Sharpening Your Profit Focus

By Janice Knight

Steve Wheatly, the manager of a successful luggage and travel accessories store, recently cut off a Google ad campaign that promoted a product on the company's website. He was paying as much as $93 per sale, but the product retailed for only $53. That kind of upside-down ROI was the impetus for immediate action, right? Nope. Wheatly reluctantly admits that he'd been watching the situation for *more than 18 months* before finally pulling the plug.

"I just didn't want to give up on the sales," he says, sheepishly.

Unfortunately, this is not an isolated example. Wheatly's tale—the story is true, though his name has been changed to protect the guilty—is not uncommon. Many business managers are much more focused on—and have a much better picture of—their revenue than they do of their profit. The focus on the top line versus the bottom line is an issue for companies of all sizes. For example, the *Wall Street Journal* recently reported that one of the Fortune 500 was reviewing its cost structure for the first time in 10 years. But it is a more pernicious problem for many small businesses that don't have the luxury of deep pockets and complacent investors.

It's 5 p.m. Do you know where your profit is?

Improving profitability requires first that you focus on it. When you talk about your company do you describe it as a "$2 millions (sales)" company or a "$100,000 (profit)" company? When you talk about how you're doing at the end of the day or week or month, is it in revenue or profit terms? Are your incentive schemes based on revenue or profit? Do you even know from month to month what your profit is?

Steps You Can Take Immediately

Though the specific steps will depend on the nature of your enterprise, here are several suggestions for sharpening your profit focus and finding ways to enhance the profitability of your business.

1. **Pay yourself first.** This doesn't mean you write yourself a check before you pay your employees, but that you account for yourself at the salary you deserve, rather than "what's left over." What do you think your time is worth? $100 an hour? $500 an hour?

What would the profitability of your company look like if you paid yourself that? If you don't like the answer, then dig into the underlying reasons.

2. **Find the customers you are better off without**. We've all heard that the 80/20 rules tends to apply to your customer base—80% of your profit will come from 20% of your customers. So far so good, but what do you do with the other 80%? The tendency is always to hang on to any source of revenue. But by trying to segment the bottom 80% further, you can often find that some of them are making you money and some are actually costing you money.

   By carefully reviewing these segments, you may be able to up the profitability of the middle tier...and then increase your profitability further by shedding the bottom tier. Turning away customers—any customers—may be the tough (ask Steve Wheatly), but that discipline can be highly rewarding.

3. **Develop a "Profit Paradigm."** Let's say your business is currently producing a 10% profit. The conventional approach to trying to raise that number it is to examine your overhead and/or cost of sales and look for another 1-2% at the margin. That approach will often produce some results, particularly if you build in a process of constant reevaluation.

   But another strategy is to target a 20% net profit and figure out how to restructure your business to achieve it. Impossible? Maybe, but don't underestimate what you can come up with by taking a more radical approach.

4. **Retention vs. Replacement.** One of the most powerful ways of thinking about long term profitability is in this simple analysis:

   - On average, businesses lose 50% of their customers every five years;
   - A 5% increase in customer retention yields a 25-100% increase in profitability.

   We all learned about the "lifetime value" of a customer during the heat of the dot.com craze. If the "lifetime value" of the new customer is $1,000, then surely you can justify the $250 investment to attract one, right? That may make sense in the abstract, but the $1,000 is a hypothetical value and the $250 is coming out your pocket.

   The real question is what is the cost of *retaining* a good customer that you already have? Often that number is a small fraction of what it takes to get a new customer—hence the enormous leverage of customer retention on profits.

5. **Enlist all the help you can get.** The suggestion box was supposedly invented in 1721 when the eighth shogun of Japan, Yoshimune Tokugawa, posted the following note: "Make your idea known . . . Rewards are given for ideas that are accepted." The Japanese have since led the way in engaging workers in productivity (and profit) improvement processes.

   But you can tap your own employees' knowledge and creativity for suggestions on how to reduce costs and improve productivity, and it doesn't take a full-blown TQM or Six-

Sigma process to do it. For many small businesses, Tokugawa's note and a real commitment from the CEO are all that's required. And if you run a business on your own, try having an "idea party." Invite friends and colleagues over, present your situation and ask for creative solutions.

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