Do I have a marketing problem?

MONEY MANAGEMENT—MANAGEMENT AID
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Do I Have a Marketing Problem?

Yes—Among Others

By Lynn D. Richardson
CIRAS Industrial Specialist

It is refreshing to observe how many companies operating in Iowa are enjoying a strong financial position. Many have learned from past experiences and are applying tried and true management techniques. Accurate and up-to-date recordkeeping alerts these companies to potential problems and enables them to identify points of weakness in time for corrective action.

This management aid was first printed in the CIRAS Newsletter. It provides broad guidelines for basic analysis procedures that can enable managers to identify symptoms of problem areas.

Unfortunately, too many companies are not enjoying the best of financial health, in spite of their potential. It is even more tragic that most don't know why. When CIRAS is called in, even at the eleventh hour, most have only an inkling of the symptoms of their problems; seldom any idea of the basic problem.

Invariably management states "If we could just raise sales to X dollars everything would work out fine." What management is saying is "At current sales levels, profits are not adequate." This is a symptom of a larger problem for which increased sales is seldom the answer.

Need Profit

The era of growth for growth's sake is past. Its path is strewn with the wreckage of those who forgot or ignored the basic tenet of economic activity—return on investment, or, to use a six letter word, profit. When CIRAS help is requested, our main goal is to determine if the business is or could be profitable. Appropriate, accurate and up-to-date records are an absolute necessity for this inquiry.

Answering the question, "Can we be profitable at current sales levels—for all product lines?" forces management to analyze all the costs related

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I used to be low bidder on every project.

About the Author

Lynn D. Richardson received a B.S. degree from Iowa State University in 1934. Lynn's industrial experience includes more than 20 years in aircraft industry management. He has served the U.S. Army, U.S. Navy, and Northrop Aircraft as a private consultant. Lynn has also operated his own automobile dealership here in Iowa. He came to CIRAS in 1968 and has worked primarily in areas of government contracts, marketing and general management counseling.

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to operations. When the first analysis is being made, management normally discovers that it doesn't know certain costs. Often, several costs have been overlooked completely. In many cases, management has established costs on educated guesses which then become the basis for selling price.

Need Accurate Data

Times have changed, and competition is so keen that not many companies will survive using guesses. Distance to the moon once was computed by estimating a quarter of the distance and multiplying by four. Few astronauts would take a chance on these computations nor will loan officers be inclined to go along without the most accurate data that management can produce.

If management plans to increase sales, all costs including the increases generated by the additional sales effort, must be computed. If marketing surveys indicate more can be sold at a reduced price, management must not be dazzled by volume alone, but must remain focused upon profit and return on investment generated by the increased volume. Many times improper cost analysis and pricing have amplified a company's loss as sales volume increased.

The criterion for survival is knowing the costs of doing business. One may use standard costs, lot costs, or unit costs as long as the system used provides a sound basis for determining a profitable sales price. Once it has been determined that increased sales are feasible, management must work closely with the sales force.

To say that sales personnel are difficult to supervise is to recognize that they are a breed apart from the norm. They are individuals who prefer to work alone and in their own way. These are perhaps the reasons they are in sales.

Need Time Management

Very few sales personnel are skilled in time management no matter how many other attributes of successful sales representatives they possess. Time spent in face-to-face discussion with potential big-buy customers is potential income for the organization and the sales representative. Time spent traveling between customers and with minimal-buy customers is a fruitless expense to the organization.

One way to assist sales personnel in improving their time management is to insist that they analyze sales results for each customer. Have them document time spent in relation to volume of sales for each customer. In many cases this will result in a search for new customers and concentration on the most productive customers.

Low volume customers can be serviced by phone reinforced by periodic visits. Time previously spent on old, low volume customers may be more productive if used to seek out new customers. Sales personnel must be convinced that time is money, and documentation on a customer-by-customer basis will prove this.

