

## Top Ten Reasons for NOT Managing Profitability

Today, our persistently weak economy is driving small businesses into two camps: the few that are growing fast, and the many that are struggling. For most, staying in place is sliding toward failure. Effective profitability management makes all the difference.

A few days ago, I discussed my new book, *Islands of Profit in a Sea of Red Ink*, with an officer of an industry association with many small business members. Her questions reflected discussions I've had with small business owners and managers over the years. Here are the top ten concerns.

### **#1 – I'm already doing it.**

There is a huge difference between managing budgets and managing profitability. Virtually every company I've seen – large and small, in over a dozen industries – is 30-40% unprofitable by any measure, and 20-30% of the business provides all the reported profits and subsidizes the losses. Even the industry leaders. Why?

Because they make three big mistakes: (1) assuming that more revenues means more profits; (2) failing to identify and focus on their profitable core of business; and (3) failing to develop appropriate information and processes to manage profitability.

### **#2 – It's a big company thing.**

Wrong. It's really important for a big company, but it is life or death for a small business. In this economy, the companies that focus on their profitable core of business are making big gains in market share and profits. I'm familiar with one small company that worked with an important customer on a new business process that really improved the customer's productivity – its sales rose from \$10 thousand to over \$1 million in a year.

### **#3 – I don't know how.**

Four building blocks: (1) the right information – granular (specific products in specific customers) not aggregated; (2) the right priorities – first, secure and grow the profitable business, then improve the marginal business, then reprice the money-losers; (3) the right processes – mostly coordinating sales, marketing and operations to get things right; and (4) the right compensation, especially for sales – matching compensation to real profitability not just revenues.

### **#4 – I'm too busy selling.**

This is a common concern because many small business owners are also chief customer officers. The real problem is that the sales force is not focusing on securing and growing the profitable core. So their efforts are dissipated over a lot of unprofitable business – much of which can be turned around with a few focused measures.

### **#5 – I'm too busy cutting costs.**

This is a big problem. If all revenues are viewed as good, all costs are viewed as bad. This leads to the big mistake of across-the-board cuts, when this is exactly the time when the company should invest in growing its profitable core of business, and generate cash by turning around its marginal business.

The most successful companies today are making big gains in market share by working with their best customers to create joint supply chain and marketing efficiencies. This increases the customers' profitability – driving huge sales increases, while lowering the supplier's own costs.

### **#6 – My CFO is really stretched.**

*Islands* explains "profit mapping" – how to develop much more granular information than that produced by accounting systems. You have to look at the profitability of specific products in specific customers. The book gives examples of how even profitable customers have 30-40% unprofitable business, which can be reversed with surprisingly simple measures.

How long does this take? A couple of capable managers can develop a profit map in 4-6 weeks using standard desktop tools. Even a busy CFO can easily oversee the process.

### **#7 – My customers are hammering me on price.**

When you make your best customers more profitable, you are no longer a commodity provider. Price pressure simply disappears.

Remember that your first priority is to secure and grow your profitable business, *before your competitors attack it*. This is the biggest danger – and opportunity – you face.

### **#8 – We can't afford expensive new software.**

No need – see #7 above.

### **#9 – We're all making budget.**

Budgets are developed and performance is judged relative to history not potential. If a company is 30-40% unprofitable, and its budget aims for a 10% improvement, the company will still have a huge amount of embedded unprofitability.

### **#10 – I don't know where to start.**

Great question. Many managers simply assume that leading a profitability turnaround requires a big, one-time, disruptive reorganization. This is a huge mistake.

In fact, the most effective turnarounds are more like getting healthy by eating good food and getting regular exercise. The process is not particularly difficult or painful, but it is a very different way of managing. I wrote *Islands of Profit in a Sea of Red Ink* to guide you step-by-step through this process.

What's the first step? Develop a profit map – you'll be amazed at what you'll see.