How to Build a SUCCESSFUL BUSINESS

and achieve the lifestyle You Want

Noel Guilford

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Introduction

If you own and run your own business you know how lucky you are to have the freedom and flexibility to decide what to do and when to do it. You also know that there is no limit to the amount you can earn to provide for your family and live the lifestyle you want.

Or do you?

In comparison to a job, where you are employed by someone else and the amount you can earn is largely fixed by their wages structure, working for yourself has no such ties. You are free to earn and pay yourself as much as you want.

But can you?

97% of the working population are employed. If you were to ask the average employed person what drives entrepreneurs, they'd say money. Not true. Entrepreneurs are driven by freedom; money simply enables this.

So, why are so many business owners struggling? Why are so many "just getting by"? Why are the vast majority of business owners no better off (or significantly worse off in many cases) than they would be in a job? Why are financial certainty and financial independence only a reality for such a small minority?

The stark truth is that compared to an equivalent salaried job, most self-employed people earn 20%-30% less than their salaried counterparts, while some earn as little as 50% of their salaried counterparts.

This seems to make no sense until you realise that **some** people who are self-employed earn ten to twenty times more than their salaried counterparts. There **must** be something they are doing differently from everyone else to get these results.

This is what I am going to explore in this book. In fact, I'll do more than explore it. I'll show you the seven strategies you can learn and adopt to build the successful business you imagined when you started your entrepreneurial journey and how to achieve the lifestyle you want.

Is that possible?

Absolutely. Others have done it. Not through luck or hard work (although it does take perseverance), but by choosing the path to wealth and then following the course I am about to show you.

Yes, achieving success and becoming wealthy is a choice most people don't make, but you can. All it takes is to decide to do things differently than most other people in your sector and step outside your comfort zone, which is where all change happens.

Throughout this book I have included some examples of the financial outcomes you can expect if you follow the suggestions I outline. These are illustrative. You may do better. However, you won't achieve anything until you decide to start and do things differently, but you must also add something as well.

There are seven strategies in this book but there is also something unique to you that will bring these strategies to life. Being an entrepreneur is a bit like being a magician – you can't create something from nothing without a bit of magic. I can't tell you what that magic is – its unique to you – but as you read this book keep an open mind for it. Only you can spot it.

Lastly, if at any time you are struggling to implement my ideas you can ask for my advice.

I'd love to receive your thoughts on this book and hear about your progress. You can contact me at **noel@guilfordaccounting.co.uk** or by connecting with me on LinkedIn at **www.linkedin.com/noelguilford**

To your success.

Noel Guilford
Chester
September 2018

Part 1
Business is a numbers game

Know your business numbers

"In 30 years working with clients I've found that those who have made the most money and gotten wealthiest are the ones who know their numbers inside out"
Dan Kennedy

When people ask me what I do I usually say 'I help businesses like yours become more successful, more profitable and more enjoyable to run.' It's far better than saying I'm a chartered accountant (although I am) which tends to make people look for someone else in the room to talk to.

Instead, I usually get a response like 'Well I need that! How do you do it?'

The answer is always that you need to start by knowing your business numbers. Numbers are the language of business, and it is numbers that will ultimately determine your success. Business is literally a numbers game.

Everything that matters in business can be expressed in numbers: your sales, your margins, your customers, your costs, your debtors, your profit, your cash flow and so on. They are all driven by numbers.

Despite this, when business owners want their businesses to grow, what do they usually focus on? A new website? Advertising campaigns? Attending more exhibitions? Direct mail campaigns? Market research?

These are all perfectly valid ways to grow a business, but if you don't understand the numbers *behind* these activities, and the impact they have on your business, the results can be, and often are, catastrophic.

You see, there's a mathematical model which sits behind every business. When you understand this model, you start to truly understand what drives your sales – and what drives your profit.

I am getting ahead of myself however. We need to start by looking at what comprises the *accounts* you get (or don't get) from your accountant, so that you can see how this all fits together.

For many business owners, the purpose of keeping books and preparing accounts – or more likely having these done by someone else – is to work out how much VAT to pay each quarter, and how much tax to pay each year. It is seen as a costly chore that adds nothing to the business, and takes up valuable time.

Nothing could be further from the truth.

Anyone running, or involved in, a business should know the financial state of the business on a regular basis, but, more importantly, they should be able to use the financial information about the business to manage it more effectively, increase sales, cut costs and take important strategic decisions about the direction the business needs to take.

Unfortunately, too many small business owners fail to get the most out of the financial information available to them: some are genuinely afraid of the 'money' side of the business, others – often those with a creative background – find numbers confusing, and have been conditioned into thinking it is all too complicated.

Ever since I qualified as an accountant, it has frustrated me that many accountants surround what we do with jargon and a mystique it doesn't justify. It is largely straightforward and common sense. Most of the time all we do is add and subtract! With a little practice anyone can do it.

Furthermore, it needn't cost a great deal. A properly designed accounting system, which enables a large amount of valuable information to be produced on a weekly, monthly, quarterly and annual basis, then analysed to allow strategic decision making, will pay for itself many times over. You choose the financial information you want, and one of the many 'off the shelf' cloud accounting software packages will do all the hard work.

First, we need to know what makes up 'accounts' and what they mean – all with as little jargon as possible.

What are Accounts?

The objective of accounting is to provide information about the **financial performance, financial position** and **cash flows** of a business. Accounts are the statements that show these things.

We are going to start by looking at **financial performance**, because that is what most people looking at accounts turn to first. It will be called the profit and loss account, the income statement or something like that, and shows the difference between income and costs during a reporting period such as a week, month, quarter or year.

Then we will move on to the **financial position** of a business which is shown in its balance sheet, sometimes called the statement of financial position. This is **the relationship of its assets, liabilities and equity at a specific date.**

- An **asset** is something owned by the business, such as equipment or stock, and also includes debtors, which are owed to the business.
- A **liability** is an obligation owed by the business such as amounts owed to suppliers and banks, the settlement of which will give rise to an outflow of resources, usually cash.
- **Equity** is the residual interest in the assets after deducting its liabilities.

Hence the name *balance sheet*; the amount a business owns (its assets) must equal the amount it owes (its liabilities plus equity). And the reason equity is an amount it owes is because it owes this amount to its owners (or shareholders in the case of a limited company).

The reason the statement is drawn up to a specific date is because it is changing all the time; in a vibrant, ongoing trading business assets and liabilities are being generated and settled, respectively, and equity (the amount the entity owes to its owners) is, hopefully, increasing as the business makes a profit.

Finally, we will look at the **statement of cash flow**; fortunately this one is the easiest to understand because it does what it says. It states the cash that has flowed into and out of the business during a period of time.

