

THE DONALD COOPER CORPORATION

Speaking and coaching internationally on management, marketing and profitability



Management tool #B-6: ©

The math of improving our profitability:

Understanding the 'math of profitability' can have a profound impact on our business...and our life. Many business owners and managers believe they must make big improvements in their business to make any real difference on their bottom line. The opposite is true. Small improvements in pricing, sales or operating efficiency can make a huge difference in our profitability.

Note from Donald: For 20 years I've been asking clients 3 simple questions about improving profitability...and no one has yet had the answers. Here are the 3 key questions about the math of profitability in any business. The answers will likely amaze you.

Question #1: If we were so good at what we do that we could raise prices by just 5% and nobody noticed or nobody cared, what would be the impact on our bottom line?

- The answer is that our bottom line would probably grow by somewhere between 70% and 100%.

Question #2: If we were so good at what we do that we could increase sales by just 5% without spending a fortune on advertising or cutting our price, what would be the impact on our bottom line?

- The answer is that our bottom line would probably grow by somewhere between 25% and 45%.

Question #3: If we could improve operating efficiency and reduce expenses by just 5%, what would be the impact on our bottom line?

- The answer is that our bottom line would probably grow by somewhere between 20% and 28%.

The amazing added bonus of profit improvement: Here's the amazing bonus that no one much talks about. Because businesses typically sell for a multiple of 3 to 7 times annual earnings, if we can improve our bottom line by, let's say, \$50,000 a year, that increases the value of, and eventual selling price of our business by between \$150,000 and \$350,000, in just that one year alone. Amazing...but true.

Note from Donald: The exact profit improvement numbers will be somewhat different for each specific business, so you'll need to do the 'math of improving profitability' for your business. It's very important that you work with your accountant to develop these numbers that will guide you in making more effective pricing, marketing and operating decisions. There is a lot at stake here.

When you have developed your specific profitability improvement numbers and filled them in on Page 2, make sure that everyone on your team knows that small efforts on their part make a big difference to the health, sustainability and success of the business.

#1 Improving profitability by increasing prices:

- a)** If we were so good at what we do that we could **raise prices** by just 5% and nobody noticed or nobody cared, the improvement to our bottom line would be about \$ _____, which is a ____% improvement in overall profitability.
- b)** Perhaps a 5% price increase is too much. So, what about a 2% or 3% increase?
- The improvement to our bottom line of a 2% price increase would be about \$ _____, which is a ____% improvement in overall profitability.
 - The improvement to our bottom line of a 3% price increase would be about \$ _____, which is a ____% improvement in overall profitability.
- c)** Perhaps we can't increase prices on everything...but where are there opportunities to raise prices, and by how much can we increase them? What would the profit improvement of this be?
- d)** Even if we would lose a few customers by increasing prices, it could still be a wise move. We'll need to make some assumptions about how much business we might lose and then do the math to see if the price increase is a good decision. The analysis would look like this.
- If we increase prices by 5% and lose 5% of our customers, the impact of those combined factors would be an ☐ increase ☐ decrease to our bottom line of about \$ _____, which is ____%.
 - If we increase prices by 5% and lose 10% of our customers, the impact of those combined factors would be an ☐ increase ☐ decrease to our bottom line of about \$ _____, which is ____%.

Some important thoughts on pricing:

So, what's holding us back from increasing prices? Is it that we're mediocre? Is it that we think it's all about price when it's also about compelling value and extraordinary experiences? Or do we just have an entitlement problem that's holding us back and hurting our bottom line?

Often, the biggest thing holding us back from asking a little more for what we sell is our own insecurity and doubt about the value of what we do. We often see business people with an entitlement problem subconsciously making bad pricing choices that sabotage their success because they don't think they're deserving.

If you truly are extraordinary, charging an extra 5% is no big deal...and probably won't even be noticed. Nobody will ever think we're worth more than we do. Funny how that works.

A key question here is, what do we need to improve to deserve the price we need or want to get? What additional services, help, coaching, convenience or improved customer experience would we need to add to make a 5% price premium irrelevant to our target customers...and how much might it cost to add those improvements?

The math of profitability is a bit complicated, but it's so very important...and most business spend no time on it.

#2 Improving profitability by increasing sales:

- a) If we can **increase sales** by just 5% without spending a fortune on advertising or cutting our price, the improvement to our bottom line would be about \$ _____, which is a ____% improvement in overall profitability.
- b) Perhaps a 5% sales increase is not ambitious enough. The impact on our bottom line of increasing sales by 10%, without spending a fortune on advertising or cutting our price, would be about \$ _____, which is a ____% improvement in overall profitability.

