# Profit Enhancement *Report*

Great ideas to substantially increase profits.

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# Keep the Blood Pumping

*Cash Is the Heart of Your Company's Life Force*

More than one business has had to shut its doors even though its books showed it was in the black. How can that be? The likely answer is restricted cash flow.

Profitability and cash flow often are misunderstood and misused. Profit equals your revenue minus expenses. Positive cash flow indicates the business is taking in more money than it's expending. Thus, the company can pay its employees, vendors and bank. Plus it can invest in its future by increasing its research-and-development budget and upgrading technology.

Negative cash flow, on the other hand, can signal a company's death knell. Without money, the company can't timely pay employees and vendors, must shelve new product development, and put off repairing aging machines. Eventually the bank will refuse to finance the deficit and leave bankruptcy as the only alternative. How can your company keep its cash flow strong? Let's examine a few methods.

## Watch Out for Falls

A fundamental planning document for any business is its cash-flow forecast. By estimating your company's financial peaks and valleys, you stand a better chance of avoiding negative cash-flow pitfalls. Managers generally prepare forecasts annually or at least quarterly and divide them into monthly or even weekly segments. Your plan should answer these four questions:

1. What payments do you expect to make during each period?
2. How much cash do you predict will come in during the period?
3. How will you make up for cash shortfalls?
4. How will you invest cash surpluses?

While preparing your forecast, remember that you're not looking at billings sent versus invoices received. Rather, you want to view your cash collections versus your cash disbursements.

## Don't Let It Bleed

One key to a healthy bottom line is to keep more cash flowing in and less flowing out. Here are some tips to help avoid a bloodbath:

**Improve billing procedures.** Many businesses slip into financial trouble because they can't send billings out in a timely manner, have difficulty collecting after billing or both.

**Offer incentives for customers to pay early.** Consider using the old standby term "2/10 net 30." This term may prompt your customers to pay their bills within 10 days — rather than the normal 30-day term — and, by doing so, receive a 2% discount.

**Keep inventories as low as possible.** Stay on top of which items are moving and which aren't. The less cash invested in inventory, the more available for other needs or investments.

**Hunt for and cut wasteful expenses.** Carefully search for wasteful expenses to eliminate. Cutting the wrong expenses can restrict your ability to service customers properly, which will cause more problems than it will fix.

## Need a Bandage?

Business owners often zero in on one thing: profits. Sure, profits are great, but what keeps a business afloat during unsteady economic times is positive cash flow. If your company takes a fall, profits won't stop the bleeding, but cash will. To improve your cash flow, please give our profit advisors a call. We can help you apply a tourniquet if your business is seeing red. ■

## Planning for Profits

*Use Break-Even Analysis as a Starting Point*

Before setting your company's annual revenue and profit goals, you would be wise to determine your company's break-even point. After you've determined that figure, you and your managers can begin to:

- Set goals in quantifiable financial terms — for example, increase sales by 10% and cut travel expenses by 5%,
- Chart the path for reaching your goals — to reduce travel expenses by 5%, work with your travel agent to ensure you're booking the most economical flights and hotels, and
- Review progress monthly and adjust and react to changing market conditions.

A business breaks even when it isn't losing money but isn't making any either. Before determining yours, it's important to understand a few key terms:

**Fixed costs.** As the name implies, these costs don't change whether sales are up or down. Examples are rent, utilities, administrative and management salaries, and lease payments.

**Variable costs.** Unlike fixed costs, these costs rise or fall depending on sales. Examples include sales commissions, raw materials used to produce products and shipping costs.

**Variable cost per unit of sales.** To calculate the variable cost per unit of sales, divide the total variable costs involved per unit by the total variable costs per sale. The result is the variable cost percent per unit. For example, if your variable costs per unit equal $25 and you sell the unit for $100, your variable cost percent per unit is 25%.

Here's the formula to determine your break-even point: Fixed costs divided by (1 – the variable cost percent per unit) = the number of units needed to sell to break even. For example, if rent, utilities, salaries and lease payments equal $10,000 per month and variable costs per unit are $25, the average sales price is $100 per unit. The variable cost percentage is 25% ($25/$100) and the break-even point for the month is $13,333 ($10,000 fixed costs/(1-25%)). In other words, you'll need to sell 133 units at $100 each to cover your fixed and variable costs for the month.

Of course you're in business to make a profit, not just break even. By knowing what that number is, you can make informed decisions on how to go beyond a net gain of zero. For help with strategic planning and determining the break-even point for your business, call one of our profit advisors today.

# What's the Value Of Value-Based Pricing?

Putting a price on your product is an art, not a science. Determining price means striking a balance between what you need to turn a profit and the market's perception of what your product is worth.

Your decision may seem easy: set the product's price at more than it costs to make it. Of course it isn't that simple. You must understand your market, distribution costs and competition before devising an effective pricing strategy. One relatively new and less-common method is value-based pricing.