This is **not** the same as the profit you have made. In fact, you can make a profit and still have negative cash flow! If that seems perverse, consider this: the profit and loss account shows sales, *whether or not you have been paid*, whereas the statement of cash flow shows the cash received only when the customer has paid.

This is why, in most small businesses, cash is more important, at least in the short term, than profit and why many early stage businesses need the owners to put money in or borrow from family, friends or the bank.

The cash flow statement also highlights the importance of keeping a very watchful eye on the amount of credit (called debtors) you give to customers. If you can – like a retail shop or restaurant – only sell your products or services for cash. If you **have to** give credit, follow these five rules:

i. Check the credit worthiness of the customer and set a credit limit;
ii. Invoice promptly – don't wait until month end – and make it easy for customers to pay;
iii. Have a system for following up as soon as the debt is due;
iv. Don't supply customers who abuse your credit terms;
v. Make sure your accounting system produces regular information on overdue amounts.

Unfortunately, most accountants do not automatically produce a cash flow statement when they prepare your annual accounts[1], although most accounting software packages have a report called something like a 'cash summary' that will produce a cash flow statement and it should be part of your month-end reporting.

I will examine these three statements in more detail shortly.

Before that, however, do you remember I said there's a mathematical model which sits behind every business? When you understand this model, you start to truly understand what drives your sales – and what drives your profit? Well, you can make a massive difference to your profits just by understanding this model and deploying some simple but **powerful** growth strategies. This understanding is essential to building and growing a successful business.

To illustrate, let me explain this with a really simple version of the mathematical model.

1 Although there are three financial statements, accounting standards only require a profit and loss account and a balance sheet to be produced annually for small businesses. I suggest you ask your accountant for all three because, as we shall see, the cash flow statement is often the most useful.

Imagine a business which has 10 customers. Each of those customers spends £100 each time they buy, and each of those customers buys from the business ten times each year.

So, we have three elements here which drive growth:

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

When you multiply these three elements together you get total sales. So, total sales for this business would be 10 x 100 x 10 = £10,000. In other words, each customer spends £100 ten times a year, so they each spend £1000 in a year. If the business has 10 customers all spending £1,000 each year, total sales, for the year, become £10,000.

Now, let's undertake some marketing and sales activities to improve those numbers. Let's imagine you are able to increase the number of customers by 10%. This means you will have 11 customers rather than 10, and total sales now become 11 x 100 x 10 = £11,000.

In other words, increasing the number of customers by 10% also increases 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 £110 each time they buy, rather than £100. Total sales now become: 10 x 110 x 10 = £11,000. In other words, increasing how much your customers spend by 10% increases sales by 10%. No surprise there.

If instead you focus your efforts on getting your customers to increase how *often* they buy from you by 10% – so that they buy 11 times a year rather than 10 – then, again, your sales increase by 10%. So, here's the rule: If you increase any single *key growth driver* by 10% your total sales will increase by 10%.

So what happens if you increase all three of the sales drivers by 10% *at the same time*? The answer is that sales will grow from £1,000 to £1,331, which is a 33.1% improvement.

Confused? You expected it be 30%? Most people do, but they are not factoring in the power of *compounding*, something we will come back to later on in the book.

For now, let's just accept that we've been looking at a *simple mathematical model* which describes how changing the main sales drivers effects total sales. This simple model is one often used by marketing consultants – and it's a great starting point – however, it's only a start.

There are other drivers that affect your sales which you must be aware of (e.g. getting customers to remain customers for longer). And for this you need a more useful mathematical model, although it is still simple. I'm going to give you a really simple mathematical model that will help you generate extraordinary results.

But, for now, the point I want to make is that you must KNOW YOUR BUSINESS NUMBERS! Unless you consider the impact of the drivers of growth on your *bottom line profit*, the mathematical model will not give you accurate or helpful information.

You need to understand the impact *everything* has on your bottom line profit, not just sales. Whilst the simple mathematical model, above, considers three of the growth drivers, there are not just three drivers affecting your growth – there are seven. Each one of these seven has a profoundly different impact on your bottom-line profit, and it is this impact you need to focus on, not just top-line sales.

So what are these seven drivers that will grow your business?

1. Getting more customers
2. Converting your sales leads into sales
3. Getting customers to spend more
4. Getting customers to spend more often
5. Getting customers to remain customers for longer
6. Pricing for maximum profit
7. Systemising everything

As we work through ***part two*** of ***this*** book, I'll explore each of them in turn.

The profit and loss account

Let's look at a typical profit and loss account:

A typical profit and loss account			
	Actual	**Budget**	**Variance**
Sales	720,000	750,000	(30,000)
Cost of sales	(518,400)	(525,000)	6,600
Gross profit	201,600	225,000	(23,400)
Gross margin	28%	30%	
Overheads	(168,500)	(180,000)	11,500
Net profit	33,100	45,000	(11,900)
Net margin	4.6%	6%	
Tax	(5,500)	(10,000)	4,500
Retained profit	27,600	35,000	(7,400)

The statement shows both actual and budgeted figures: many times I hear from the owners of small businesses that they cannot prepare a budget. A budget (and cash flow forecast) is one of the most useful tools in the tool box and is simple to prepare. I'll say more about this in the chapter on cash flow statements. Every business can and should prepare a budget, for the next twelve months.

For businesses that want to grow their sales, I often hear it suggested that they offer a discount to their customers. Let me offer a word of warning about this. The impact of discounts is largely misunderstood, particularly amongst small businesses. I'll explain this further in the chapter on pricing.

I have also calculated the gross and net margin figures in the typical profit and loss statement. Every business should know these numbers. In practice, sales and gross profit **should** be analysed by customer, and by product, so that strategic decisions can be taken about which products to invest in and which customers are too much trouble!

A tax charge is included – not because it has been paid, or is even payable for many months, but because it needs to be paid, and so it must be accounted for now (and ideally put away in a separate bank account so it isn't spent).

One key figure is missing! Like most small businesses, the net profit shown is a *notional* profit and to show the true profit we need to remove the missing figure.

As with most businesses, the full market salary of the business owner has not been fully reflected in the profit and loss account. To arrive at the true profit in any business, you start with the notional profit in the accounts, then deduct an "owner's salary adjustment" (which is the difference between the owner's full market salary and the owner's salary that has already been deducted in the accounts).

In our example, although the accounts show a notional net profit of £33,100, the business owner only takes the minimum salary he is allowed in order to stay within the personal tax threshold. He estimates that he would have to pay £30,000 to employ someone as good as him to do the work he does rather than the £10,000 in his accounts. So his true net profit is only £13,100, i.e. the £33,100 notional profit minus the £20,000 owner's salary adjustment. (£30,000 minus the £10,000 already charged in the accounts)[2].

