UKBA™ UK Business Advisors Ltd

Boost Your Business

Practical Business Advice from the Independent Experts Issue 76 November '13

Knowing Where You Make Your Money

By measuring your performance, your performance will improve. You will see what has worked and what has not. It will also show you how you are progressing towards your vision.

How much money do you make on each transaction?

This is called your gross profit: sales less directly attributable costs. Costs comprise:

- the materials that you purchase from third parties
- the labour you use in making the product or service
- any directly attributable overheads

The words "directly attributable" are particularly useful in helping you decide what costs to include at this stage.

It only includes costs that vary with your production - so not the rent for the office or the office-based staff.

This enables you to understand your pricing better.

How much money do I need to cover my overheads?

Identify the cost of your total overheads. Say this is £1 million. Identify how much money you make on each transaction - your gross profit.

Say this is £100.

Take your overheads (£1m) and divide it by your gross profit (£100) and this will show you how many transactions you need to sell to make a profit. 10,000 in this example.

Now play with it. If you were to reduce your selling price by 10%, how many do you need to sell? Reduce your overheads, etc. You can also do this by month, and use it for target setting.

Furthermore, it enables the Sales and Marketing team to understand what the requirements are.

This is called the break-even point.

It's very useful in helping you to understand just how you do make money.

When does the money come in?

People sometimes get confused with the difference between profit and cash.

Accountants do not always help here because they predominantly prepare Profit & Loss accounts which have only a remote relationship to cash.

A business can be profitable and still run out of cash. This not difficult to understand. Profit disregards the timing of when the money comes in from customers and goes out to suppliers and employees.

Understanding the timing of payment is as essential as knowing whether you are making a profit. This is cash-flow.

Cash-flow forecasting is an essential business tool. It helps you to manage the future - and get plans in place to deal with issues arising from that.

Short term cash-flows need to be on a weekly basis for the next thirteen weeks. Try to maintain it at a reasonably high level. Prepare the forecast monthly and retain that in an unmovable column. Update the cash-flow on a weekly or even daily basis.

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What Are The Consequences Of Price Increasing Or Decreasing?

It is an often debated subject whether to increase prices but seemingly less so when it comes to decreasing prices - with many businesses content with offering discounts or “buy one, get one free” offers. Both actions have consequences on your bottom line, but maybe you're not aware of the effect.

Before looking into more detail about that and before you take any action be sure that you know your cost of sales and your profit margin for each product or service that you sell; this will enable you to see what difference your pricing strategy can make.

It is also important to note, that prior to making a “global” decision about your pricing, you should test the market and see what the outcome is. Select a few customers to see what the reaction is to a change in price.

Hopefully your customers are buying on value nor price - or at least that is the sort if ideal customer you should aspire to.

If you feel you need to add value to your existing offering, particularly in the case of a price increase, explore what you can do that doesn't incur extra cost to you but adds more value to the end user. For example, a money back guarantee or extended warranty?

Don't just make an arbitrary decision one way or the other on pricing, monitor and measure the impact it has on your business and your customer base.

The following table indicates the increase in sales that are required to compensate for a price discounting policy. For example, if your margin is 40% and you reduce price by 10%, you need sales volume to increase by 33% to maintain your profit.

And you reduce your price by:	If your present margin is 20%	25%	30%	35%	40%	45%	50%	55%	60%
	To produce the same profit your sales volume must increase by:								
2%	11%	9%	7%	6%	5%	5%	4%	4%	3%
4%	25%	19%	15%	13%	11%	10%	9%	8%	7%
6%	43%	43%	25%	21%	18%	15%	14%	12%	11%
8%	67%	47%	36%	30%	25%	22%	19%	17%	15%
10%	100%	67%	50%	40%	33%	29%	25%	22%	20%
12%	150%	92%	67%	52%	43%	36%	32%	28%	25%
14%	233%	127%	88%	67%	54%	45%	39%	34%	30%
16%	400%	178%	114%	84%	67%	55%	47%	41%	36%
18%	900%	257%	150%	106%	82%	67%	56%	49%	43%
20%	-	400%	200%	133%	100%	80%	67%	57%	50%
25%	-	-	500%	250%	167%	125%	100%	83%	71%
30%	-	-	-	600%	300%	200%	150%	120%	100%

If you adopt a premium pricing strategy, the following table shows the amount by which your sales would have to decline following a price increase before your gross profit is reduced below its present level. For example, at the same 40% margin, a 10% increase in price could sustain a 20% reduction in sales volume without loss of profit.

And you increase your price by:	If your present margin is 20%	25%	30%	35%	40%	45%	50%	55%	60%
	Your sales could decline by the amount below before your gross profit is reduced								
2%	9%	7%	6%	5%	5%	4%	4%	4%	3%
4%	17%	14%	12%	10%	9%	8%	7%	7%	6%
6%	23%	19%	17%	15%	13%	12%	11%	10%	9%
8%	29%	24%	21%	19%	17%	15%	14%	13%	12%
10%	33%	29%	25%	22%	20%	18%	17%	15%	14%
12%	38%	32%	29%	26%	23%	21%	19%	18%	17%
14%	41%	36%	32%	29%	26%	24%	22%	20%	19%
16%	44%	39%	35%	31%	29%	26%	24%	23%	21%
18%	47%	42%	38%	34%	31%	29%	26%	25%	23%
20%	50%	44%	40%	36%	33%	31%	29%	27%	25%
25%	56%	50%	45%	42%	38%	36%	33%	31%	29%
30%	60%	55%	50%	46%	43%	40%	38%	35%	33%

UK Business Advisors is a group of over 100 independent and experienced, professional business men and women offering practical business advice covering a range of skills covering all industry sectors and pillars of business:

Finance | Sales | Marketing | Operations | Resources | Management | Strategy

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Next month: What You Need To Know About Exit Planning

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