Profits Hiding in Plain Sight - #3

Michael Jackson

Inventory Turnover.

Bankers, Accountants, and Financial Analysts have had access to business software capable of merging a business Balance Sheet and Income Statement to determine Cash Flow and calculating literally dozens of financial ratios that are generally not as telling as one might expect. Primarily because you need a baseline or industry standards that apply equally well in large metro markets as well as small business in the Flathead.

The same programs are generally capable of highly interactive analysis in the form of 'What If' questions. The operator may input a desired outcome such as 'Increase Profits by a certain dollar amount or a percentage. The results can be more fun and enlightening than the business owner has had in years of being in business.

Let's say that your Net Profit is $25,000 and you come to the alarming conclusion that you could make more than that working for wages. But, on the other hand it is nice being your own boss and if you could just double your bottom line to $50,000 you and your banker would sleep better at night. You have two choices to address your current shortfall. You might take the corporate road to quick turnaround by reducing staff, eliminating raises and benefits, and handing out unrealistic performance goals. Sound familiar? Please don't take that approach!

Look at your business from the inside out, like a skilled surgeon. Take the temperature, feel the pulse, then get out the scalpel. If you are unsure where to make the first cuts, consult with experts with the data you need and get a second opinion. Your Financial Consultant, and perhaps your friendly Business Expansion And Retention (BEAR) partner can show you the way to carve out the $25,000, and perhaps more. I am guessing that you will find the 'hidden dollars' embedded in your office expenses, efficiency, advertising and marketing, accounts receivable / payable, use of cash, and yes even some salary expense. Most likely the salary expense will not be because you are overpaying your staff, you may not have the right individuals in the right positions or they are not adequately trained to perform to their potential. Once again, your BEAR team might have great ideas on you staffing and training.

The Silver Bullet.
My message today is what I almost always find to be the 'Silver Bullet' in managing your profits ---- Turnover. My most successful businesses maintain a laser focus on 'Inventory Turnover'. There is yet one more 'Turnover' number that will drive the bottom line that I hope to cover in a later message, Employee Turnover.

I had a bank client in Idaho that was an RV dealer. This dealer made more money than I ever thought possible in the auto, boat, and rv business. I asked him the secret to his abnormal success. His one word response, Turnover. He shared with me that he will not stock any units that he cannot turn over 5 times a year. He only sells slower moving products by special order. Assume he buys a $50,000 RV for $25,000

(I understand they don't quite hit 50% mark up, but this for illustration). For one $25,000 investment he turns it into $250,000 in annual sales for annual profit of $225,000. Now, assume his competitor only turns their stock 2.5 times – this same $25,000 inventory expense will net $100,000. A difference in profitability of $125,000 on just one stock item!

I had a second client who manufactured square log beams for open beam rustic homes. His business was hit hard by 911 and most of his orders were cancelled. He had fallen behind on a very large loan with a national bank in Seattle and they offered to discount his loan by $500,000 if he could refinance elsewhere. My bank was not interested in bailing out another bank of its non-performing loans. I introduced him to a Financial Planner who made a proposal to evaluate his numbers and cash flow for $25,000. They went straight to the scalpel, looking into all income and expense, operations, and 'Inventory'. His inventory consisted of logs of various species, fir and larch, pine, cedar. Together, they focused on his yard full of logs, including an oversupply of Cedar at a cost of $1,200 per thousand board feet. The business plan we proposed to my board showed that adjusting the inventory to the sales volume would result in $300,000 increase in Net Profit. The loan was approved and paid off early. His parting comment to me when I left Idaho was that this was the very best $25,000 he ever spent!

There are several reasons that businesses end up with wrong Inventory mix. Sometimes it is result of high pressure by sales person, minimum order requirements, or a volume discount that potentially becomes a high price to pay to get that 5% discount. Have you ever noticed your buyer loading up on merchandise they have a personal like or passion for?

Final thought on inventory. As demonstrated above, you must include the cost of carrying inventory into your pricing model just as you include freight and financing. Do not fall into the trap of using 'keystone' pricing on all merchandise / products. A high turnover product may be profitable at 40% mark up and a slow or seasonal product may require (and deserve) to be priced at 60%. You have to know your 'true cost' of your inventory. And, yes, we have a BEAR partner that is an amazing resource for Lean Manufacturing and Lean Office practice that includes pricing.

If you would like to learn about the Cash Flow and Financial Analysis, you can get a very comparable Profit Mastery course from our Small Business Development Center SBDC, at Flathead Valley Community College. The instructor is John Balsam, a highly capable financial wizard and all around great guy. And the best part – that $25,000 consulting fee you can avoid. The last price I saw on this class at FVCC was $295. Call John today to find out the next offering. You will not be sorry. jbalsam@fvcc.edu / 756-3836.

As reminder. Your most valuable asset in your company is your employees. Do not look to them first to solve a Profit issue. And, if you are able to make more money with their help, share it with them rather than beat them out of their next raise. You will be alarmed when you lean the real cost of 'Employee Turnover' and you will also be surprised to really look at why employees leave an employer.

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