



How to Regain Your Profitability during the Recession & Recovery

October 2009

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These are tough times & only the tough will survive. This is classic Darwin because not only will the tough survive but they will prosper because they will devour the weak!

Don't be fooled by the headlines that tell us sales are down x%. What is never reported is the price at which these sales were made or in other words what gross margin was achieved. Let's face it; most businesses can achieve good or even great sales numbers if they mark everything down by 30, 40 percent or more & that's what's happening in many industries.

This strategy may be good for cash flow but it's disastrous for profits & can't continue for very long. The weak will go out of business creating opportunities for their competitors to acquire then cheaply or simply take over their market share.

In the first two white papers we discussed cash flow forecasting, budgeting & safeguarding your business. Here we will discuss profits & losses.

I am often asked "why are we not more profitable?" Interestingly, it's not possible to work directly on profits. Profit is a resultant, the difference between income & expenditures, so that's the way to approach it.

Income

Of course we are talking here of what is often referred to as "increasing sales" This topic of income encompasses sales, marketing, customer service, product selection, branding, after sales service, delivery methods & many other activities of this nature.

We often find that this topic, hard to believe but it's true, is not given the depth of thought that it deserves. Mature businesses in particular may not be focusing adequately on this area. Why is it that some businesses can reach a certain sales level & often plateau out while others sell many times more? It's often because of an inability to think outside the box.

A fresh set of eyes (& ears) may ask the following questions:

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- a) How do you sell your products?
- b) What are your sales channels?
- c) Are you using the internet to sell or market?
- d) Who has responsibility for sales in total?
- e) Who sets the sales goals?
- f) What is the method of accountability?
- g) How are sales people compensated?
- h) What sales training is there?
- i) How do sales & marketing interact?
- j) How do they agree on targets?
- k) How does the sales team interact with supply or production?
- l) What other products or services can we sell?
- m) Why do our customers buy from us?
- n) Why don't they?
- o) What do our customers think of us?
- p) What other channels are available to us?
- q) Do we export?
- r) Which products make us the most money?
- s) Which products make us the least?
- t) What does our market research look like?
- u) Are our products still timely or too mature?
- v) What is the demographic of our customers?
- w) What are the long term trends in our industry?
- x) How do we spend marketing dollars
- y) How do we measure results?
- z) Finally, what should our sales be?

As you can see we easily ran the alphabet but there are still a myriad of other questions that need to be asked & answered. What we are looking for is a deep self examination & the realization that our business like every other business can be improved. We just need the time to focus. How you get the time is another topic. (Hint...its called delegation)

Gross Margin

Sales, of course, represents the top line of our business but what we really get to spend is not the gross revenue but the gross margin from that revenue i.e. sales less direct costs. Let's not get hung up on what's direct & what's not. Suffice it to say direct costs are those that vary directly with sales be that purchases or production, labour & things like freight.

Most businesses know their gross margin but we find that few businesses know how that is made up i.e. what products or services deliver what margin? Most businesses do not analyze how those margin dollars change from year to year. Of course they can see from their financial statements if the gross margin dollars went up or down but few bother to analyze how much those dollars changed as a result of volume & how much as a result of pricing, both in and out. This is essential information.

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Let's discuss margin analysis. Certain goods or services yield different margins. This depends often on scarcity, purchasing power, efficiencies, competition, branding & what the market will bear. Let's say a business sells 10 product types. An analysis needs to be made as to the margin from each type so that we can see the higher & the lower. Now, it doesn't necessarily follow that you only pursue the higher. Maybe the lower does a much greater volume or maybe the lower provides the entre to the higher. An example of this would be a new car. The margin on new cars is small but the margin on warranty work or service work is very high. A camera body has a miniscule margin but a camera bag does not.

Having said that there may be low margin items that should be dropped because they involve too many other costs such as marketing or inventory investment & that's why an analysis needs to be done.

We recently analyzed the gross margin of a service provider (actually a contractor) & we found that they only really made money on small jobs not larger ones. We also found that certain customers were never profitable, just too tough to deal with. The client had the data available but simply hadn't done the analysis. Now they know where to focus their efforts & what work to turn down.

A focus on gross margin & how it's changing is essential to becoming more profitable.

Expenses

This is the area that most business focus on in tough times. There is indeed some justification for this because it's the area that we typically can control the easiest. We can cut costs quite quickly & usually this is the right decision. However, no company ever cut its way to greatness & so we need to be judicious. We need to match expenses to revenues & this is one reason for careful budgeting (see white paper number 2). Often the biggest expense is labour & of course this needs to be examined. Where can we rationalize, what do we do that we could stop doing? What is the right ratio of labour to revenues in our industry? Who among us would find a package attractive? Do we need to go to a shorter work week? These & many similar questions are the right ones & need to be addressed.

However, we also need to keep in mind that we are not in business just for the duration of the recession & we need to consider how will we function when we return to normalcy & what will it cost to rebuild the team?

In terms of other costs each one should be examined starting in order of magnitude. The challenge is that many managers are the ones who drove these costs in the first place & may have some difficulty in making cuts. Senior management needs to get involved & set parameters based on the budgets. For example, if a business spent 100 on marketing last year senior management may set 70 as this year's budget & managers simply have to figure out the areas they will cut to get there.

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“How we do it here” is a mind set that need to be challenged. Just because we always did our own repairs/payroll/accounting doesn't mean it shouldn't now be outsourced. (The benefits of outsourcing arise because the supplier has economies of scale & the user only pays for what they use). This needs to be considered even if it results in de-hiring.

Essentially then an efficient business is one with little or no fixed costs & nearly everything is variable. This allows a huge margin of safety in a bad economic environment but at the same time allows for growth as & when that occurs. It also has the benefit of lowering the capital that needs to be invested.

One counter intuitive thought is that some business may actually need to increase their expenses to become more profitable. This may arise if you need to open new markets or design new products or services. It may happen because you need to have great people to delegate to so that you can focus on other things. A simple mantra that we believe creates success is “everyone in the business should be doing that which they do best” In other words, everyone should be delegating those tasks that can be done better (or at least nearly as well) by someone else allowing that person to spend 90% of their time doing what they excel at. The results of this process can be dramatic. Please note this invariably applies to senior management or owners more than anyone else.

So, there are no simple answers when it comes to profitability but there are many answers, just not easy ones. If it was easy everyone would be super profitable. However, by using some commonly used techniques & by using the numbers as your guide most companies can become more profitable than they already are.

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