

The critical numbers every business owner must know

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Source: How to build a better business and make more money: Simple ideas that really work for entrepreneurs. Written by Steve Pipe, Mark Wickersham, and Shane Lukas

Business is made up out of numbers.

Just about everything in business that matters can be expressed in a number. Your sales, your margins, your customer base, your costs, your profit, and your cash flow. They are all driven by numbers.

When business owners want their businesses to grow, they normally focus on creating a new website, launching a big advertising campaign, attending more trade exhibitions, do direct email campaigns or more market research.

These are all perfectly valid ways to grow your business, but if you do not understand the numbers behind these activities and the impact they might have on your business, results can be less attractive or catastrophic.

There is a mathematical model which resides behind every business, and when you understand this model, you start to truly understand what drives your profit. Here is the big secret. You can make a massive difference to your profit just by understanding and deploying 9 simple but powerful growth drivers. This understanding is essential in building and growing a successful business.

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To illustrate, let me explain this with a simple mathematical model:

Imagine a business which has 10 customers. Each of those customers spends R100 each time they buy, and each of those customers buys from the business ten times each year.

We have 3 growth drivers here.

1. The number of customers
2. How much they spend on average each time, and
3. How often they spend.

When you multiply these 3 elements together, you get total sales. Total sales for this business would be $R100 \times 10 \times 10 = R10\,000$.

In other words, each customer spends R100 ten times a year, so they each spend R1 000 in a year. 10 Customers spending each R1 000, total sales for the year become R10 000.

If this was your business, you could undertake some sales and marketing activities to improve any of those numbers. Let us imagine you can increase the number of customers by 10%. This means you will have 11 customers rather than 10, and total sales now become $11 \times 10 \times R100 = R11\,000$. In other words, increasing the number of customers by 10% will increase sales by 10%.

Maybe you decide to focus instead on increasing how much they spend by 10%. If you do this, your customers will spend R110 each time they buy rather than R100. Total sales now become: $10 \times 10 \times R110 = R11\,000$. In other words, increasing how much your customers spend by 10% will increase sales by 10%.

If you instead focus your efforts on getting your customers to increase how often they buy from you by 10%, they will buy from you 11 times a year rather than 10 times. Then again, your sales increase by 10%.

The rule is, if you increase any single key growth driver by 10% your total sales will increase by 10%.

Let us take it up one level.

What happens if you increase all 3 of the sales drivers by 10% at the same time? In other words, customer numbers go up from 10 to 11, each spending R110, and now buying 11 times a year.

Sales will grow from R10 000 to R13 310, which is 33.1% improvement. You expected 30%. Most people do, but they are not factoring in the power of synergy, something I will come back to in later articles.

Let us just accept that we have been looking at a simple mathematical model which describes how changing the main sales drivers affect total sales. This simple model is one often used by marketing consultants and it's a great starting point.

The point I want to make is that numbers matter! Unless you consider the impact of the drivers of growth on your bottom-line profit, the mathematical model is not going to give you accurate or helpful information.

For example, you may have heard the expression, “Turnover is vanity, profit is sanity.” This explains how it is much more important to focus on improving profits than it is to improve turnover (or sales). Some customers, products or services are simply not profitable, so getting more of them is detrimental to profit.

You need to understand the impact everything has on your business profit, not just sales. And whilst the simple mathematical model above considers 3 of the profit drivers affecting your profit, there are 9. Because these drivers each have a profoundly different impact on your bottom-line profit, it is this impact you need to focus on, not just top-line sales.

Regards
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