Marginal gains mean a lot

I now want to consider how even a small price increase, and a small reduction in costs, can generate significant additional profit. Did you know, for example, that 5% + 5% + 5% can equal a 95% increase in profit?

	Before	Inc/dec	After	Increase
Sales	10,000	+5%	10,500	5%
Cost of sales	(7,000)	-5%	(6.650)	
Gross profit	3,000		3,850	28%
Overheads	(2,000)	-5%	1,900	
Net profit	1,000		1,950	95%

2 There is a fundamental difference between limited companies and unincorporated businesses (sole traders and partnerships). With a limited company the profit and loss account shows the profit after charging 'directors' salaries (in this case £10,000). For an unincorporated business the profit and loss account does not show a salary for the business owner at all; instead they take drawings which are only shown on the balance sheet.

You don't need **huge** shifts in your sales, costs and expenses to make a big difference to your profits.

Do you know your break-even point?

Having set a realistic price for your product and services, and learnt how not to offer a discount to get more sales, it's time to check that your business will make a decent profit. This means that your sales need to be higher than your costs and expenses. However, to know if it's higher you need to know the point at which your sales equal your costs and expenses, which is why this is called your **break-even point**.

Break-even point = Sales minus (costs + expenses)

If you sell more, then you make a profit. On the other hand, if you sell less then you make a loss. Surprisingly, even though it is relatively simple to calculate, few business owners know their break-even point. However, if you can make a reasonable estimate or, even better, forecast your sales and costs, conducting a break-even analysis is a matter of simple maths. You do need to know one more thing about costs, however, and this is the difference between fixed and variable costs.

Fixed costs are costs that are the same, regardless of how many items you sell. All start-up costs, such as legal fees, stationery and computers, are considered fixed costs, since you have to make these outlays, before you even sell your first item. Then, your annual payments for rent, rates, heating, insurance, lighting, and so on, are all fixed costs.

Variable costs are the costs that you incur on making, buying and selling each unit you sell. For example, if you are operating a shop and you buy items for £1 each, then that pound represents your variable cost.

Of course, setting your price is critical to your break-even analysis; you cannot calculate likely revenues if you don't know what the unit price will be. Unit price is the amount you plan to charge customers to buy a single unit of your product (or an hour of your time if you provide a service).

Now you know the values of the three variables – fixed costs, variable costs, and the price of the product – you can calculate your break-even point, in terms of sales volume. The formula to conduct your break-even analysis is to take your fixed costs, divided by your price, minus your variable costs. As an equation, this is:

Break-even sales (units) = Total fixed costs/
(Unit selling price - variable costs per unit)

This calculation will let you know how many units of a product you'll need to sell to break even. Once you've reached that point, you've recovered all costs associated with producing your product (both variable and fixed). Above the break-even point, every additional unit sold increases profit by the amount of the unit contribution margin, which is defined as the amount each unit contributes to covering fixed costs and increasing profits.

Recording this information in an Excel spreadsheet will allow you to easily make adjustments, as costs change over time, as well as experiment with different price options, and easily calculate the resulting break-even point.

If you want to calculate your break-even sales in value (rather than unit) terms, first express your gross margin as a percentage. The equation for calculating break-even sales value is:

Break-even sales (value) = Fixed costs/ Gross margin percentage

It is important to understand what the results of your break even analysis are telling you. If, for example, the calculation shows that you would break even when you sold your 500th unit, decide whether this seems feasible. If you don't think you can sell 500 units within a reasonable period of time (dictated by your financial situation, patience and personal expectations), then this may not be the right business for you. If you think 500 units are possible but would take a while, you may need to raise more working capital[3] to finance the initial losses of the business.

Alternatively, take a look at your costs – both fixed and variable – and identify areas where you might be able to make cuts.

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3 Working capital is the amount of capital your business needs to finance your stock and debtors; I will examine how you calculate the amount of working capital you need in the chapter on the cash flow statement.

Lastly, understand that breakeven analysis is not a predictor of demand, so if you go into a market with the wrong product or the wrong price, it will be tough to ever hit the break-even point. But knowing how much you need to sell to break-even is a good starting point.

The next element of your profit and loss account is your cost of sales. This is made up of the variable costs that you incur on making or buying the products you sell and typically will include materials and goods purchased, direct labour and sub-contractor costs. In the typical profit and loss account example above, the actual cost of sales was £518,400 against sales of £720,000 giving a gross profit of £201,600 and a gross margin of 28%.

A lot of small business owners confuse gross *margin* with *mark-up*. Let me explain the difference.

Mark-up is the amount (usually a percentage) which you want to add to your costs to arrive at your selling price. So, for example, if your costs are £60 and you want to make £40 profit, your mark-up will be 67% (40/60 expressed as a percentage). The percentage mark-up they need tends to be higher than many business owners think.

In this example, the margin is 40% (calculated as 40/100 expressed as a percentage). The margin percentage will always be lower than mark-up, but if you confuse them you could end up 'marking up' by 40%, rather than 67%, which would give you a selling price of £84, a gross profit of only £24 and a margin of 28% which is much lower than you expected and may be insufficient to cover your overheads. So understanding how to calculate and apply mark-up percentages and margins is an essential business skill.

The final element of your profit and loss account is your overheads. Costs which are not directly related to making/producing/assembling the product or service you sell to your customers are, generally, called overheads. In a typical manufacturing business, these costs account for up to 25% of revenues, and an even higher proportion in service based businesses.

It is often the case that a significant proportion of these costs are unnecessary and wasted. Numerous studies have determined that between 15-25% of the costs in a manufacturing business are wasted, and that for a typical service company somewhere between one-quarter and one-third of its annual budget is spent on work that is of poor quality, or irrelevant, to the customer. Much of this is rework but because it is often masked as 'real' work it is very difficult to quantify.

If those studies are correct, that in itself presents an interesting strategic dilemma for your business. Before you go chasing more customers or more business from existing customers, should you look at your systems and processes to eliminate the waste? If you don't, will you just be putting more volume through an inefficient system? If, instead, you focus on eliminating unnecessary costs and waste, you may make a bigger, more immediate impact on the bottom line.

Eliminating unnecessary work and wasted costs is not easy, and is not helped by accountants who measure costs in terms of, for example, salaries and wages rather than in terms of the work people actually do. The key to changing this is to find out exactly what people do, how well they do it and how relevant it is to the customer. By looking at overheads in this way, you can identify how much adds value and how much is wasted.

We recommend that costs should be analysed under three headings: sales and marketing, administration and occupancy.

