Forbes

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"Siff-ting" through the Family Business: I untangle the problems.

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# Do You Really Know Where Your Profits Are Made?

So you think you know where your company's profits are coming from? Believe it or not, most business owners and CEOs do not. I see this again and again as I consult with new clients. They *think* they know where their money is made but the reality is something completely different.

Here's an example: I met with the CEO of a middle market manufacturing business, and he told me that they make their money on a niche product line with a 72% gross margin that turns over once a year. But when my partner and I looked closer, we found another product line with a 45% gross margin that turned over six times a year. The product line with a 45% gross margin was obviously where the majority of their profits were being made, yet since 45 is smaller than 72, these results had been totally overlooked by the CEO. As a result, resources weren't being allocated to the extent this product line deserved.

This dynamic is more common than you think. In fact, I would predict that 60%– maybe even 70%– of middle market CEOs are wrong most of the time when it comes to knowing where their greatest profits are located.

There are plenty of reasons why smart, dedicated CEOs make mistakes like this. Here are the top four:

1. **Firefighting takes top priority.** Running a business is challenging and involves a lot of detail work. Being too deep in the forest makes it tough to see the trees.
2. **People do what they like.** It's human nature. Some CEOs love the finance part of their job while others gravitate towards the marketing aspects and still others favor sales or manufacturing. At the end of the day, the CEO's interests will determine what gets the most attention.
3. **They're making money.** Many companies that don't know where they make their true profits are nonetheless profitable companies. Everyone is still making money and supporting their lifestyles and paying their employees. As long as they're making *enough* money to support a fulfilling lifestyle, being the *most* profitable company possible isn't necessarily a top priority.
4. **Some of the value is hidden.** Inventory and materials need to be tracked. Costs need to be correctly allocated to product lines. When a CEO or business owner visits their warehouse, for example, they shouldn't just see goods and materials… they should see *cash*.

Here's another example: A client of ours had just acquired a competitor and as a result ended up with two warehouses. One warehouse was functioning at 55% efficiency and the other was at 35%. With these clear stats, it seemed like a no-brainer to shut down the less efficient warehouse, which of course would also eliminate other problems, e.g. the added cost of shipping from two locations. However, the company was locked into a two-year lease on the less efficient warehouse, so the CEO accepted that all he could do was to move on to another project and wait out the lease. We convinced him however, that he at least had to ask his landlord about getting out of the lease… at least *ask*!

When he contacted the landlord, it turned out that someone else had expressed interest in the space so it wasn't a problem at all for my client to leave the lease.

Our client then worked out a mutually beneficial settlement.  The result was a win-win situation for the client and the landlord. There are three key lessons to be learned from this example:

1. Do not be afraid to openly ask questions, especially when there is potential to dramatically improve your overall business.
2. Be willing to explore alternatives outside your comfort zone.
3. Challenge yourself to go beyond the traditional way of resolving problems.

Sometimes, improving your company is really about changing your mindset. Instead of being satisfied with the status quo, take proactive steps to improve the profitability of your company. Here are a few things you can do:

1. **Benchmark against Competitors.** Do a serious, metric-based analysis. You may know that you are profiting by turning over inventory five times a year but do you also have a gauge on where your competitors stand? What if everyone else is turning over 7 times or 8 times a year? What is your competition doing differently and thus what can you change?
2. **Get the numbers**. Get the facts, get the numbers, keep track of *everything*… and do it consistently. Measure, measure and measure!
3. **Talk to your CFO or Controller.** Most reports don't really tell you where you're making your money. This kind of analysis is usually not required in the monthly reports. You'll find it well worth getting that deeper analysis.

The bottom line: Understanding where your *true* profits are made is key.  It's your job as CEO to improve productivity, performance, and effectiveness… not just now and then but again and again, and with consistency. Focus on the key things that drive your profits, as this will result in a competitive advantage that will be both real and sustainable.

This article is available online at:

http://www.forbes.com/sites/lawrencesiff/2012/03/06/do-you-really-know-where-your-profits-are-made/

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