

Up Your Profit



Nearly all leaders and investors aim to enhance company profits, especially during periods of decline. Increasing profits typically involves two main approaches: growing revenues or cutting costs. However, executing strategies based on either approach can be challenging and may yield unforeseen outcomes. In the complex landscape of business, change can either accelerate progress or introduce complications.

Grow Sales

There are two ways to grow sales: raise prices or sell more. Raising prices is a seemingly quick way to drive profit to the bottom line, but there's a tradeoff. A high price tag might deter customers — simple cost and demand. Instead, you could increase your marketing with new innovations, better-trained sales teams, new locations, promotions, etc. which could increase sales. Or you could increase your own price tag.

Keep in mind that with each unit sold, there's a

cost of goods that eats into the profit margin. Henry Ford had a brilliant solution to his problem. In 1909, Henry Ford's Model T sold for \$220, equivalent to nearly \$6,000 today. Ford aimed to boost sales by making cars more affordable, believing that even his own employees should be able to buy them. Despite opposition from the board, who doubted his approach and even tried to remove him from the company, Ford persisted. By 1914, he managed to reduce the price to \$99 per car. While profit margins on each unit decreased, sales soared, and the company's overall profits skyrocketed from \$3 million in 1909 to \$25 million in 1914. The transformation from horse-drawn carriages to automobiles is evident in photographs of New York City from 1900 to 1913.

Reduce Costs

If you search through the earnings transcripts of public global companies, you'll likely encounter executives highlighting their cost-cutting efforts.





Why? Because lowering expenses, provided sales remain steady, leads to higher profits. There are many sources of costs in any business and therefore many pieces to trim, but it's crucial to exercise caution and avoid cutting too deeply. If you cut employee benefits, for instance, you might lose valuable employees and incur greater costs to hire new people and train them. Many companies struggling during the last economic downturn boosted their profits by laying people off. The challenge with this strategy is that, as demand increases, you may not have enough of the right employees to meet customers' needs.

For example, Circuit City saw declining success in 2007, and its new CEO eyed an opportunity to amp profits back up by laying off every sales associate earning 51 cents over its "established pay range" — essentially pulling the plug on 3,400 of its top performing workers at once — a detrimental move. Circuit City quickly realized it also fired its most hardworking, knowledgeable associates best able to help customers. And, why would remaining employees work hard if the reward raise could get you a pink slip? Over the next eight months, Circuit City's share price dropped a shocking 70 percent, and in November 2008, the company declared

bankruptcy. Though the cut made numerical sense on paper, Circuit City didn't realize that the price of demoralizing its employees would shut it down. But have they tried turning it off and on again?

Conclusion

In the end, if a company wants to increase profits and continue to grow, it must increase revenue and control costs. Both working together creates the strongest company. Reducing costs may be efficient, but if it doesn't enhance the company's overall strength or its capacity to generate more sales, then what's the purpose? Likewise, if the expenses incurred from boosting sales offset the revenue gains, there's no net benefit. Success in the long term is achieved when a company effectively manages costs while simultaneously driving sales growth.

Activity

“Profit or perish,” said Fred DeLuca, co-founder of Subway, “There are only two ways to make money: increase sales or decrease costs.”

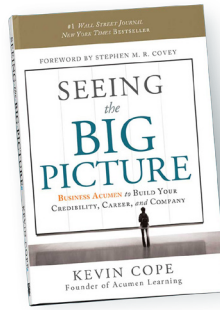
Let’s say you own two Subways, one in the mall and one across the street from the high school. You sell your subs for \$10 and the cost to make the sub is \$2 — giving you a \$8 profit — and you sell an average of 100 subs. You’ve challenged your store managers, Brooklyn and Lou, to boost revenues. Brooklyn cuts costs by 10% — making \$9 of profit per sub. Lou decides to increase sales by 10% or sells 10 more subs every day. Calculate who ends up making the most profit.

Revenue		Expenses		Profit
(100 subs x \$10)	–	(100 subs x \$2)	=	\$800 of profit
(100 subs x \$10)	–	(100 subs x \$1)	=	\$ <input type="text"/> of profit
(110 subs x \$10)	–	(110 subs x \$2)	=	\$ <input type="text"/> of profit

1. Why do you think the results came out as they did? Can you see why companies regularly institute organization-wide cost-cutting measures?
2. What do you think the results would have been if Brooklyn and Lou combined their plans into one?
3. What would be the consequences of making our products more affordable? What about more expensive? What is our company’s pricing strategy?
4. What ideas — like innovations, new locations, promotions — has our company implemented to increase sales?
5. If our company fired the highest 20% earning employees, what do you think would be the consequences?
6. Under what circumstances is it appropriate to cut employees — if ever — to increase profits?
7. What are some areas of waste in our department? How can we help decrease costs?

At its heart, *business acumen* means knowing how your company makes money and making better decisions around the money-making process. As a business leader, you are in a unique position to bridge the gap between functions. You can grow the business in a way nobody else can.

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