

The Power of Small Change

Discovering the DNA of profitability for your business!

By David Quirke



Business owners often think that they need to take dramatic steps to improve the profitability of their business. Many believe, for example, that if they want to double their profits they need to double their sales. Still others think that they need to take on many more people, thus bringing with it, many more headaches. This doesn't have to be the case. The difference between the DNA of a chimpanzee and a human is only 2% but what a difference that makes. 2% less and you are spending the rest of your natural life learning how to crack open a nut and 2% more and you can fly a rocket to the moon. You may be surprised to find that the difference between a successful and an unsuccessful business is surprisingly similar.

So what is the DNA of profitability in a business?

Broadly speaking there are five simple areas that we can look at to improve the profitability of a business. Let's start to build these areas up one by one

- 1. Leads:** This is any realistic, potential customer to your business. Someone who might realistically buy from you. For example, someone who enquires about your product or service by walking in to your premises, phoning, faxing, e-mailing or any other method of contact.
- 2. Conversions:** This is the percentage of leads who actually decide to buy from your business. They actually reach into their pockets and buy.

- 3. Average Euro Sale:** This is the average amount of money a customer spends with you whenever they buy something from you.
- 4. Transactions:** This indicator is how many times in a recorded period (for example, a year) that a customer will purchase from you on average.
- 5. Margins:** It is no use having a huge turnover and no profits. Therefore, this indicator is what net profit your business achieves on its turnover.

These will, of course, vary considerably across businesses and industry sectors. The Average Euro Sale might be €100 in a clothes shop but it might be €25,000 in an auto dealership. Most business owners are aware of these concepts but many can not tell you what these measurements are for their businesses. I have found that simply by measuring these elements on a consistent basis can increase the profits in a business and always (without fail) surprises a business owner who has not had a policy of measuring them before.

Having measured them how can we get them working for our business?

Let's take an example and work from there. Let's say we own a clothes shop (this is just for simplicity. This would, however, work for any business on the planet). Let's say the starting figures are as follows:

Leads (1):	8,000
x	
Conversions (2):	25%
=	
Customers:	2,000
x	
Average Euro Sale (3):	100
x	
Transactions (4):	2
=	
Turnover:	€400,000
x	
Net Margin (5):	15%
=	
Net Profits:	€60,000

Where does the Power of Small Change Come in?

Let's try and increase each of our numbered areas by 10% and see there that leaves us:

	Start	+10%	+100%
Leads (1):	8,000	8,800	16,000
x			
Conversions (2):	25%	27.5%	50%
=			
Customers:	2,000	2,420	8,000
x			
Average Euro Sale (3):	100	110	200
x			
Transactions (4):	2	2.2	4
=			
Turnover:	€400,000	€585,640	€6,400,000
x			
Net Margin (5):	15%	16.5%	30%
=			
Net Profits:	€60,000	€96,930	€1,920,000



Alright, I know the 100% increase scenario might be a little far fetched (although I actually saw it achieved once) but even the 10% scenario represents an increase in net profit (money in your pocket) of €36,930. Not bad by anyone's standards.

- Work this out for your business.
- Do it now and see what it works out as.
- No don't wait.
- Not even for one second.

Well done. Now you can see the potential here.

That's all well and good but my business is different!

Many business owners (normally those who can't tell you what the above metrics are for their business) say that it would not work for their business but in reality I have never seen a business where some form of this won't work. It is always possible. Here are a few points to remember, however:

- **Doesn't have to be expensive:** Some business owners believe that it all has to be very expensive, that you have to spend huge amounts on advertising to get more leads etc. This is not the case. Quite often I have seen cases where the spend has actually gone down. The advertising was simply ineffective and not tested and measured.
- **Test and Measure everything:** You cannot change what you haven't measured. If you know the return on investment for any form of marketing you know whether it is worthwhile continuing or not.
- **Creative marketing:** Try and be creative about how you market your business. You can advertise and if it works that's fine but sometimes businesses do nothing else. Look for other methods such as strategic alliances with other businesses. There

are literally hundreds of strategies to increase each of the areas listed above and some of them are bound to be of use to your business.

- **Believe:** This is probably the most important of the lot. Simply stop saying that it won't work in your business and start testing it out for yourself. Consistently measure these areas and see what it does for your business. It will work.

Remember, Profit is not Cash Flow!

It is important to remember in all of this that profit is not cash flow. The majority of small business failures are actually a result of cash flow and not profit. There are many examples of small business that sold so much so fast that they couldn't pay their bills. Primarily because they weren't paid quickly enough from their customers but now have to pay more bills to their suppliers to cover their newly increased sales.

To some this will sound obvious, to others it will come as a surprise. However, to me the only surprise is how many business owners actually don't plan for their cash flow throughout the year. Often they don't have a basic cash flow forecast, let alone the ability to model potential changes in their businesses. For example, can you model the effect on your cash flow of?

- A change in your turnover (even a slight one)
- An increase in your prices
- A decrease in your prices
- A change in inventory levels
- Taking on a new salesperson or any new employee, or indeed letting one go
- A change in your receivables or your payables (how quickly you get paid from your customers or pay your suppliers)
- Reducing your overheads
- Increasing your borrowings

Do you just carry out changes and assume/hope that it will be beneficial? Do you just try and increase your sales and assume/hope that this will be good for business?

Sadly, whilst increases in sales are normally good for business, surprisingly often it isn't. It can cause a myriad of problems such as more work, increased overheads, cash flow problems, operational or production issues.

It is always better to model the changes before you carry them out to see what the impact will be on your business and, indeed, your life.

The unfortunate fact is that cliches are sometimes correct. Turnover is vanity, profit is sanity, and cash flow is reality.

Conclusion

The good news in all of this is that in order to dramatically improve the profits and cash flow in a business sometimes it only requires a few tweaks and not a major overhaul. This is normally true in many other areas of the business, such as operational efficiencies, human resource issues, financial operations and indeed in time management issues as well.

It is also easier to manage a large task such as dramatically improving a business by breaking it down into small tasks. If your business wants to start improving profits start by simply measuring where you are in each of the areas above. Once you know where you are (and you are careful about your cash flow), we can then talk about improving each of these areas (although I have a sneaking suspicion that the act of simply measuring them will lead to improvements in your business). Don't take my word for it, after all you don't know who I am. Do it yourself and see!!

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