Janmar Consultants Inc.

All Businesses Can Always be Run Better – Ensure You are Focused on What Gives You the Most Bang for Your Buck

Profit Improvement

If profits are too low, it is easier to remedy this by reducing costs, not increasing sales. The reason? Costs are more within your control than sales.

Within your company, your key KPI's need to be monitored to ensure they are where you expect them to be. At the same time, you need profit improvement and profit monitoring processes and procedures in place and working.

Executive Summary

All businesses can always be run better – ensure you are focused on what gives you the most bang for your buck.

Profit improvement is like motherhood and apple pie. What business owner isn't interested in it?

When you boil profit improvement down, the actions taken to achieve it falls into one of four things:

1. Sell more
2. Increase prices
3. Get customers to buy more often
4. Reduce costs

This then boils down to two causes of low profits:

1. **Sales are too low**
2. **Costs are too high**

Executing on even one of these will produce positive results, but if you can execute on both at once you will have an immensely successful business.

If profits are too low, it is easier to remedy this by reducing costs, not increasing sales. The reason? Costs are more within your control than sales. Additionally, reducing costs generally has an immediate impact, whereas increasing sales takes time to take affect.

However, you need to be careful not to cut costs too much that it impacts your ability to operate and/or grow your business.

The moral of the story is, if profits are too low and you need a quick impact, don't bet or hope for sales to increase…control or reduce your costs.

Be careful if reducing costs to not cut costs to the point where it impacts your ability to operate and/or grow your business

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- **How a Janmar Consultants part-time CFO can help you increase profits?**
- **What are Key Performance Indicators (KPI's) for your business?**

Introduction

Profits are required for your company's long-term sustainability as they allow for:

- **A return to the shareholders for the money they have invested in the business**
- **The business to continue to be expanded profitably, including attracting and hiring high quality employees**
- **Bonuses to be paid to key employees**
- **Attracting additional investors, if required**
- **Attracting new customers and expanding existing ones**
- **Additional debt to be borrowed where needed or decrease the carrying costs of existing debt**
- **A "war chest" to build up to allow the business to sustain an economic or business downturn**
- **A reinvestment in the business to support growth into additional locations, markets and products, including the research and development needed for each of these**

A business with a long history of profitable operation, allows the business to work through a temporary profit downturn, usually with an injection of a temporary loan. However, reducing costs is usually required in conjunction with this temporary loan to return the business to profitability.

The key is to determine what is the cause(s) of the decreased profits. If left unchecked generally the profits continue to decrease, which then leads to lower cash flow or worse negative cash flow, which then runs the risk of the business going into a downward spiral it cannot stop. When profits start to decrease, the sooner it is addressed the better.

Decreasing profits, if left unchecked, will in all likelihood result in additional decreasing profits and hence decreasing cash flow

Three Quick Benchmarks for Business Profit

Three quick and dirty Key Performance Indicators ("KPI's") that can be used as a benchmark of how well your business is performing:

1. **Gross Profit is the profit a company makes after deducting the costs associated with making and selling its products, or the costs associated with providing its services.**
2. **EBIT or Operating Profit is the profit from business operations (gross profit less operating expenses, amortization and depreciation), before deducting interest and taxes. It is the measure of how efficiently you produce and sell your product or service.**
3. **Net profit is how much money your company generates after paying all expenses.**

Our tried and tested rule of thumb for a well-run business is as follows – pre-tax profits should be 50% of gross margin. For example, if your gross margin is 20% then the pre-tax profit should 10%. If taxes are 2.5% this would mean you are making 7.5% net after tax profit.

The above results will need to be compared to previous actual results as well as other ratios/KPI's to see how well your business is performing.

Accordingly, we also need to look at gross profit percent, operating profit percent and net profit percent.

- Gross profit percent = gross profit divided by sales. It is a metric used to assess a company's financial health and is a measure of how efficient you are at using direct costs (materials and labour) in your production process. The higher gross margin percent the better, as it means your direct costs are lower and you are retaining more dollars for every product/service sold.
- Operating profit percent = operating income divided by sales. Is a measure of how much revenue is left after paying a company's variable costs. It also shows what profit is available to pay interest, taxes and make distributions to owners. Again, the higher the operating profit percent the better. It also tells you whether your operating/fixed costs are too high.
- Net profit percent = after-tax net income divided by sales. Tells what portion of each dollar of sales is left after paying all expenses. Once again, the higher the net profit percent the better. The higher this is the more money there is to distribute to the shareholders. A low net profit percentage may mean – sales are too low, gross profit is too low, operating costs are too high, the business is too capital intensive if amortization and depreciation are too high, interest is too high which means the company is over-leveraged, or income taxes are too high

