illustrates how small marginal changes, although modest in themselves, can combine to create a huge difference.

Profit turn-arounds of this magnitude cannot be achieved year-in and year-out, but every business has room for improvement. The choice is up to the owner/manager.

It is worthy to note that on the basis of a capitalization rate of 20%, the improvement in the profit of this business increased the value of its goodwill as a going concern by $75,360. (Not bad for a year's work and certainly worth the management consulting fees that were charged.)

But there is something important to remember: The advice and assistance that was given would have been absolutely useless unless the client had been prepared to make a total commitment to the task.

In the final analysis, it's up to you!

ESTIMATE YOUR PROFIT IMPROVEMENT POTENTIAL

It's quite amazing what affect relatively small changes can have on your bottom line. The following example shows how you can quantify the profit improvement potential of your business—given modest changes in the key variables that make up sales, fixed costs, and margins.

COMPONENTS OF PROFIT	PRESENT POSITION		CHANGE FACTOR		POSSIBLE POSITION
Number of Customers	1,000	x	1.05[1]	=	1,050
	x				x
*multiply this by the average purchase frequency	10	x	1.05[2]	=	10.5
	=				=
Number of Sales Transactions	10,000				11,025
	x				x
*multiply this by the average value of a sale	$62.50	x	1.05[3]	=	$65.63
	=				=
Total Sales Revenue	$625,000				$723,570
	x				x
*multiply this by the gross margin	40%	x	1.05[4]	=	42%
	=				=
Total Gross Margin	$250,000				$303,899.72
	-				-
*subtract the fixed overhead from this	$220,000	x	1.10[5]	=	$242,000
	=				=
Net Profit	$30,000				$61,899.72
					-
Take the Net Profit in the "Present Position" and subtract it from the Net Profit in the "Possible Position." →					$30,000
					=
Profit Improvement Potential →					$31,899.72

The result is a Net Profit increase to $61,889—more than double the present profit!

Change Factor Notes:

1. To determine a 5% increase, the change factor is 1.05. Example methods of increasing the number of new customers gained are cultivating referrals sources, creating host-beneficiary relationships, using mailing lists, and improving inbound conversion rates. Example methods of decreasing the number of customers lost include providing awesome service, creating extraordinary guarantees, and collecting customer surveys or feedback forms.

2. To determine a 5% increase, the change factor is 1.05. Example methods of increasing the frequency of purchases are direct mailers to existing clients, creating buyer or user clubs, improvement of customer relationships, and systematization of post-purchase interaction.

3. To determine a 5% increase, the change factor is 1.05. Example methods for increasing the average value of each sale are product recommendations through cross-selling and up-selling, testing different product/service displays and menus, and systematization of service delivery.

4. To determine a 5% increase, the change factor is 1.05. Example methods for increasing the gross margin are raising prices and lowering variable costs. Variable costs could be lowered through improvement of production, supply, or distribution schedules, renegotiation of supplier contracts, and evaluation of material usage.

5. To determine a 10% increase, the change factor is 1.10. The increase in fixed costs is being shown to allow for the increased level of team training and systems that may be necessary to produce the other noted changes.

YOUR PROFIT IMPROVEMENT POTENTIAL

Let's see what the result could be for your business!

COMPONENTS OF PROFIT	PRESENT POSITION	CHANGE FACTOR	POSSIBLE POSITION
Number of Customers	x	x =	x
*multiply this by the average purchase frequency	=	x =	=
Number of Sales Transactions	x		x
*multiply this by the average value of a sale	=	x =	=
Total Sales Revenue	x		x
*multiply this by the gross margin	=	x =	=
Total Gross Margin	-		-
*subtract the fixed overhead from this	=	x =	=
Net Profit			-
Take the Net Profit in the "Present Position" and subtract it from the Net Profit in the "Possible Position."			=
Your Profit Improvement Potential			

YOUR PLAN OF ATTACK

Even if you are already the leader in your industry, there will be opportunity to improve the profitability of your business. It is not always easy to achieve, but it's certainly possible.

You need a plan of attack. Specifically, you need to find out exactly what your existing and potential customers want—it's not always the lowest price. (This will form the basis of your marketing plan.)

You then need to organize your business so that you can delight your customers. (This forms the basis of your operations plan.) This will require giving attention to your team members and equipping them with the resources and skills they need to excel in what they do...You must systematize your business.

Finally, you need a management control plan in place to make sure everything is working the way you designed it to work. This will focus on the things you must get right to succeed. We call these things your ***Critical Success Factors.*** We measure how your business is performing in relation to them with the use of ***Key Performance Indicators.***

As Michael Gerber—author of *The E-Myth*—said, *"The reason most businesses don't work is that the people who are supposed to be managing them are too busy working* ***in*** *them rather than working* ***on*** *them."*

He means that they're doing the technical work. They're working with their hands rather than their heads. There's a limit to what the hands can do, but no limit to what the head can do.

We believe that as your *Business Fitness Trainer,* our job is to help you re-engineer your business, so that it runs like a well oiled machine. And once that's achieved, we want to help you keep it there!