

Figuring out the ratios for sustainable business

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Things are starting to move forward for my business. Any suggestions on ratios that I should look at, for planning purposes, as we ramp up this year?

The following ratios should help you to have a healthy, sustainable business. Let's start with finance: keep 3 to 6 months of operating revenue on hand, in cash, or cash equivalents. In sales, optimum growth is typically 15 percent per year. In operations, gear the ratios based on the quantity of products or services you're producing. In marketing, spending 15 percent of gross profit on marketing is just plain good sense. In human resources, keeping productivity at \$150,000 per employee will usually lead to optimal profits.

SAVE AND GROW

If your business has been hurt by the recent downturn, and you don't have 3 to 6 months of reserves on hand, don't worry. Work with a plan to build up reserves. Get on track by putting 10 percent of the money you receive from clients into a "don't touch" savings account. If you can't afford to put away 10 percent, start with 5 percent. Practice putting money away every week, as you get funds in. Do everything you can to not take money out of the savings account. If you have to take money out, start putting the same 5% or 10% away the very next week.

You'd be amazed at the peace of mind that comes from having cash on hand. You'll sleep better at night, knowing you have money to get through tight spots. Eventually, you'll have enough money put away that you'll be able to invest, and make money on your money.

Now for growth rates. Fifteen percent year over year growth is optimum. That allows you and your business to build infrastructure as you grow. You'll have time and resources to handle and correct the mistakes you find along the way.

Pushing sales forward 15 percent each year is not a herculean effort, but it is enough to stay well ahead of inflation. If you're not sure you can hit 15 percent, try at least for 12 percent, settle for 10 percent. Anything slower, and the business isn't going to keep up with the economy as things heat up. On the upper end, try to cap yearly growth at no more than 20 percent per year. Anything more and your firm is likely to make mistakes and cost itself gross profit through errors.

Plan operations ratios based on the specifics of your business. Figure out how many units you'll have to produce this year. Set weekly productivity goals. Monitor quality, with the objective of no more than 5 - 10 percent error rate. If the error rate goes up, slow production down and fix the problems. Once you're back in the 5 - 10 percent zone, push the speed of production back up and see if quality holds.

When it comes to marketing, most small businesses don't understand it, and don't spend enough on it. Fifteen percent of gross profit committed to marketing means the business will grow. Always have a series of marketing initiatives underway, and another group of efforts in the research and planning stage.

Marketing covers a broad spectrum. Web-based efforts include designing a Web site, e-mail marketing, search engine optimization and pay-per-click campaigns. You can combine print and Web efforts by dropping mail that makes offers and pushes readers to the Web site. You can focus on print campaigns alone, using letters, postcards and advertising. Then there's telemarketing, networking, seminars, mentoring, and connecting people you know with people you don't know through breakfasts, lunches and dinners. The list of things you can do to market your business is practically endless.

On the human resources front, one challenge for every business owner is having the right number of people for the right amount of sales and production. A good tuning ratio is to have between \$125,000 and \$175,000 income per employee, counting everyone from the CEO to the janitor. To figure out the ratio, take any material costs out of revenue, then divide by the number of full time equivalents. Divide all working hours by 40 hour/week to get your number of full-time equivalents. When the ratio falls below \$125,000, it's time to push hard to get more sales, or cut back on hours. When the ratio gets over \$175,000, it's time to add the next person.

Using \$150,000 as the average goal, start to take action whenever the average goes above by placing ads. When the average goes below goal check the backlog to determine if you're having a sales or production issue. If it's a sales issue,

focus on marketing and sales fixes. If it's a production issue, focus on training and possibly on replacing underproductive employees.

Looking for a good book? Try *How We Decide* by Jonah Lehrer.

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