AMERICA'S SBDC WASHINGTON

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Insight Solutions Success

Making and Keeping Money

"I can't seem to make any money!" Surprisingly, this is a common lament among business owners. How much money they make depends on a lot of things. Factors such as timing, competition, management, and certainly, the industry affect the potential and size of profits. However, fundamentally, profits are the difference between revenue and expenses.

Profits result from decisions on selling price and expenses. A selling price which is too low or expenses that are disproportionately high will result in a negative impact on profit. Consider two factors that affect price: competition and cost. Comparable products or services must be sold at a price within range of the competition to attract a share of the market. However, basic operational expenses are inevitable and keeping and expanding market share may drive additional expenses.

The first place to look to increase profitability is cost of sales. Depending on what is sold, direct cost of sales consists of materials (or merchandise), freight in, and direct labor (including subcontractors). However, manufacturers also include factory overhead, value-added materials, etc. The cost of sales is a proportionate or variable part of price. A reduction in cost of sales has an immediate positive impact on gross profit.

To increase gross profit, minimize direct costs without sacrificing quality:

- Negotiate material or merchandise prices that result in the lowest cost - though this might mean higher volumes or scheduled purchases. Since holding inventory carries financial risks such as storage costs, obsolescence, spoilage, waste, and shrinkage, one can't afford to buy too much. Therefore, strike a balance between volume discounts and holding costs. A good resource for seeking suppliers is www.thomasnet.com.
- The costs of freight can be overlooked so separate, track, and evaluate them. With good planning, a variety of methods and vendors can be chosen to deliver the goods.
- Minimize labor costs by hiring less costly workers, supplying owner labor, or improving efficiency. Less costly workers probably means more time training and greater supervision so use this option wisely. If owner labor is the best use of resources, then more profit will result. However, the owner still needs time to run the business. A very practical way to reduce the cost of labor is to evaluate processes. Save labor time by making sure employees have all the resources needed to complete their jobs. This means achieving a smooth work flow, minimizing bottlenecks that result in wait time, and keeping equipment and vehicles in good repair. Open lines of communication with employees will avoid downtime and improve rapid response to problems. Impact Washington—https://impactwashington.org/ provides training on this topic.

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Making and Keeping Money Continued ...

Since the objective is a positive net profit, next shift attention to overhead costs. Overhead costs are typically fixed every month -they must be paid whether or not a sale is made-and control of overhead begins with good recordkeeping. Lower space costs by extending the terms of leases or assuming the costs of improvements. Other fixed expenses will depend on the industry. Take time to shop for the best deals on insurance, telephone plans, advertising, travel, and other industry -specific costs. Some expenses such as electricity, water, office supplies, etc. can be minimized by avoiding waste.

Home-based businesses have an advantage because of lower overhead and greater price flexibility. However, for the business to grow, it will be difficult to keep this strategy forever. A greater volume of sales usually results in increased fixed costs for space, employees, etc. though it can also mean more purchasing power and higher efficiency.

Position the business in the marketplace so that it optimally meets business and personal goals. If the goal is to grow the business, prices may need to rise to have profits sufficient for reinvesting. Plan to make money by using break-even analysis and setting financial targets. A tool to calculate break-even is at https://www.score.org/resource/break-even-analysis-template.

Since not all business models are created equal, it helps to benchmark costs with others in the industry. Good resources are the RMA Annual Statement Studies and Industry Norms and Key Business Ratios through Dun and Bradstreet. They are available at most regional libraries. Trade organizations may also have financial statistics for comparison .

One last point--**making money is not the same as keeping money**. The cash profit of a business is the fuel that grows it and growing businesses place a high demand on profits. Owners are constantly using profits to increase cash reserves, buy inventory, add equipment and vehicles, pay short and long-term debt and pay taxes. What is left is equity. That equity can be converted into disbursements (thereby reducing the cash reserve) or left in the company as "fuel". Therefore, choices on how to use profits affect the ability of the owner to keep money.

The industry, the market environment, the local cost of operation, and a business owner's ability to manage cash are the keys to having a business that makes and keeps money.

Highlights on How to Make and Keep Money:

- Adopt a competitive and sustainable pricing strategy.
- Keep accurate records.
- Track and minimize expenses.
- Set financial targets.
- Know where all the cash goes.
- Evaluate then make improvements.

This was written by Janet A. Harte. Janet was an SBDC Certified Business Advisor for the Vancouver Small Business Development Center (SBDC). The Washington SBDC is a network of 25 centers in Washington managed by Washington State University. Advisors provide in-depth, confidential and no-cost customized advising to businesses within Washington State. To locate your local SBDC advisor please visit the SBDC web site www.wsbdc.org/contact-an-advisor.