

CFO Solutions

As hard as I'm working, I should be making more money

Whether you own your own business or work for someone else, this thought has certainly crossed your mind. If you work for someone else, you probably have the security of a steady pay check to carry through those periods when you work too much. When you take the huge step out on your own and start your own business, you can't rely on that steady income stream from your boss. Your compensation fluctuates with the wins and losses of your business. This can be exhilarating (typically after a big win) and it can be frustrating as well (typically after a big loss).

The short answer to this problem is to charge more. If you have little competition and can set your own prices this is a great answer. If you have competitors chomping at the bit to pick up your clients, or potential clients, this may not yield the desired results. You could end up increasing your workload by the additional effort required to sell at a higher price without improving your financial results. If you own your own business and find yourself in this situation, you should consider: 1) how much you want to make, 2) how much you make from the products or services you sell?

1) How much do you want to make? The first step in this journey is to determine how much is enough. We all want to make as much as possible but that's an elusive goal. A clearly defined goal is easier to achieve. At least it's easier to recognize when you've achieved it. Your goal might be an absolute dollar amount; I want to earn \$100k per year. Your number might be a percentage; I should make a 15% net profit on sales. The important thing is to establish a realistic and identifiable goal.

2) How much do you make from the products or services you sell? This is a simple profitability analysis. Subtract your Cost of Goods Sold from your revenues to determine your gross profit. Don't worry about overhead when you are looking at gross profit. To calculate your gross margin, divide your gross profit by your sales. To determine your net profit subtract your overhead costs from your gross profit. Your net margin is your net profit divided by revenue. When you complete these calculations, you'll be staring at a few numbers. You might be thinking so what.

Your gross margin and net margin provide insight when you have statistics against which you can compare. Take a look through the financial press and see if you can find gross margins or net margins for businesses similar to your. You can also check out the web sites of companies you admire or don't admire. If they are public companies, the investor relations section of their web site will provide quarterly and annual financial statements. Find their income statement in their annual report or their 10K and check out their gross and net margins. While you can't make an apples to apples comparison between large public companies and small private companies, this review will start to give you a sense of where your business falls in the spectrum of profitability. You should also look at your gross margin by your product or business segments. Identify the two or three major segments of your business and determine the revenue by segment. Next determine your cost of production or inventory by segment. Which of your business segments have the highest gross margin? Is it the one you thought? To calculate a net margin by segment you will have to figure out a reasonable way to allocate your overhead costs. This can get more complicated. One simple approach is to allocate by segment revenue. After you calculate your margins with current overhead, add in the amount you would like to make and calculate new margins.

How do your segments compare? Do the results match your expectations?

You may find that your lowest revenue product is your highest margin product. Sell more of that and you increase your bottom line. You may also find that your largest segment is your lowest net margin.

Evaluating your gross and net margins by product or service line and against competitors is a reasonable place to start when you are trying to figure out how you can improve your financial results. You can use other parameters to evaluate your productivity and efficiency. Some of these parameters will focus on sales. You can evaluate profitability by type of client, by salesperson, or other nuances of your product or service. Some of the parameters will focus on costs. Look at the largest line items on your income statement; where are you spending a lot of money. What are your expenses by vendor. There are many ways to evaluate your business and your business' ability to generate positive returns. The key to resolving the issue is in your numbers and you should start to look at them in more detail to unearth the opportunities that they highlight.

Running a business is like juggling. You have to have the right number of balls in the air and you have to be able to respond at the right time. Knowing your gross and net margins will help you evaluate the number of balls, the height of the balls, and the speed of the balls you are juggling. It might be easier to achieve your goal if you eliminate a ball or the answer may be to change out a ball. Until you have the right information to evaluate your results, you will continue to play with the same balls and get the same results until one day you drop them all and maybe decide to pick up darts.

Greg Caudell is the president of CFO | Solutions. CFO | Solutions provides business advisory and financial management services to small businesses. Greg's experience includes consulting and corporate finance for large multinational companies. He also spent three years as the CFO for a mid size investment management firm. In 2005, Greg started his own his financial consulting business to help other small business owners achieve their dreams.