Profits Should Not Be Guesswork
They Should Be by Design

Do You Have a Profit Plan for Your Business? Do All Your Employees Know Their Role in that Plan?

The two critical activities a business must focus on to create a sustainable business model are increasing profits and decreasing costs. Yet these two fundamentals are the last rubrics a typical business owner thinks about when launching their business. In the beginning, it is all about the owner's vision and the team's excitement. Then reality gets in the way. While the concepts – increase profits, decrease costs – are self-evident, the process of integrating these rubrics into the fabric of the business are not as easy to achieve. What is needed is a profit plan, i.e. profit by design that focuses on gross profit, net profit, cost of goods sold, and cash flow. Further, the entire team, all employees, must understand how their work helps fuel profits, influence costs, and ultimately drives their paychecks.

The Foundation for Achieving Competitive Advantage

More than one company has closed its doors drowning in revenue while unable to pay its bills. Understanding how much money your company has to pay out in bills every week is vital in keeping it afloat. To ensure your company is financially healthy, it's important to create a sustainable business model, or "profit by design" plan.

As companies grow, the dynamics will likely change with it. Growth requires companies to shift from CEO-centric to enterprise-centric in order for new processes to take root. This is when profit by design becomes crucial. The challenge for CEOs is that you don't know what you don't know, especially when it comes to understanding profits and costs and how these metrics relate to planning, performance and sustainable growth.

At the heart of profit by design is focusing on profits, managing your margins and understanding your cash flow. Businesses learn the hard way that without a solid understanding of how much money it takes to operate now and in the future, you can go out of business.

Understand the Basics of Profit by Design

Successful companies develop a laser-like focus on revenue by category, or revenue-group) and the critical factors that affect revenue performance. Knowing where and how revenue develops allows companies to predict and control their actual revenue, help ensure financial operating resources and avoid "cash crunch" crisis. The key starts with developing and tracking the basic performance metrics including projected revenue, cost of goods sold and margins. Tracking key metrics means you'll know what's going on and won't be blindsides by basic cash issues.

Tracking Metrics Alone is not Enough

The next step is to plan for profits. In order to create a sustainable business, a leadership team must now focus on increasing profits while decreasing costs. Otherwise, the additional aspects of accounting and financing are moot. And though most CEOs understand the need for a business plan, too many are unaware of the fundamental profit design of their business, including the essential rubric for creating profitability. Gaining clarity on the following nine topics forms the core of a profit fitness plan:

1. Revenue generation
2. Strategic and tactical focus
3. Gross and net profits
4. Cash flow
5. Cost structure
6. Customer satisfaction
7. Staff voltage
8. Product and service quality
9. Company innovation

For each revenue group, it's critical to first know the gross margins so that you can explore new options where margins are low. Assessing both gross and net profits in your organization can help you with this because you can see when it's time to develop new approaches to reduce cost of goods sold. A higher profit margin is ideal because it shows your organization's sales are generating profits. Understanding these measures allows leaders to develop well-thought-out strategies, anticipate and plan for problems and make better business decisions.

Once you understand your margins, it's time to analyze your direct labor, direct materials and allocated overhead costs to identify expense reduction opportunities. Don't assume you have identified all costs associated with your products or services. Continue to track and monitor costs, and reduce costs where feasible. Concurrently, determine line items on your profit and loss statement where employees can make an impact. Challenge the staff to help show savings by brainstorming ideas to cut costs.

Be Transparent and Encourage Financial Literacy

The core challenge with profit by design is about making sure your company is testing all assumptions on a regular basis and sharing this information within the business. At the leadership level, continually review how the company competes on quality, price, technical superiority and customer loyalty. Equally important is the review of profits, cost of goods and respective margins.

As well, ensure your employees have a basic understanding of how their job helps the company make (and keep) its financial stability. Get employee insight started by instilling financial literacy in your team, and help them understand the difference between profit and cash flow. Transparency is crucial in reassuring employees that the company is stable.

Also consider that the ways in which information is distributed throughout the company affect profits and costs. The easier it is for people in the organization to get access to essential information, the easier it is for them to succeed and make the company more profitable. Financial transparency is about sharing revenue, profit and projected sales with everyone in the company. This knowledge, when coupled with employee key results, enhances accountability, increases understanding in how a business operates and makes everyone a stakeholder.

Track Your Cash Flow Regularly

Take the time to understand how fast cash comes in and goes out by tracking your company's cash flow weekly, bi-weekly or monthly. Then, compare these numbers to the previous year's metrics. Analyzing receipts and disbursements, knowing your cash reservoirs and planning for the future is also critical. This can help you make better decisions because you won't be surprised by your company's finances, and you will be able to leverage even a small amount of cash for great benefit to the business.

Know the Early Warning Signs of a Cash Flow Crunch

- ✓ Having difficulties paying vendors or making payroll.
- ✓ Making interest-only payments on a corporate credit card or business lines of credit.
- ✓ Using personal assets to cover expenses.
- ✓ Converting a business line of credit to a note.
- ✓ Significant drop in sales or customers.
- ✓ Significant, unexpected expenses.

To avoid problems, implement financial key performance indicators that pay attention to inbound revenue accounts payable aging, increased expenses, cash flow and margins. When possible, renegotiate long-term vendor contracts.

With an understanding of a company's finances, leaders and team members are better able to plan their budgets, forecast their needs, manage cash and positively influence the financial performance of the company.