*Value-based pricing considers industry segmentation, competitors' pricing, and substitute products or services — all of which can make pricing more strategic.*

## Traditional vs. Value-Based Pricing Methods

Pricing has been studied throughout history, yet traditional pricing models remain essentially unchanged. Here are two standard methods:

**Cost-based pricing.** Determine your production costs and add a markup above that cost. The markup provides your profit margin. This easy-to-apply approach almost guarantees you won't sell at a loss.

**Competitive pricing.** Research the going rate of similar products in your industry and set your price within your competitors' price ranges. You may choose a range of prices based on your target market niche.

Value-based pricing combines these two traditional methods and offers excellent opportunities for stabilizing or increasing your profit margins. This method considers industry segmentation, competitors' pricing, and substitute products or services — all of which can make pricing more strategic.

## More Value = Higher Price

Value-based pricing is driven by the value your product creates for customers. For example, say your company helps a client develop a new product and, through your business solutions, you reduce the time to market by three months. You could then price your services to reflect the value you added by designing a product that

began making money earlier than originally planned.

What will it take to move your organization toward value-based pricing? Start by answering these six questions:

1. How can you measure the product's actual value?
2. What is the product's perceived value?
3. What will happen if we change our price?
4. Which product attributes have the highest value?
5. How do customers choose between alternatives?
6. Do various customer groups value our product differently?

Another way to understand your product's value is to ask your customers. Use focus groups, customer surveys and historical pricing analysis. Once you discover why your customers value your product, you can begin to develop your pricing strategy.

## Higher Price = Higher Customer Demands

If your value-based pricing strategy calls for a price increase, be prepared to greatly enhance customer service. Remember, this pricing method is based not only on time and materials, but also on knowledge and expertise. Your ability to analyze, draw conclusions and provide recommendations to customers' problems is key to your continued business success.

## Get Your Pricing Gun Ready

The focus of a value-based-pricing strategy should be on your customers — not your company. If customers don't buy your product, nothing else matters. Costs are only the starting point. To make an effective pricing decision, you need information on the customer's price sensitivity, real and perceived product value, and the competitor's pricing. We can help you settle on the right price for your product. Please give our profit advisors a call. ■

# A View From the Edge

## *Sharpen Customer Focus by Gaining a Competitive Edge*

In today's marketplace products exist to fill the needs of most individuals and businesses. To gain a competitive edge, you must identify your products' features and associated benefits, and demonstrate how they're better than the competition's. A competitive edge may:

- Increase sales and market share,
- Improve profit margins in new or existing markets,
- Boost your chances for success in competitive markets, and
- Develop hard-to-copy product or service mixes.

Here's a closer look at areas within your company where you can create a competitive edge.

### Triple-Edged Sword

The qualities that distinguish your organization from your competitors depend largely on why your customers purchase your products or services. Through strategic business planning, you've likely identified your target market and selected products or services to offer those customers. The results of this planning are key in determining which of three areas to consider as your company's competitive edge:

**Operational efficiency.** If your business structure relies on efficiently run processes to reduce costs, consider this as your edge. Doing so requires that you outperform your competition by:

- Rapidly responding to changes in market demand by adjusting your product line to meet customer expectations,
- Ensuring that you offer reliable products that consistently satisfy your customers' needs, and
- Offering quality products at competitive prices.

**Customer service.** Service-oriented companies that match their product or service to meet individual needs generally

use customer service as their advantage. These companies rarely compete on price. For customer service to be your competitive edge, outperform your competition by:

- Producing your product to meet your customers' individual needs,
- Providing customized service to each client, and
- Providing relevant information such as potential business trends or government regulations impacting all prospects.

**Product leadership.** Organizations that provide state-of-the-art products and services typically use product leadership to set themselves apart. These businesses create new products or services based on specific marketplace demands. For product leadership to be your competitive edge, outperform your competition by:

- Ensuring your customers consistently perceive you as a technology leader,
- Giving customers enhanced benefits through product technology, or
- Providing technological solutions to clients' problems.

Keep in mind that your company may not fit neatly into one of these categories; most businesses don't. But to ensure you develop and implement the correct competitive strategy, consider your company's strengths — including employees' skills and business processes, competition, market position, and industry trends. Then choose which edge type your business will most likely succeed in achieving.

## Shredding the Competition

Your competitive advantage is your ability to serve a market segment more efficiently than your competitors do. Remember that customers with specific needs are usually not ready or willing to make sacrifices. Some like the latest product technology, while others may desire quality products at discount prices.

## 4 STEPS TOWARD GAINING A COMPETITIVE EDGE

In simple terms, the process of becoming the preferred provider consists of these steps:

1. Discover your capabilities and resources within your target market.
2. Find a place in the market where you'll be able to leverage those capabilities.
3. Develop a strategy to capture and maintain your position.
4. Implement and fine-tune your strategy.

The competitive edge you choose depends on the demands of your target market, the product or service you offer, and your company's values, resources and expertise. In all instances, direct your activities toward achieving a competitive or differential advantage. To sharpen your competitive edge, please contact one of our profit advisors. ■

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