1. The sales and marketing costs in a business are those directly related to obtaining new customers, generating orders from new and existing customers, ensuring those orders are fulfilled, and following up to ensure the customer is satisfied and will place future orders.

   As we shall see, however, (and as is the case with all costs), there is a distinction to be drawn between productive and non-productive costs. The problem for you, as the business owner, is that this distinction is hard to draw.

   There is a saying, attributed to John Wanamaker, that "Half the money I spend on advertising is wasted; the trouble is I don't know which half." That, of course, is no longer, or should no longer, be the case with the ability to split test marketing campaigns, measure online marketing using analytics, and so on. But how productive is every hour a salesperson spends visiting customers, how often does an order go astray and need chasing and how many hours are wasted in meetings?

I propose an analysis of your sale and marketing overheads that goes beyond the usual information in your management accounts. Let me give you an example.

A computer software business has three sales people costing (including salaries, bonuses, travelling, benefits etc.) £300,000 per annum. The sales manager has asked for an extra sales person to meet the sales budget but the owner isn't so sure. He asks for an analysis of the activity of each of the existing sales people to be conducted over a month with the following result:

Sales costs (£000s)

Activity	**Productive**	**Unproductive**	**Total**
Visiting customers	80	0	80
Travelling	40	20	60
Processing orders	20	0	20
Reprocessing orders	0	30	30
Checking prices	5	5	10
Chasing warehouse	0	20	20
Attending meetings	50	30	80
Totals	**195**	**105**	**300**

So, not only does the business not need another salesperson, in fact, almost one-third of the current activity is non-productive.

This example, obviously, requires different numbers to be produced than is typically done by accountants, but this is not difficult to do if the focus is on people (activity) and processes.

Sales and marketing overheads are typically analysed into categories such as advertising, brochures, website, samples and so on. These descriptions are rarely useful, and have often been chosen because they are easy to measure.

I advocate a more meaningful analysis of sales and marketing overheads that will aid decision making and shape your strategy. How different would your business look if you analysed your sales and marketing overheads into categories such as:

- researching customer needs
- acquisition of a new customer
- obtaining a customer order
- processing a customer order
- providing customer service

Initially, this may seem difficult and require some arbitrary allocation of costs, but once a system is established, it should be no more difficult than your existing analysis. What it will do, however, is focus attention on the actual costs involved in, say, acquiring each new customer, and identify those costs which do not contribute to revenue or profit.

2. Not unlike sales and marketing costs, administration costs tend to be people based, but administration costs are more difficult to associate with what is relevant to the customer. They tend to be thought of as 'the things we just have to do', but, if that is the case, they must be done for a reason. That is why, once again, I advocate analysing the activity and relating it to a customer need. Then, it is a cost which can be absorbed directly into the customer activity.

   Let me explain. Someone is doing the administration and if you analyse what they do it might look something like:

   - managing suppliers, obtaining quotations and paying bills;
   - managing payroll: sales staff 25%/factory 65%/admin10%;
   - sales analysis and collecting customer debts.

   Each of these activities can be allocated and absorbed into a cost elsewhere. Any unallocated costs can then be scrutinised to see if they are really necessary.

3. Occupancy costs relate to the costs of occupying your business premises and include rent, rates, insurance, utilities, depreciation, maintenance and repairs. They are often seen as fixed costs that you can do nothing with but pay! While this may well be true, there are always questions you should ask about all your costs. When it comes to occupancy these include:

    1. Do you really need premises at all? Could you and your staff work from home?
    2. Do you need all the space you currently occupy? Can you reduce it by hot-desking?
    3. Can you sublet unused space?
    4. Are you using technology to maximise remote working?
    5. Are you using the cubic capacity to the full?
    6. How much 'luxury' space are you paying for – reception/boardroom?
    7. Can you reduce the amount of stock you hold?

    So controlling costs may need a bit more work on the numbers but should pay dividends…preferably to the business owner.

What other numbers should a business owner know?

There are other key numbers that do not appear in a set of accounts, and, yet, are really important numbers to understand and measure. Some of these, like the cash conversion cycle, I will explain in later chapters but for now you should be aware that certain key numbers that are mainly to do with your marketing metrics won't be included in your accounts unless you – or your accountant – measures them on a regular basis.

These metrics are beyond the scope of the book but include:

- the lifetime value of a customer
- cost of acquiring a new customer
- sales lead conversion rate
- average sales value
- customer turnover rate.

The statement of financial position

The statement of financial position, or balance sheet as it has long been called, is a combination of amounts a business owns and owes, but is a statement most business owners rarely study in detail.

This is understandable because the balance sheet contains a variety of information, some of which is useful, and some downright misleading. It would be a mistake, however, to write-off the balance sheet as not being useful for business owners wanting to improve their performance and profitability.

The balance sheet represents the accounting equation: the foundation of all bookkeeping and accounting called the double entry system meaning that for every transaction a business undertakes there are two entries in its accounts.

The accounting equation is:

Assets = Liabilities + Equity

Where equity itself is a liability because it's the amount owed by the business to its owners, or shareholders; this confuses some business owners but becomes clear when you recognise that the business and its owners are legally separate.[4] It's like giving a loan to another person: they owe it to you until it's repaid.

Assets

Assets comprise fixed assets (those that the business will use for several years) and current assets (those that will turn into cash during an annual accounting period).

Fixed assets are further separated into tangible and intangible assets, and are shown at cost, less amortisation or depreciation. The resulting amount is meaningless in terms of the value of the business.

4 A company and its shareholders are separate legal entities whereas a sole trader and his business are technically 'one' entity legally, however for the purposes of understanding the accounting equation we always consider the business and its owners as being separate.

Intangible assets comprise goodwill, know-how and brands, and are often the most valuable items a business owns. However their 'real' value is rarely shown on balance sheets. The reason most intangible assets aren't shown on balance sheets is shown by the likes of Google, Facebook, Apple, and Coca Cola whose value is mainly the value of their brands, but these are notoriously difficult to value.

Tangible assets are land, buildings, plant, machinery, vehicles, IT equipment, etc. These are shown at the price when they were purchased (which could be some years ago), less accumulated depreciation.

Current assets include stock, debtors (often called accounts receivable) and bank accounts.

Liabilities

Liabilities comprise long-term liabilities (those which are not due to be paid for at least a year) and current liabilities such as creditors (often called accounts payable), loans, overdrafts and taxes (corporation, VAT, PAYE).

Equity

Equity or capital is the amount owed to the owners, or shareholders, and represents the original capital invested in the business, plus its accumulated earnings, less dividends and drawings, paid back to the owners.

So why is the balance sheet useful?

