



The **Fountain** of **Youth** for your **Business**

Four best practices for sustainable profitability



Bottom Line profitability is the Fountain of Youth for a for-profit business.

The famed mythical spring bestows anyone who drinks from it with youthful benefits, including restoration, longevity, and healing. Fortunately for business owners, the Fountain of Youth for a business is not fictional. It's called **Profitability**, or **Operating Margin**.

For businesses experiencing financial difficulties, a focus on improving profitability has the power to heal those difficulties and restore the company to financial health. A continuous focus on profitability, for any business, will ensure the longevity of the company. There are many Best Practices that will allow you to tap into these benefits for your company, and this eBook will explore four of them.

B O T T O M L I N E

#1 Best Practice

Set a goal and measure against it



Peter Drucker, a legendary management consultant, is credited with saying “*what gets measured gets improved*” nearly 50 years ago. These words have timeless relevance. A desire for improvement without an intent focus is only a wish. An intent focus without a target is merely a guess. The first step toward improving your profitability is to take action on your desire to improve by establishing a target.

Once established, take steps to keep the goal visible. Again, desire without focus is only a wish. Focus on your goal every day by nurturing a culture that is engaged with the desired outcome. Communicate the goal to your employees who can help make it happen. You can even share the rewards by incentivizing them **to achieve their own personal targets that will contribute to the overall goal.**



DESIRE w/o INTENT = **WISH**

FOCUS w/o TARGET = **GUESS**

Creating a goal without regular evaluation is an exercise in futility. Assess results on a regular basis to know if you are progressing toward your target or if you need to make adjustments. Again, improvement comes with measurement because you are focused on it. When you are focused on it, your actions will support attaining your goal of improved profitability.

An example of this is my Fitbit. I set a target number of steps that I want to take each day, and during certain periods of the day I have a target for each hour. My Fitbit is also a watch, so I look at it frequently during the day. Included on the face of the device, besides time, are circle graphs that tell me in an instant how much progress I’ve made toward achieving my daily goals. In addition, if I haven’t reached my prescribed steps in an hour, I feel a buzz on my arm 10 minutes before the hour, and I can see how many steps I need to take to reach my goal. This is an example of a tool that promotes focus and gives feedback to support attainment of my goals.

#2 Best Practice

Capitalize on ROI to control operating costs



Operating costs are expenses incurred that are not specifically related to creating and delivering a product or service to a customer. They include things like rent, marketing, travel, and office supplies. Some of these costs are incurred because there is no choice, like taxes and fees. But other costs support activities that increase profitability and provide a **Return on Investment (ROI)**. A savvy business owner evaluates the pool of operating costs using ROI analysis as possible to make informed decisions.

To evaluate the pool of operating costs, treat each one like you might treat an investment. Before investing, you probably define at least one goal that you want to achieve from the

investment, and you establish the amount of funds you're willing to part with to make it happen. Let's say you want an investment that will provide a 10% annual return and is convertible to cash within 48 hours, referred to as *highly liquid*. Then you evaluate your various investment options based on historical returns and liquidity terms. Your goals help you evaluate each alternative so you can make an informed decision on where to invest. Once you have decided to make an investment, you track it to ensure that it continues to meet your expectations and propel you toward your goals. And if it consistently underperforms, you may opt to discontinue the investment in favor of another one.

This same process can be applied to operating costs. For instance, let's assume you have the opportunity to attend numerous trade shows throughout the year.

The steps you take will be the same as outlined on the previous page.

1

Allocate finite resources in the form of funds and personnel, typically a budgeted amount

2

Use data to estimate which of the trade shows will provide the highest estimated return in the form of profitable sales

3

After deciding which shows to attend, track the costs for attending the trade shows selected, the resulting sales and cost of sales, and the return on the investment made in each event

4

Compare the results to your expectations and calculate the contribution to revenues, profits, and operating margin

5

Armed with this information, assess the quality of the investments based on their impact to profits

6

Use that assessment to make an informed decision as to whether you will invest in this trade show again, seek another trade show, or invest in some other type of marketing activity

#3 Best Practice

Know your break-even point



Break-even is a revenue target. It is the revenue required to have no profit and no loss because it just covers all the expenses. Break-even is generally related to a specific cost structure, and if the cost structure changes, the break-even target also changes.

The first step to understanding your break-even is to identify fixed costs and variable costs. The costs to create and deliver your company's product or service are typically *variable* in nature. Assuming variable costs are 40%, for every dollar of revenue you receive, you will pay 40¢ for variable costs, leaving 60¢ to cover operating costs. As revenues increase or decrease, variable costs increase or decrease in the same 40% ratio.

Operating costs are typically *fixed* in nature. An expense like rent is a fixed cost because it's predictable and consistent from month to month. As the name implies, a fixed cost amount will not change as revenue changes.

Taking the above example a step further, if a company's operating costs average \$15,000 per month, and every dollar of revenue yields 60¢ to pay those operating costs, the company must generate at least **\$25,000 in monthly revenue** in order to be able pay those fixed operating costs. Every revenue dollar over \$25,000 contributes 60¢ to profits.

This is an important concept and demonstrates the value of managing the company's operating costs. Assume that ROI analysis was applied to the operating expenses and resulted in a decrease to \$12,000 per month. The same \$25,000 in monthly revenue will generate **\$3,000 in profit**. In addition, it would not benefit the company overall if the cost of measuring that ROI exceeded \$3,000 per month.

#4 Utilize Benchmarks

Compare. Learn.
Improve.



Benchmarks are external to the company and when used properly, can provide valuable feedback about its financial performance. Benchmarks are gauges based on averages and are best used by companies that lag their peers.

Profits or Profitability? Profit or Margin?

The terms profits, profitability, and margin are often used interchangeably. But in fact, profits refer to dollars, which is an integer, or a number. Profitability is akin to margin, which is a ratio, or a percentage. While the amount of profit you make is certainly important, ratios are a valuable tool that allow us to evaluate dissimilar items. For instance, assume the following revenue, profits, and margin of two companies of different sizes in the same industry.

| | Company A | Company B |
|-------------------|-----------|-------------|
| Revenues | 1,000,000 | 500,000,000 |
| Operating Profits | 150,000 | 15,000,000 |
| Operating Margin | 15% | 3% |

Company B's profits are 100x the profits of Company A. But Company A's profitability is significantly higher than Company B. We can't draw many conclusions by simply looking at profits but evaluating the margin will lead to insightful questions and better information about the two companies' operations.

Benchmark data is typically presented as ratios and can be free or require an investment. It is available from both public and private sources, but it is most helpful when it is relevant to your company's data. If using benchmarks is part of your profitability strategy, make sure you understand the characteristics of the benchmark group to ensure you are comparing yourself to your peers.



The Life Sustaining Fountain of Youth

A for-profit business exists for that very purpose — to deliver profits. Profits sustain the life of a business. Without it, a company will die. A persistent focus on profitability is a wise investment of resources for every business owner, no matter the current financial health of the company. There are many tools available to help manage profitability, including understanding your break-even revenues, considering operating costs as an investment, and finding relevant benchmarks to assess your company's financial results. But remember, a desire without focus is a wish. Focus without a target is a guess. It all starts with setting a goal.

[Learn more today](#)



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