Can you improve your profitability?

Identifying unrealised potential

Take your profit and loss (P&L) statement, for example. In itself, it simply provides a historical record of how your business has already performed - it does not explain how to improve your performance in the future.

But our advisory services can enable you to use your P&L statement to determine:

- Where there is unrealised profit potential
- What is blocking the realisation of that potential
- How to remove those blockages

We can analyse your entries using various ratios such as:

- Gross profit/sales
- Profit before tax/sales
- Contribution/overheads
- Net profit before interest/interest

This type of close examination will reveal areas where there could be unrealised profit potential. These might include:

1. Low gross margin
2. Low sales
3. Excessive interest
4. Excessive carrying costs

Let's look at each of these in turn:

1 Low gross margin

To monitor and improve profitability effectively, we would examine the gross margin for each product or service - and how this margin is performing over time.

If we discover that the gross margin on a particular product or service is low, we would need to know if this is a new development, or part of a continuing trend.

The next stage is to try to understand what is causing the problem. We would start by looking at the broad picture and then gradually narrow the focus of the investigation. Here are some questions we might encourage you to ask:

Product/service mix

Do we have the right product/service mix? Are we adapting to changes in the marketplace? Are we following our competitors or leading them?

Productivity

Are our employees/management meeting acceptable performance standards? Are outdated or inefficient working practices affecting productivity? Can we improve our operational procedures?

Pricing

Is the cost of sales rising faster than our selling price? Are we pricing for volume or for profit?

Buying

Can we strike a better deal with our suppliers? Are we buying too much or too little at a time? Can we take advantage of cash discounts?

Stock

Are we carrying too much or too little stock? Is our stock management system causing hold-ups?

These are just a few suggestions, but they give an idea of the type of factors that contribute to low gross margins.

In our experience, most businesses have room for profit improvement in one or more of these areas.

2 Low sales

If your sales figures are not meeting expectations, once again you need to try to understand the causes and devise ways to remove them.

Questions you might ask include:

Pricing

Are we pricing competitively? Could we increase our profits by lowering our selling price - or even by raising it?

Sales & marketing

Are our sales and marketing strategies as effective as they could be? Are our sales and marketing staff performing effectively? Are they motivated to go for volume or for profit? Are all staff who interface with customers/clients trained in cross selling?

Stock

Are our stock levels too low, thereby preventing us from meeting orders in full, or on time?

Customer service

Are we losing key customers/clients or failing to gain new ones because our staff are not providing first class service? Are there ways we can add value to our product/service by improving customer service? Would adding or increasing a delivery charge adversely affect sales or not?

Operational procedures

Are operational procedures such as order processing as efficient as they could be? Could we make savings and/or improve productivity by streamlining them?

Debtors

Are we carrying an unusually small number of debtors? If so, would less stringent credit policies, for example, allow us to increase sales without incurring excessive risk?

We believe in leaving no stone unturned in your search for roadblocks to profitability. The more you identify and remove, the better the results on your bottom line.

3 Excessive interest

Interest payments can be a substantial part of your total outgoings, and in our experience most businesses pay more in interest than they need to.

It is often easier than you might imagine to renegotiate financing, especially if you are an established mainstream business with a good track record.

You would need to carefully research your options, prepare your case, and either approach alternative lending sources or use this possibility to gain leverage with your existing lenders. These are all matters we can help you with.

Reducing your liabilities in this way not only improves your profits, it also strengthens the financial profile of your business and gives you increased credibility and leverage in other areas.

4 Excessive carrying costs

Two reasons why your carrying costs might be excessive are:

- Excessive stock levels
- Excessive debtor days

There are two main causes of excessive stock levels:

- Inefficient stock management system
- Carrying surplus stock to deal with surges in demand

Since stock is a major cost, excessive stock levels can be a major drain on profitability. Streamlining your stock management system and moving towards just-in-time production methods can result in considerable improvements on your bottom line.

Excessive debtor days could be the result of a number of factors, but the two most likely are:

- An over-generous credit policy
- Slowness in pursuing late payments and bad debts

In these cases, it is important to consider whether you can tighten your credit terms without harming sales - and introduce a more vigorous debt collection procedure.

Releasing your profit potential

As you can see, preparing a profit and loss statement is just the beginning - the real work is using it to identify areas of unrealised profit potential and devising ways to release that potential.

As the foregoing illustrates, reviewing and improving profitability covers many aspects of your business, but these are all areas in which we can assist you.

As your accountants, we are committed to helping you improve your profitability - why not contact us today and get the ball rolling?