Hidden within the balance sheet is all sorts of useful information which a business owner can use to improve the performance of the business, which usually means finding ways to increase the cash flowing into the business. For example, by measuring:

1. Working capital: the amount invested in stock and accounts receivable (less accounts payable);
2. The cash conversion cycle, which I'll explain in the next chapter on the cash flow statement);
3. Stock turnover: a measure of how quickly stock is sold and replenished;

4. Debtor days: the number of days sales invested in accounts receivable;
5. Creditor days: the number of days credit taken from suppliers;
6. Gearing: the percentage of loans to equity in the business.

The balance sheet may also contain 'provisions'. These are liabilities, which may be shown as current or long term, and are amounts which the business *might* owe to somebody, but isn't quite sure whether it does and even if it does, doesn't know exactly how much or when. Provisions are often used by accountants to show a 'true and fair view' of a business's financial position, even though they are baffling to some business owners.

It is why the balance sheet, like the profit and loss account, is based on estimates and assumptions -and not fact – and why the third and final statement is probably the most useful of all.

The cash flow statement

The cash flow statement, sometimes called the cash summary, records the flows of cash in and out of a business. Like the profit and loss, it records the flow over a period of time – a week, month, quarter or year.

The irony of the cash flow statement is that it is the most useful of the three financial statements, but is the only one that accountants rarely include in the accounts they prepare for their clients. To understand why this is, you need to understand that accounting rules and regulations dictate the information that is *required* to be published in accounts. These requirements concentrate on information considered to be useful to external investors and creditors, rather than the information that will be useful for business owners.

Its other distinguishing feature is that it is, also, the only one of the three statements that is based on fact, rather than estimates and assumptions[5].

The cash flow statement is divided into three sections:

1. Operating cash flow;
2. Financing cash flow; and
3. Investing cash flow.

The most useful of these is the *operating* cash flow statement as this records whether net cash has flowed into or out of a business over a period of time and determines whether the business is solvent and for how long it will remain so.

If operating cash flow is positive then the business will be accumulating cash for distribution to its owners or for future investment. The business is solvent and healthy.

If operating cash flow is negative this represents a warning sign and if it remains negative for any length of time then the warning rises to critical. The business is running out of cash. A simple calculation to compare 'cash burn', the weekly or monthly negative operating cash flow, with cash reserves will tell you how soon cash will run out if the reserves are not topped up.

5 A detailed explanation of why accountants use estimates and assumptions when preparing accounts can be found in Appendix 2.

What is important for business owners to understand is that operating cash flow can be negative even if the business is showing a profit.

In the long term, however, just topping up reserves by, say, borrowing more, will only delay the inevitable insolvency of the business. Without positive operating cash flow over the long term a business will eventually fail.

The *financing* cash flow statement shows the flows of money invested by way of equity from the owners and loans (positive) and payment of dividends, interest and loan repayments (negative).

The *investing* cash flow statement shows the investment being made in the business through the acquisition of fixed assets.

Where has all the profit gone?

A question I am quite often asked by business owners is "My accounts show a profit but I've got no cash in the bank; where is it?"

The answer is always to be found in the cash flow statement, and I usually end up preparing a reconciliation for the business owner between profit earned during a period and cash flow. This is simple to prepare and should, really, be on every business owners agenda for their monthly review of their accounts. The usual items making up the difference are:

- Owners drawings or dividends
- Tax and VAT payments
- Loan repayments
- Purchases of Assets
- Increases in stock
- Increases or decreases in working capital.

I hope you can start to see why the cash flow statement is such a useful tool that should be in every business owners' toolbox.

The cash conversion cycle

One of the most useful key performance indicators (KPIs) a business owner can know is its cash conversion cycle. This is the number of days (or weeks) it takes for £1 spent by the business to be returned in cash. Consider this example:

Example:

A business buys raw materials for £1 on 30 days credit from a supplier and pays in 30 days. The materials are used to manufacture goods which are placed in stock. 25 days later the goods are sold on credit and the customer takes 60 days to pay.

Number of days before customer pays = 60

Number of days sales held in stock = 25

Number of days before suppliers are paid = 30

Cash conversion cycle = 55 days

So if annual sales are £500,000, the working capital required is **over £75,000** as follows:

$$\frac{£500{,}000 * 55}{365} = £75{,}342$$

In this example of a business that sells on credit and holds stock, the cash conversion cycle is the sum of the number of days there are in debtors (before a customer pays) plus the number of days stock is held, LESS the number of days required to pay creditors (before suppliers are paid). The total of 55 days – the time it takes for the £1 to return to the business – is nearly eight weeks, which is more than most people realise. The cash conversion cycle is the length of time the business owner has to 'invest' in the business before a cash return is made.

Using your annual turnover, you can work out the amount of working capital your business needs. I find that this is almost always greater than business owners expect.

There we have it; a guide to where you'll find the business numbers you need to know. In part two we'll start to look at the seven drivers that will grow your business.

Part 2
Growth strategies

How to get more customers

Many business owners wanting to grow their business start with, "I need more customers." After all, isn't getting more customers the most obvious way of growing a business? Well, as you'll discover, it's not always the most *effective* way; but, as it is what many businesses concentrate on, we'll start here.

Now, what are *you* currently doing to get more customers? How many different strategies or methods are you using? Here are some of the most common options:

- Social media (e.g. Facebook, LinkedIn, Twitter, YouTube, Instagram)
- Opt-in (or lead) pages on your website for collecting email addresses
- Networking
- Search Engine Optimisation (SEO), pay-per-click (PPC)
- Advertising, direct mail, trade shows, referrals
- Telesales, salespeople
- And word-of-mouth.

But, despite their potential, many businesses only use a tiny fraction of these possible strategies to get more customers. And with the strategies they do use, there is always room for improvement.

So, the two keys to getting more customers are:

1. Making your *existing* strategies more efficient and effective
2. Testing *new* strategies

Let's look at an example that illustrates both of these points. Would you say that referrals (which can include recommendations and word-of-mouth) are a good way of growing your business? Or, even, if not at the moment, they certainly *could* be, couldn't they?

You see, referrals and word-of-mouth recommendations are *the very best ways to get new customers*. There are two main reasons why:

1. When someone's friend, family member or another contact they know, like and trust tells them that you are the person they should buy from, that's a far warmer introduction than a mere advert, brochure or cold call. It means they're much more likely to actually buy. Referrals convert into sales far more effectively than cold leads.
2. Secondly… *referrals are free!* Millions of pounds are spent every day in the UK on advertising and marketing campaigns, yet the single most effective way to win new customers doesn't need to cost you any money at all.

