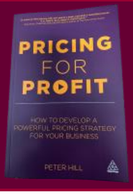


Profit Potential Worksheet
Additional Notes

<u>Overview</u>

The worksheet seeks to identify the potential profit improvement from changes to the way in which revenue is generated. It is a simplified version of a more complex computer model, and as such has some limitations as to the accuracy of the figures. Whilst the logic still works and the principles will remain the same, the numbers only illustrate the key issues.

If you wish to get a more accurate view, and talk with an accountant who understands this modelling tool, visit www.ranone.com and look up a member firm in your area, and ask him to show you the TBR PIP software.

<u>Know the numbers</u>

The starting point for any "what if" scenarios, is a clear starting point. This is shown as a simplified profit and loss account showing **Turnover (A)**, **Cost of goods sold (B)**, **Gross Profit (C)**, **Overheads (E)** and the resultant **Net Profit (F)** for the last 12 month period available to you.

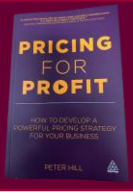
If you are unable to obtain this information, then you must invest in a good accountant to help you to produce it on a regular basis to help you manage the business.

In addition to this, we need to know where the turnover comes from. We do this by looking at the number of customers we start with (G), the rate at which we win new ones (H), the rate we lose them (J), and as a result the number we have at the end of the year (L). This should look something like the number of live accounts you have on your sales ledger, but if you do a lot of cash sales business then you may simply have to estimate the numbers as best you can.

We then look at the average number of times they buy (M) (every week equals 52 etc) to get to a total number of transactions in the year (N). At this point you can do a simple logic check as this should roughly equal the number of invoices raised by you in that year. If not, then your estimates of customer gains or losses may be wrong, or the average frequency may not be right.

This then enables us to work out, on average, how much each individual transaction is worth (O), by taking our turnover and dividing it by the number of transactions (A divided by N).

Note: When we work with many businesses, we can spend several hours trying to get accurate numbers for this starting position. We could pick some sample accounts to see if 6 times a year frequency seems right. We could take turnover for a month and divide by the number of invoices raised to see if the average is reasonable. If the business does want to improve profits in the short to medium term, it may be important to ensure that there are mechanisms to measure these numbers on a regular basis to monitor changes. I.e. at what point is a customer considered "lost"?



The change scenarios

The worksheet then takes each aspect in turn and helps to work out the impact on overall profit of various changes.

I.e. a small change in the rate at which new customers are won from 10% to just 12% adds a further 16 customers at the end of the year, which filters through to a profit increase of £5,710 in the example, i.e. over 11%.

The question then arises as to what actions can be implemented to achieve this better conversation rate. In my experience, simply recording it, and reporting “new clients won” and if appropriate showing this by salesperson, branch or department can have a profound effect.

Similarly a small change in the rate we lose customers (by prioactively speaking with them more often for example) can have a similar effect (in fact the maths is identical for these two options).

If we focus attention on promoting special offers, mail shot prompts about certain seasonal products etc, can help to get customers to buy more often. Obviously those buying every week may have less potential, but those buying monthly can be persuaded to spend again if nudged in the right way. In the example, a change of just one in 10 customers buying once more per year increases profits by almost 10%.

All of these options are about “more of the same”. Hence the impact on number of customers served and the volume of transactions, are all still multiplied by the average transaction value which we calculated at the start.

We then need to look at squeezing more money from each individual transaction. This is done in three ways:

1. More volume, i.e. selling 5 items instead of 4
2. Higher value, i.e. selling them a premium (gold) option instead of say entry level (bronze) option

Both of these have increases in cost of goods sold, and for simplicity we assume that the profit margin worked out at the start (30% in the example) remains the same but that on average we just squeeze a little extra value from each sale. In reality “gold” options should command a slightly higher price as well as being more volume and greater value.

Thus the small change shows in increased turnover, but at the same profit margin. This still shows 12% increase in the bottom line

3. Just charge a little more. A pure and simple price increase.

Therefore the increased turnover will have the same cost of goods sold as the start position, but will therefore increase the gross profit and as a result the gross profit percentage. As can be seen from the example, and no doubt your own figures when you work them through, small changes in prices filter almost completely down to the bottom line, hence showing a £20k or 40% increase in profits on the example.

<u>The combined position</u>

When we work with businesses on profit improvement projects, we need to be clear as to which area we attack first, and then how other areas are integrated into the development plan as we proceed.

Clearly some actions benefit many areas, for example excellence in customer service will keep customers longer, encourage them to spend more, convince some to pay a higher price, and are the very things that attract new customers as well.

We therefore get business owners to think about the next three years.

If you make no changes to the business, and continue with a “more of the same” mentality, then the likelihood is that you will end up with the same result, plus or minus inflation or external economic factors. But let’s say it is reasonable to expect a similar year in year 3 to the last year if nothing changes.

If however, we undertake a controlled and sustain programme of change to attack all these areas, then by year three, we may be better at winning and keeping customers, and at up selling and cross selling products and services to them, and getting them to buy more often and at slightly higher prices. If we could achieve the modest improvements shown in the example, but in all areas, there is a compounding effect of all these elements.

In the example, individual improvements total just over £42,000 but the combined figure is an increase of £44,322 or an 89% increase!!

<u>Your figures</u>

Hopefully you can follow the worksheet and insert your own figures to see what these changes, and in particular the pricing one has for your business.

Just remember the two sayings...

- ***It is a sign of madness to keep on doing the same things and expect a different result***. If you want improved profits, then what do you need to change?

- **If it is to be it is up to me**. If you want improvements, YOU must make changes.

Peter Hill
Author Pricing For Profit