Need Personal Analysis

Each sales person should be analyzed on his or her net worth to the organization. From the gross profit generated by total sales of each person for a given period, management must deduct total sales expense and salary of the sales person concerned. This will establish the true value of the sales person's effort.

Management must establish a breakeven point, before compensation/commission rates can be increased. Both management and the individual sales person benefit since expenses have been realized. Also management can easily allocate overhead to sales personnel in proportion to sales and determine an equitable compensation plan.

Benefits of Program

Experience has shown that this program has a direct and almost immediate positive effect on sales. It identifies low volume customers, provides time to locate new customers, tends to weed out nonproductive sales personnel and increases production of the hard hitting sales personnel, who like to be recognized.

In this segment we have been concerned with identification of costs, establishment of a proper sales price, sales personnel team management and adequate compensation in relation to return on investment for the organization. In the next issue we will discuss financial considerations involved in doing business, and trouble signs that can be deduced from accurate, timely and appropriate records that should be maintained by any company that expects to survive and grow in the competitive world of commerce.

Center for Industrial Research and Service
Iowa industry and related service firms call on CIRAS for help in handling their problems in all areas such as engineering, technology, production, marketing, management, and finance. When necessary, CIRAS helps bring firms into contact with persons, organizations, and agencies that can help provide solutions. CIRAS is an industrial extension arm of University Extension, Iowa State University.
To obtain help, contact:
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Managing Your Company for Profit

By Lynn D. Richardson
CIRAS Industrial Specialist

In the previous issue we skirted the edges of the business and management pool. In the following paragraphs, we will discuss considerations that may enable a firm to swim even if the water becomes deep or turbulent.

The primary consideration that will determine whether a firm sinks or swims is "gross profit"—call it gross margin, contribution, etc. Gross profit is the money remaining to cover all costs other than direct costs of labor and materials.

What is an acceptable gross profit return? When I started with CIRAS ten years ago, a 25 to 30 percent gross profit would produce an acceptable net profit after all overhead costs were absorbed. In the companies we work with today, we suggest a minimum gross profit target of 40 percent.

Gross Profit Problems

Often a firm will request our assistance in organizing its records and in preparation of an application for a line of credit from a lender to help it over a "temporary" slump; the client is out of cash and is having difficulty with accounts payable. Experience has shown that no company can borrow its way out of debt so our first question to the client is "Where are you now, and what are your costs?"

Unless the client represents a new or rapidly expanding company, we invariably find that the gross profit from current operations is too low for it to survive no matter how much new money is obtained. Additional debt would only increase the burden and prolong the agony. The profits will not support current operations, much less service additional debt.

One recent situation involved a client seeking an additional line of credit which he hoped to justify on an 8 percent gross profit.

Increasing Gross Profit

How can gross profit be raised to a point where an acceptable net is achieved? There are two alternatives to consider, individually or in combination. You can reduce costs, increase prices or a combination of both. Cost reduction is based on hard-headed, common-sense judgments that come easy after one knows what each product and function is actually costing and why.

There are basic considerations regarding price increases—one can pass on material and labor increases experienced by all producers. However competition will seldom permit a firm to pass on inefficiencies, waste and poor judgment. If gross profit is too low, increased sales will increase expenses significantly and deteriorate the condition of the company—as was discussed last issue.

When our clients report they can't see how competitors sell at a certain price because the clients would go broke if they sold at the same price, one of two conditions exists. Either the competitors have lower costs or don't know their costs and will soon be in a serious cash flow situation themselves.

Good Records Needed

In this and the preceding article, one can deduce the necessity of maintaining accurate and timely management oriented records. Records record history; past, present and provide a reasonable forecast of the future. An accurate recording of history enables one to avoid making the same mistake twice and increases the probability for success.

No company will remain static for very long. A firm will either decline or grow, but growth must be controlled and achieved in an orderly manner. Experience indicates that if a company grows at the rate of 15 percent annually, compounded, it will double its business in five years and growth can be sustained from capital generated internally from sales of products or services.