No surprise then that most business owners agree – in principle – that referrals and word-of-mouth are the cheapest and best ways to get more customers. I rarely come across a business, however, that actually has any systems in place to generate those all-important referrals systematically.

I have never come across businesses that are constantly inventing and testing new referral systems. Think about your own business: what do *you* have in place to give you a constant stream of recommendations in a systematic way? How often do you test *new* versions of those systems, to see whether they give you even better results? I'm not asking about recommendations that just fall into your lap – I'm asking about recommendations that you get because you have referral systems in place.

Every business should constantly be searching for new ways to get even more referrals. So, here are just five possible referral systems you could introduce:

1. Customer questionnaires that include a "Who else do you know who could benefit in the same way that you have?" type of question.
2. Your team asking that same question every time they talk to customers.
3. Joining a referrals network such as 4Networking.
4. Giving your customers multiple sets of your card, brochure and special offer literature to pass on to their friends and contacts – and perhaps even rewarding them in some way when they do.
5. Systematically asking for recommendations on LinkedIn.

These are just a few of the possibilities. The great thing about referral systems is that, unlike advertising, they won't cost you anything.

So, thinking about your systems... How many do you have? How many more do you think you should have? How many new referrals systems are you going to test? And how many extra customers do you think they will help you to win?

Referral systems are just one strategy for getting more customers… There are numerous other strategies that you could develop. For example, you could look at:

1. Differentiating your business from your competitors in ways that your customers value – so that more of them choose you than ever before.
2. Testing different scripts to find out which words give you the best results when customers say, "Why should we buy from you?"
3. Giving customers something extra, something that is worth a lot to them (but costs you little), since this will help you stand apart from your competitors.
4. Using press releases to advertise your business for free.
5. Getting others to help you grow your customer base for free by creating strategic marketing alliances – for example a plumber and an electrician could double their respective customer bases simply by introducing their customers to each other.
6. Writing better headlines for all your marketing literature – including adverts, mailshots and flyers – so that you catch and hold your prospects' attention better than ever before.
7. Increasing the response rates to all your marketing initiatives, by re-writing all of your marketing literature – including adverts, mailshots and flyers – to make them much more compelling and effective.
8. Using the latest research findings to make your marketing literature even more compelling, still.
9. Educating your customers about the benefits to them of dealing with you – since the more they understand about what they will get out of dealing with you, the more likely they are to buy from you.
10. Using video to demonstrate your expertise and promoting your videos through YouTube and other social media channels.
11. Using pay-per-click advertising on sites like Google, Facebook and LinkedIn.

12. Using social media channels such as Facebook, Twitter and LinkedIn to share valuable content, and build relationships with people who you would like as customers.

However, let's go back to the very first strategy we looked at – creating referral systems that *automatically generate* referrals and word-of-mouth recommendations for your business.

Just focusing on a referral strategy can have a big impact. Let's look at an example.

If you could capture two referrals from each of your customers every year and if you could convert half of those referrals into new customers – that's one new customer for every existing customer – then you would double your business every year, wouldn't you? That would be a 100% increase in sales!

Let's imagine you're just starting in business and you only have two customers now. If you repeat that process every year, asking every customer for two referrals and converting half of those referrals into new customers, you'll have grown from two to over 2,000 customers by the end of year 10!

The power of referrals is clear. By planning, and using, an effective referral generating system, you can double (that's a 100% increase), treble (a 200% increase), and even quadruple (a massive 300% increase) your customer base in just a few years.

Now, I'm not saying that this kind of doubling *will* happen, but certainly when you put some great systems in place, referrals could have a very dramatic effect on your business!

Questions to ask yourself about getting more customers

- How many different "getting more customers" systems do you currently have?
- Which systems currently work best and how can you capitalise on this?
- Which systems aren't working well? How can you improve them? If you can't, what should you replace them with?

How to convert more leads into sales

In the previous chapter I looked at how to get more customers by getting more sales *leads*, but how good would it be to get more customers *without* having to get any *more* leads? And of course, you can do that by converting more of your *existing* leads into sales – our next key growth driver.

Let's look at an example.

Last year a small publisher generated 100 enquiries – i.e. 100 sales leads. The business owner visited each of the 100 once only, and managed to turn 20 of them into sales. So, his sales lead conversion rate was 20%.

This year he got another 100 sales leads – but managed to convert 50 of them into sales.

How? Well, the first 20 he won in exactly the same way as the year before – after just one visit. But he used a different system with the remaining 80 who didn't say "yes" at his first visit.

In fact, he introduced systems for:

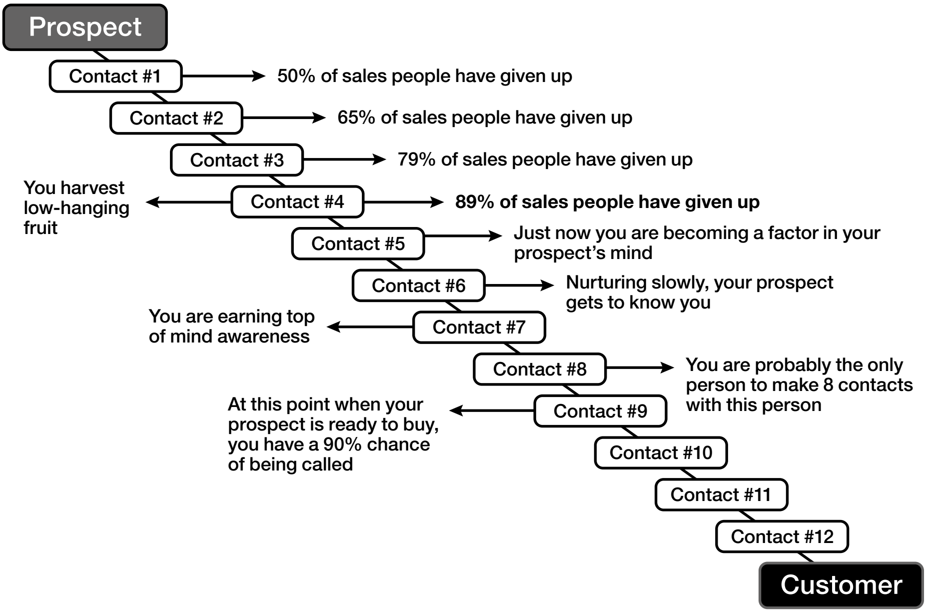
- following all 80 of them up;
- visiting all 80 of them again;
- diarising when he was going to telephone them (and sticking to it);
- sending them a newsletter;
- sending them postcards when he went on holiday;
- inviting them to open days at his premises;
- sending them press cuttings that he thought they would find useful;
- sending them copies of letters he received from other delighted customers, and
- telling them about the other contracts he was winning with prestigious customers.