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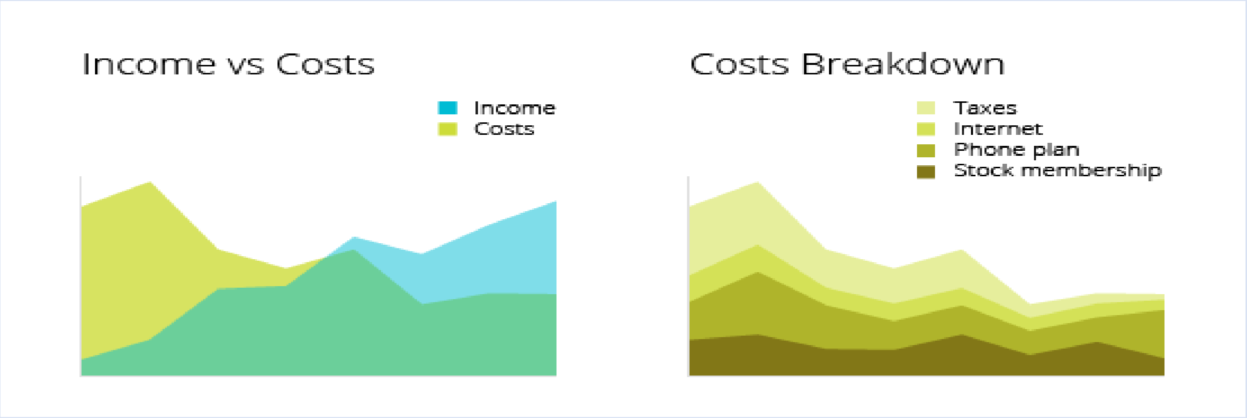


Quick Benchmarks for Business Profits and What Causes Low Profits

Only two things:

1. **Low sales**
2. **Costs too high**

The reality is your business could be suffering from one, or both.

Low sales can be caused by a variety of factors:

- Too few customers – this can be caused by the loss of customers, or not enough customers buying your product/service.
- Too low of selling prices – you may be charging too little for your product/service. This may or may not be able to be remedied as you need to be careful that a price increase does not drive away customers to a competitor. You need to careful here as you may conclude your selling prices are too low when in fact your direct costs may be too high to produce your product/service.
- The wrong product mix – you may have lower priced and higher priced products/services as part of your offerings. Customers may be buying more of your lower priced products and not enough of your higher price products. You need to assess how you can drive sales to your higher priced products or package your lower priced products in a different way to drive higher sales and margins.

Costs being too high can also be caused by a variety of factors:

- Direct material costs are too high for your products.
- You have too many people. This could be too many direct labour employees, too many supervisors or indirect production employees, too many office staff, or too many executives.
- Your fixed costs are too high, excluding people. This could be a result of costs being too high in sales, purchasing, finance or administration. Your facility may be too large for your level of sales. Insurance costs may be too high. Marketing and advertising costs may be too high also. These are just a few examples. You may be performing an activity in-house that may be more cost effective to be outsourced.

The reality is remedies to low sales take longer to put in place and become effective than costs being too high. The reason - sales fixes involve a third party that you cannot control – namely the customer. You may put in place steps to get more customers, increase selling prices or change your product mix, but at the end of the day you need the customer to place another order for this to become effective and then once the order is placed you need to deliver the product/service.

For costs, these are completely within your control as the business owner. However, you need to be careful not to cut costs to a level that it impacts your ability or capacity to carry on business.

If your material costs are too high you can either negotiate new prices with your suppliers or you can find another supplier to provide the product to you at better prices. This however will also take time to become effective.

No one ever enjoys having to make cost reductions, but if it means the difference between saving your business or not it is well worth it.

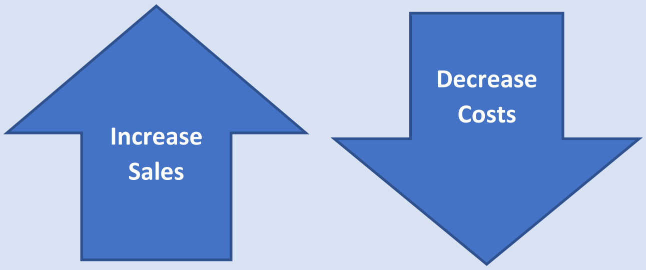
If you have too many people, this can be remedied within a few hours/days if you want. Essentially, when the people are no longer at your company their costs stop, subject to paying out vacation and severance pay. The other thing to bear in mind is, if staff reductions are needed you need to ensure you save employee morale. The other thing is executive reductions always result in higher savings. One senior executive leaving is usually the same as 3-4 direct employees from a dollar perspective.

No one ever enjoys having to make cost reductions, but if it means the difference between saving your business or not it is well worth it.

How a Part-time CFO From Janmar Consultants Can Help You Improve Profits

Our experienced team of veteran, seasoned CFO's have worked in companies where steps to improve profits have had to be made. They can supplement or lead your team with their years of experience. Results will be achieved faster and they will assist you with developing and implementing metrics to indicate when profits begin to lag or decrease.

As we mentioned before there are two main ways to improve profits that your CFO can assist with:



Increase Sales

Raising Prices

The biggest impact to increase sales is to increase prices, since every additional dollar goes straight to profit. More volume, whether by

selling more or selling more volume, only contributes the gross margin of the sale.