If growth exceeds 15 percent annually, additional funds must come from sources outside the business through debt or equity financing. A major pitfall to avoid with debt financing is the hazard of short term money. Business requires flexibility that only long term money can provide. A minimum of 4 to 5 years is suggested when establishing a line of credit or other external source of financing. Short term money is too

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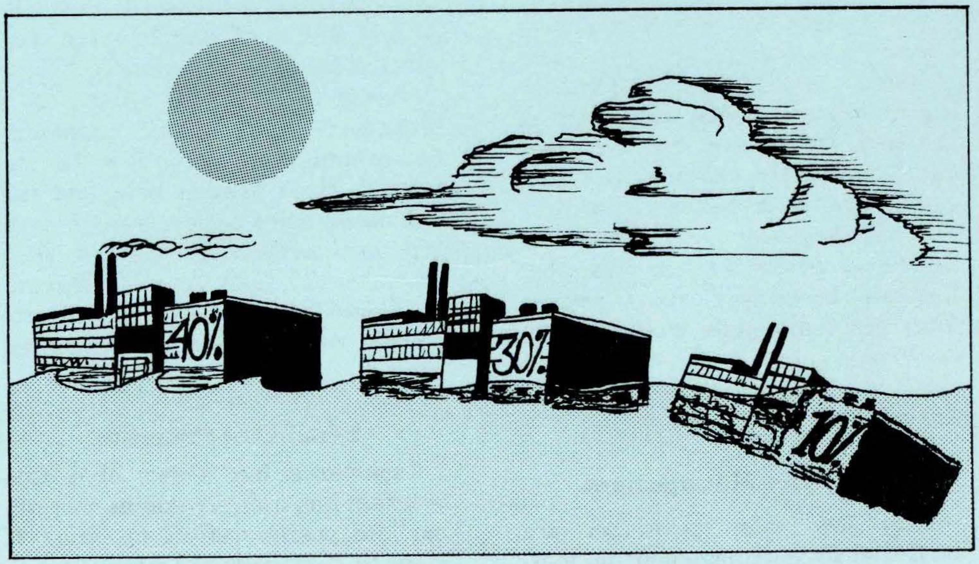

Swimming with gross profit.

subject to change and is exceptionally sensitive to minor adversities in the economy.

Know Financial Needs

Another important consideration when arranging for external financing is to know how much is actually required. Management doesn't improve its image by asking for too little initially and then going back again and again to ask for more. A lender could soon feel management is confused; most loans are made based upon the quality of management.

The danger of asking for too little initially soon leads to a serious cash flow situation for the company if funds rightfully due to accounts payable obligations are utilized for day to day operations. One will soon be back to the lender seeking additional funds with little or no additional collateral. One's alternative of seeking Small Business Administration assistance is restricted, because assistance can not be obtained to bail out a previous lender. The solution is to know what is needed initially and to negotiate to obtain it at the best price and for as long as possible.

If management does its homework, it need not approach a potential lender as a beggar with a subservient attitude. Management is a customer trying to buy the lender's product—cash and credit—and the lender wants to sell to stay in business.

A lender needs to see a plan which displays a firm's requirements and how it will pay for the product. The vehicle suggested to accomplish this is a cash flow projection.

Plan Cash Flow

An accurate cash flow projection will show a potential lender exact needs for a specified period, i.e. four to five years. The cash flow will show how much is needed, when, and for what purposes. It also tells how and when you plan to repay the loan, It demonstrates a degree of professional management that will enhance one's probability for a successful loan negotiation.

In summary, these two articles have discussed sales, cost identification, pricing, growth and financing. I am confident that attention to basic principles will enable sincere managers to obtain an acceptable return, to obtain the financing they need, and to repay what they borrow under reasonable and foreseeable conditions.