In other words, he became *systematically persistent* – but without ever becoming a pest. He kept his name on the tip of their tongue and he kept asking them for the business.

As a result, 30 of the 80 remaining enquirers eventually chose to buy from him. So, his conversion rate went up by 30 from the original 20 to an eventual 50. By introducing some systems, his sales lead conversion rate increased from 20% to 50%.

Now you may be thinking 'Why spend so much time following up…they're never going to buy from me?'

In fact, recent research by Microsoft revealed that, on average, a lead (a prospective customer) needs to be contacted between 10 and 12 time before they'll buy from you, by which time, most of your competitors have given up, as this graphic shows.



Source: Microsoft

And of course, persistence is only **one** of the many possible "converting more sales leads into sales" systems that you could use.

Everything in this book can apply to any business at all. Take the ideas, think them through, and work out how to apply each one to your business. Of course, the nature of your sales process will vary widely depending on what you sell and how you choose to operate. Despite this, it *really doesn't matter what business you're in*.

Here's an example of a retail shop: retailers often say to me, "We don't have a sales process. People just come in and choose whether to buy or not." In actual fact, every customer who enters a shop is a prospect – a sales lead. Just entering the shop does not automatically mean that they will buy something… and it's only when they buy something that they go from being a sales lead to being a customer. It's the retailer's job to convert them from a sales lead into a paying customer.

Many retailers, whether they know it or not, have a standard sales script. This is how it goes: "Can I help you?" Now this is a dreadful sales script. You couldn't do much worse.

Ask yourself how often you've replied positively to that question, compared to: "No thanks, I'm just looking." Immediately, there's a barrier between sales lead and retailer. Both parties now feel uncomfortable, and the sales lead feels compelled to move away or even leave the shop.

There's a much better process:

The switched-on retail business has a very different sales script. It's one that generates results! Here's how it goes…

When somebody enters the shop and starts browsing, the retailer approaches the sales lead and says, in a friendly tone, "Hi there, my name's Dave. If there's anything I can do to help you, I'm just over there, please come and talk to me."

There are no closed questions (because you don't want a "No" response). Instead, the customer thinks: "That shop assistant cares about me. He's introduced himself, and now I know that if I need any help, I just go to Dave over there and ask my question."

This script is hugely better than the first one. With those few small changes, the sales conversion rate rises significantly. So here's my question for you: what small and simple changes can you make to your sales script that will make a huge difference to your business?

Remember, too, that the retailer's increase has happened without spending a single penny more on advertising, and without needing to create a single additional sales lead.

Have you noticed how often I use the word "system"? It's for a very good reason. It is not at all good leaving things to chance. If you want to get the best possible results, you must have a plan. You've got to create systems so that you do the right things every single time, and you've got to keep testing different systems to see which work best. You've got to train your team so that they can use those systems, and you've got to measure the results.

As we just saw with our example of the publishing business, persistence systems alone can increase the number of sales leads converted into sales from 20% to 50%. What impact would that kind of increase have on *your* business?

Of course, this is only one of dozens of strategies that you can use to convert more of your sales leads into sales. For example, there are strategies for:

1. Planning your sales approach in meticulous detail – because it is too important to be left to chance, or made up as you go along.
2. Practising your sales approach until you can do it perfectly.
3. Creating a sales process that removes all the issues that cause customers to say "No" – so that many more of your customers end up saying "Yes".
4. Using automated email systems which generate "autoresponders" to, automatically, keep in touch with your prospects and continually send them valuable information, as you build a trusted relationship with them.
5. Stressing the real benefits to the sales lead of what you provide – and in a clear and concise way.
6. Making buying less risky for customers. You see, many customers don't buy because they feel they bear all the risk – losing their money or wasting their time on the wrong choice. By making doing business with you less risky, or even removing the risk entirely, your customers are more likely to buy from you.
7. Using video on your online sales pages for getting more visitors to click on your "Buy Now" button.

It is also important to understand how a sales lead will convert into a customer. My wife and I recently went shopping for a couple of armchairs for our new sitting room. We had decided the room needed a make-over as it was one we rarely used and could be put to better use. We settled on another sitting room (no TV allowed) to create a comfortable space for reading and listening to music.

Now, shopping is one of my least favourite activities (unless it involves selecting an item on Amazon and having it delivered the next day), but, on this occasion, it required my input as it involved ensuring the items purchased were practical and comfortable, and not just pleasing to look at (which wasn't on my list of criteria at all).

What does this have to do with converting sales leads? Well, as it turned out, it was very instructive about how – as customers – we make buying decisions.

It all comes down to a combination of emotional and logical decision making, and if you don't understand the various stages a sales lead goes through, then you could well end up losing out to a competitor.

Here are the five stages we went through: awareness, interest, evaluation, testing and finally the purchase. Each has its own characteristics.

1. **Awareness** was easy, but largely driven by how we felt, rather than logic; a nearby retail park has at least five furniture stores, it's easy to park and meant not having to find parking and walk between several city centre stores. Don't try and convince me it's more logical to carry out detailed research online, and then visit stores in several different locations; it *felt* better going somewhere where the stress level would be low. This is why the way you attract customers – and the time you have to do it – has to be easy and quick. If it's online, you have seven seconds!
2. **Interest** was less emotional, but still a factor; as we walked into the stores how welcoming did they feel, were the staff friendly, did they offer coffee (one store even had cookies)? You may think this makes no sense at all, but I must admit to walking in and straight out of one (heavily advertised) store, because it didn't feel right. Is your website doing that to prospects? Do you do all the hard work to get them to your website and then they bounce straight out?

3. **Evaluation** and its now all about logic. I want to see and – next step – test the products that met my criteria. Don't appeal to my emotional side, or you'll seem evasive by not switching to logic when I have, and answering my questions. Ask me what my criteria, budget, must and mustn't haves and preferences are, and show me exactly what you've got that meet those criteria. In addition, you'd better know the answers without having to ask someone.
4. **Testing** the product, for me, is, still, all about logic (that's why you needed to know my preferences). If the chairs have to be well-stitched leather that won't slide, that is a logical test. You can now ask me: is it comfortable, is it the right height, will it be comfortable when you are reading, and so on. Do you offer a 'test before you buy option'?
5. **Purchasing**, interestingly, reverts back to emotion, and is a stage by which many sellers get confused. They think it's all over! Far from it. I now want to feel good about my decision. Once you've ticked my logical boxes, and I've switched back to emotion, you need to recognise it and validate my decision. I need to *feel* confident that I've made the right decision.

And these are the stages **your sales leads** will go through. Does your process recognise these stages and have a system for each one?