8 thoughts on how we could increase sales:

- 1. Reality check:** Do we offer compelling value and experiences that 'grab' our target customers, clearly differentiate us from our competitors and make us 'famous'? Mediocrity is no longer an option. What do we need to do or fix to be 'extraordinary'?
- 2.** There's no point in being the best if we're also the best kept secret. In many businesses, the easiest way to increase sales by 10% to 15% is to make sure that all of our target customers know all the ways that we can be helpful...and then to remind them on a timely basis.
- Do we have an up-to-date customer *and* 'key prospect' database? Do we use those 2 databases to proactively, consistently and cost-effectively deliver valuable info and remind people that we exist?
 - Do we creatively and consistently market our business by creating events that entertain, educate or otherwise engage our target customers?
 - Do we have a database of 'media and key influencers' in our field and do we regularly send them interesting and helpful info about what's going on in our industry and our business?
- 3.** What additional products or services could we offer that would attract new customers or increase sales to existing customers? Do any of our existing products or services make us look bad? What will we do to fix that?
- 4.** Are we easy to do business with? Do any our policies irritate or frustrate customers and drive them away? How can we completely turn those around to make them into 'customer magnets'? An example is a ladies fashion store going from, *"Limit 3 items in the change room."* to *"Please take as many items into the change room as you wish!"*
- 5.** Is our place of business confidence inspiring? Does it add value to our customer experience, or detract from it? Are we in the right location to attract and serve our target customers wonderfully, efficiently and conveniently? What location would be more appropriate? Why aren't we there?
- 7.** Are our staff talented, passionate, knowledgeable, empowered, acknowledged and rewarded? Do they have a sense of urgency and a sense of pride? If not, what needs fixing and how will we do that?
- 8.** If we sell 'B to B', do we have a list of key prospects that we can serve as well as or better than our competitors? Are we clear about what our 'value pitch' is to these prospects? Who has the responsibility for turning these prospects into customers?

A list of 5 things we commit to do to increase sales by at least 5% in the next 12 months.

1. _____.
2. _____.
3. _____.
4. _____.
5. _____.

#3 Improving profitability by reducing expenses:

a) If we can **reduce expenses** by just 5%, without diluting the customer experience or team morale, the improvement to our bottom line would be about \$ _____, which is a ____% improvement in overall profitability.

Some examples of how to reduce expenses:

A **pizza restaurant** spent \$40 on plastic bins and zip-lock bags to create a portion control system for cheese and immediately improved their bottom line by 24%. Cheese is the most expensive ingredient in pizza, so they focused on that. What are your biggest cost items and how can you control them?

By switching from serving bacon all the same length to bacon of uneven lengths, **Marriott Hotels** saved \$2 million a year. Nobody cares if their bacon is all the same length. It was a costly and irrelevant quality standard.

By changing the packaging of their Kirkland Brand cashew nuts from round jars to square jars, **Costco** saved the shipping expense on 600 truckloads of nuts per year because they could fit more jars on each pallet. It's called "cube utilization"....using space more efficiently.

Do you have space or facilities that you don't need that could be sold or rented out for revenue? Could you relocate to less expensive space? A **lawyer** friend of mine, in sole practice with 2 legal secretaries to back him up, sublets prime downtown office space, usually on a 5 to 10 year sub-lease, for a fraction of what he'd pay as a lead tenant. So, he may have to move every 5 or 10 years. No big deal when he has just saved \$300,000 to \$600,000 on rent.

By the way, this same lawyer friend always drives beautiful Jags or Mercedes and has never bought a new car in his life. He buys one or two year old cars and saves \$20,000 - \$30,000 every time. He has a frugal mentality and he does the math.

Are you **overstaffed** or are you keeping **non-performers** who are costing you money, time and, perhaps, customers? What is it costing you to not deal with non-performance?

Do you have **unprofitable customers** that cost you more to serve than they're worth? Can they be rescued...or should you refer them to another company who may be able to serve them profitably? One trucking company that I've worked with fired unprofitable customers and grew their bottom line by \$12 million.

Your staff will have lots of ideas on how you can operate more efficiently and they've been waiting for you to ask...so ask them. Add this subject to your regular Staff Meetings, or create a specific 1-hour "Idea Fest" where everyone must come up with at least one idea to save money. Give them at least a week's advance notice so they can do their homework.

So, what will you do, starting right now, to think and act more frugally to reduce expenses by just 5%?

A list of 6 things we commit to do to reduce expenses by at least 5% in the next 12 months.

1. _____.
2. _____.
3. _____.
4. _____.
5. _____.
6. _____.