

Make Your Business Profitable Overnight

You know you should be making more profit than you are making with the sales you have. You just aren't sure why your business is not making the kind of money it should be. Wouldn't it be great if someone or something could point out where you are going off track? There is a way you can figure it out – **you need to use a budget.**

A budget is one of the most misunderstood and overlooked tools for an owner to manage a business with. Properly used, a budget can literally turn a business into a profitable enterprise overnight. How is that possible?

Imagine you are getting ready to take a drive from New York City to Phoenix. You know where you want to go, so would you just get in the car and start driving, thinking, "I know the general direction, so I'll get there eventually?" Of course not. Chances are, you would check out the route ahead of time on Google or Mapquest or some other tool. You would probably also program your destination into a GPS unit, so that it could give you turn by turn directions as you are driving. You would have a plan to get there, and you would follow your plan.

Most business owners don't realize that in the same way a GPS can give you direction when you are driving, a budget can give direction to your business. Instead of just saying, "I want to make a profit, and I'll get there eventually," you can have a plan and follow it to get you to where you want to go with your business.

It should be noted that most accountants are aware of budgeting, but they seldom suggest the use of a budget to their clients, quite possibly because they don't appreciate the value of it. Of the ones that may say something, very few actually take the time to go through the process of using a budget with their clients.

So what is a budget? A budget is a roadmap for planning the income and expenses of your business, typically broken down into monthly amounts. Your roadmap allows you to look at your revenues and expenses on a monthly basis, compare them to your plan, and see whether you made any wrong turns. If you do a budget analysis with a business that is not making money, you can immediately see where adjustments need to be made, and if you make the proper adjustments, you create profit. This is why we say that you can literally make your business profitable overnight. With knowledgeable input from someone who has an understanding of what to do to change the numbers, the process invariably works. We have been successful in using it to redirect clients to profitability time and time again.

How you arrive at your budget numbers is paramount. You need to analyze each line item of income and expense. You also need to do this with a critical eye toward what actually needs to be spent. Some people think that simply looking at what they spent last year for a particular category is sufficient. This prior year "baseline" approach is the type of approach used by governments. It just assumes that all expenditures were completely justified. This is why governments are broke or spending at the rate of enormous deficits. Unlike them, you can't simply print money or compel people to pay you more. Your

business has to live in the reality of being competitive while trying to earn a profit. The approach that makes the most sense and that we recommend is called a “**zero base**” budget.

With a zero base budget, you start from zero with each line item, and allow for only what is realistically needed to produce the sales that you presently have. What you spent on a category in the previous year may come into play in helping you determine what you need to spend on an ongoing basis, but it is not your starting point. If you have been overspending in a particular category, why would you want to use that amount as a guideline?

The first step is to figure out how much money you have to work with. The number one stipulation is going to be that the business can not spend more money than it takes in. Makes sense, right? Since that is the limit on spending, you need to know how much the business will take in. All of us wish we had a crystal ball to know what the future holds. You probably can’t know for certain how much revenue your business will generate every month, but you can make some educated suppositions.

- **How much revenue has the business been generating lately?**
- **What is the monthly average over the past couple of years?**
- **Are there any new contracts coming on, or any contracts expiring?**
- **If there is seasonality to the business, you will need to take that into consideration as well.**

One word of caution: guard against the typical optimism of the entrepreneur. We all have a tendency to think, “I’m going to increase sales by 10% every month,” or some similar idea. Don’t think about where you want the sales to be, look at where they are. You need to look at the sales projections as realistically as possible. Once you have your estimate of monthly sales, you are ready to start laying out your budget.

The sales number goes at the top, and all the expenses will be subtracted from that to come up with the net profit. We normally recommend starting with a bottom line profit of 10%. This is a healthy goal for most businesses. So if your sales are projected to be \$60,000 for the month, the target net profit would be \$6,000, for sales of \$100,000 the target net profit would be \$10,000, and so on. You put the net profit at the bottom, and now you can start filling in the lines in between. All of the line items should be entered as a dollar amount but also with a percentage of sales calculated.

The next line item you should address will be cost of goods sold. This is subtracted from sales to arrive at a gross profit number. Your business will have a normal range of where this cost will fall. Some service businesses may not actually have a cost of goods sold, so the gross profit will be the same as the sales. A manufacturing company may have many components of cost of goods sold, such as raw materials purchases and direct labor. So how this is calculated will depend in part on your industry, but again, each line item needs to be looked at individually. For example, how much material do you need to buy to generate the projected revenue? Once you finish this section and come up with a budgeted gross profit, you are ready to move on.

Now you can fill in all the rest of the line items, such as:

- non-production salaries and wages
- payroll taxes
- insurance

- rent
- utilities
- repairs and maintenance

If you have an income statement, you can use that as a guideline for the different categories, but don't let it influence you on the amounts. Take rent, for example. You know what you currently pay. What you need to figure out is how much space do you actually need to generate the sales you are producing, and then how much should you be paying for that space? That is the number you use for the budget.

When you get to the point where you have every expenditure filled in, you can calculate what the budgeted net profit is. If the net profit you come up with is equal to or greater than your targeted 10%, congratulations, your budget is complete. However, chances are you will be below the net profit target, and you are going to have to make another pass at it. Another way to look at it is start with your 10%, add all the other expenses to that, and if you are equal to or greater than the sales number, you have the expenses too high. Either way, if the numbers aren't working out, you have to go through it again.

If you didn't hit your 10% target, you need to figure out what expense line items are budgeted too high and reduce them. A good guideline to help you in this regard is to obtain averages of similar size companies in your industry. Look at where the percentages should be, based on other companies in your industry, and adjust your budget line items accordingly. Go back and revisit whether all of the line items really need to be at the levels you set them. You may need to go through this process two or three times to get to the point where your net profit is on target.

When you finally have your budget complete, you now have a working tool to help you navigate your business. You can compare your actual results on a monthly basis to your budget, to figure out where your business may have gone off track. For line items that are not within the budgeted amounts, you should investigate why they are different, and come up with strategies to get them in line.

For example, let's say your payroll was 20% of sales in a given month, and your budget has it at 16%, because that is in keeping with the averages for your industry. You would want to find out why it was so much higher than your budget.

- Did you allow too much overtime in the month, so that there is a scheduling issue?
- Is the owner compensation too high for the level of sales the business is generating?

There can be a number of factors that affect the different line items, and the trick is to accurately determine what is causing the variance from the budgeted amount. Once you understand why the amount is different, you can make whatever adjustments are necessary to make sure that the future amounts come into line with your budgeted expectations for your business. Now you are managing your business into profitability!

(Getting your budget in place is a good first step. If you really want to lock in your success in business, then download our whitepaper, **"Increase Your Odds to Stay in Business"** at www.yourprofitauthority.com.)

Going through the budgeting process is often an eye opening exercise for the business owner. If done correctly, you may learn some things about your business that you didn't realize. It's good to keep in



mind that a budget is not chiseled in stone. As better information is obtained, or as conditions change, then the budget numbers should be adjusted. The whole point of the budget is to give you a tool that you can use to help you manage your business. The more realistic a business owner is about their business, the more useful a tool your budget will be.

This budget process is all very detailed and can take some time to do properly. You may feel that you need to spend your time selling, or developing new products. The good news is you can still get the benefit of using a budget by bringing in the expertise to help you do it, so that your time can be focused on the things you do best. We invite you to call us for assistance with setting up your budget or evaluating whether your business is on track. Green Zone 9 Advisors can quickly get you on the road to profitability and help you stay there.

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