Additionally, don't make the mistake of thinking your products must be cheaper than your competitors. You want your customers to believe your product/service is more valuable to them than your competition, this will lead them to pay more for your product.

New Customers vs Existing Customers

When trying to increase sales many business owners focus on new customers. However, it costs five times more to attract a new customer than to retain an existing one.[1] The reason? They already have existing relationships, and for one reason or another it is working for their business. Switching suppliers may be a mistake for them.

Accordingly, it is better to focus on existing customers and satisfy them, so they buy more, more often. Is there also a way to add additional products that they currently don't purchase from you? Increasing customer retention rates by 5% increases profits by 25% to 95%, according to research done by Frederick Reichheld of Bain & Company.[2] At the same time because they are existing customers, they know you and do not have fears or objections that first-time customers do.

Your CFO will assist you and your team to develop strategies to increase your sales whether through increased selling prices, or higher volumes.

Decrease Costs

All businesses need to control costs. A lack of controlled costs will erode profits, or worse lead to losses. You CFO will stress that any reductions in costs cannot be at the expense of decreased quality or services.

They will also separate your costs into the major cost buckets, which may be:

[1] Source: Forbes Magazine. Don't spend 5 Times More Attracting New Customers, nurture The Existing Ones, September 12, 2018

[2] Source: Loyalty Rules! How Today's Leaders Build Lasting Relationships, Harvard Business School Publishing, September 2001, Frederick Reichheld

What are Key Performance Indicators ("KPI") for your Business

Your CFO will work with you to identify and document your KPI's. You as the business owner know what these are. Afterall, you built a successful business and what you focus on or what you look at daily is what has made your business successful.

These may include:

- Daily or weekly sales
- Order bank also know as order back log
- Cash collections
- Units produced by production per day or shift
- Average sales dollars per employee
- Gross margin %
- Daily gross margin dollars
- Inventory levels
- Days of inventory on hand
- Days of sales in accounts receivable

Your CFO will ask you what these KPI's should be or look at the trends of these KPI's over time to determine the benchmark needed for acceptable profit. This will then need to be communicated throughout the organization, so all team members understand what is required/needed. Your CFO will then look at how your KPI's relate to improving profits.

The above items are all financial based KPI's or profit drivers. Financial based profit drivers relate to profit. Examples include:

- Price
- Fixed costs
- Variable costs
- Sales volume
- Cost of debt
- Inventory

However, there are also many non-financial KPI's that may impact your business. Examples are as follows:

- Market share
- Customer satisfaction
- Unprofitable customers
- Weather
- Employee training
- Employee morale
- Employee safety
- Business culture and values

Your CFO will help you determine what KPI's are best for your business

To assist you with increasing profits your CFO will look at the viability and feasibility of many things, including the following:

- Investigate alternative suppliers to ensure you have two supply sources for all major items
- Are there any government grants your business can utilize
- Research to determine if there are better, cheaper means to deliver your product/service to the customer
- What are the trends of your KPI's
- Analyze and review material overheads to see if they can be reduced with minimal negative business impact
- Currency hedging
- Develop incentive plans for all employees
- Investigate competitors to see what they do better than your company
- Can you take advantage of the benefits of the Scientific Research and Development Tax ("SRED") credit program
- Are there better, less expensive ways to deliver advertising and marketing
- Is there a better location(s) for your business(es)
- Investigate bank and interest charges to determine if there are any potential savings
- Are there any redundant expenses or employees and what, if anything, can be done about them
- Review shipping and delivery charges to see if they can be reduced
- Investigate if there are better quantities to purchase materials in to take advantage of efficiencies and economies of scale
- Are there any activities done in-house that should be outsourced
- Review supplier invoices for errors and to ensure you are not being overcharged

All in all, your CFO will assist you and your team, with developing and implementing systems and procedures to ensure KPI's are monitored and reviewed on a periodic basis, and to ensure expense control systems are in place and working. This will ensure you and your team are consistently focused on profit improvement and it gets the attention it deserves. Afterall, profit improvement is not a one-off thing you look at once and never again or even once a year and then forget about it. It is a continual process that needs monitoring and action. Your part-time CFO is there to support or lead the finance team and assist other areas of the business as needed. This will allow you, as the owner to focus on growing the company, and if profit improvement processes and procedures are in place and working it will be profitable growth.

Conclusion

You as a business owner went into business to make money. It's the only reason business owner's go into business. If not, you're a charity, not a business. Unprofitable sales are a waste of time and money. Assuming you are in business to make money then you want to ensure that you make money from every sales dollar.

Within your company, your key KPI's need to be monitored to ensure they are where you expect them to be. At the same time, you need profit improvement and profit monitoring processes and procedures in place and working.

A part-time CFO from Janmar Consultants can assist you with ensuring these processes and procedures are in place and your business is operating as profitably as you want it to be, at a fraction of the cost of a full-time junior accountant. Call us today, we're here to help.

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