There are two more elements to the buying decision that come into play and need to be understood. These are risk and trust. The greater the risk (or value) of the purchase the longer the buying process; we need to *feel* that we have given the buying decision proper attention. This is interesting because even when we have completely bought in, emotionally, to the purchase, we will often slow down the actual purchase itself to show that we are being rational.

Trust is equally important, and explains why people often choose a brand, or are willing to pay more for something from a company which they already trust rather than from one they haven't heard of. (In reality very few purchases are made solely on price.)

This process is why **you may have heard the phrase 'sell the next step'**. Letting your sales leads move through the process at their own speed gives them a sense of control. The key is to make sure that one step leads to another, you leave the lead wanting a little more at each stage, and you recognise as they move through the stages, and adjust your selling style (emotional/logical) accordingly. Once a lead's brain has moved into a logical gear answering with an emotional response makes you sound evasive.

So, after three hours, five stores and a great many chairs tested, we settled on the ones we wanted; what to me was interesting was that we bought from a store that doesn't pay its staff commission, and yet, the same assistant stayed with us throughout the process, was extremely knowledgeable about the product and recognised as soon as we had moved from testing to purchasing and changed her approach immediately. Must have been some training going on there! Is your sales process as good?

And there are also strategies for:

1. Proving that your products and services are as good as you say – which makes more people likely to buy from you (whereas asking them to 'take your word for it' just encourages them to be sceptical).
2. Testing different scripts to find out which words give you the best results when replying to each and every objection raised by your customers.
3. Producing standard documents that your team can give to customers before, during and after the sales process – including price lists, FAQ sheets, proposal letters, guarantees and anything else your customers need to understand why you really are their best option.
4. Becoming better, and more persistent, at following up, in various creative ways so that your prospects eventually say "Yes".
5. Using great questions that show your customers that you are interested in them, and which unlock the information to enable you to focus on matching their real needs.

Let's look at giving guarantees. Business owners often say to me "We can't offer a guarantee – customers will be asking for their money back and we'll never make a profit". In fact, all the evidence points to the opposite. A well-constructed guarantee presented in the correct way, so that the customer understands exactly how and when, and in what circumstances, they can ask for a refund will dramatically increase sales, and reduce customer complaints. The extra income (and profit) will far outweigh the few refunds that have to be made.

Questions to ask yourself about converting more leads into sales

- Have you mapped out your entire sales process in detail so you can identify each of the key steps?
- What are all the reasons customers say “No”, and what can you do differently so they end up saying “Yes”?
- How many “converting sales leads into sales” systems do you currently have?
- What impact do you think that this could have on your sales lead conversion rate?
- Which systems currently work best? How can you capitalise on this?
- Which successful “converting sales leads into sales” systems have you observed in other businesses? How can you adapt what they do so that it works for your business too?
- Do you have a well-constructed guarantee?

How to get customers to buy more from you

Most small business owners spend the majority of their time working out how to find new customers. The real power behind business growth, however, lies in the customers you already have.

The third growth driver is getting your existing customers to buy *more* every time they do business with you. The easiest way to increase your sales is to sell more to your existing customers, and there are two reasons why:

1. It's free. No ads, no mailshots, no costly database. You already know who they are, where they work, and what they already buy from you.
2. They are already in a buying relationship with you. They know, like and trust you, so they're much more likely to say "Yes" when you offer them something extra. Psychologists have proved that once a customer has spent money with you, they are more likely to do so again that go elsewhere.

So, how can you get an existing customer to buy more from you?

Often, the simplest systems can be the most effective. Let's look at an example that you've probably seen and experienced, first hand. In fact, it's one of the many incredibly powerful "getting customers to buy more" systems – the one they use at McDonald's.

Like many of the best systems, it is a simple script – one that anyone can use in their business. Imagine that you are feeling hungry. You see a McDonald's and you say to yourself, "I'm hungry, I fancy a burger." When you arrive at the counter and ask for a burger, how do they reply? "Would you like fries with that?" Now, it doesn't matter which McDonald's you go to anywhere in the world, they will always ask that question.

Through testing, they've discovered that it's the best way – the best system – to get customers to spend more money. And if you start to do the maths, you will see why that simple system – that simple script – has helped make McDonald's literally millions of pounds in additional profits. If a hamburger is £1.50, and fries are 75p, then rather than spending just £1.50 on the burger, when a customer says "Yes" to the question, they end up paying £2.25 for burger and fries. And that's a 50% increase in the amount of money that the customer takes out of their pocket and puts into the till.

Now, not every customer will say "Yes" to the question. But what McDonald's found by testing is that a significant proportion of customers *will* say "Yes" – even though many of them came in with the intention of ONLY buying a burger. So, let's say half of their customers say "Yes" to the offer of fries. That will still add 37p – or 25% – to half of the burger-based transactions.

That's how powerful "getting customers to spend more" systems can be. Of course, McDonald's continually tests its systems. The "Would you like fries with that?" script is now "Would you like to make that a meal deal?" They then add, "Would you like to go large?" It's all the same concept.

It's not just McDonalds – other big brands do something similar. Recently, I went to Cineworld and queued up to buy some popcorn and a drink. There was a great big sign saying "You can go large for just 75p!" Like many others, I went for it, because for just a small amount more money I feel I'm getting much better value. Put yourself in the vendor's shoes: an extra squirt of Coke and a bit more popcorn has very little cost, yet they've upsold me to the tune of 10%. That's a 10% increase in their sales. Can you *imagine* the increase in profits this yields? On top of this, because I feel I've been clever going for the better deal, they've made me a happy customer into the bargain!

Here's another example. My local Chinese takeaway knew that their average spend was just over £20 (they knew their numbers!) so they put on a 'special offer'. Spend over £25 and get free wontons and a bottle of coke. Now the wontons and coke cost less than a £1 for a £5 increase in sales. Not only did sales to existing customers go up, but new customers, who'd heard about the promotion, started coming.

Of course, asking the "*do you want to go large*" type of question (often referred to as "upselling") is just one possible strategy. There are dozens of other strategies for getting your customers to buy more every time they do business with you. For example, you could test:

1. Increasing your prices by 1%. In every business I have ever seen, this has had absolutely no effect on the volume of sales, and is therefore

the simplest way of getting your customers to spend more. We'll come on to pricing in more detail in a later chapter.

2. Showing customers your most expensive items first. This will, usually, result in them choosing a more expensive option than if you showed them your cheaper items first.
3. Offering three sizes – small, medium and large. Coffee shops and wine bars use this a lot, because very few people go for small, whereas if there are only two sizes, most people will opt for the smaller one.
4. Bundling two or more items together, and offering them at an advantageous price – for example, "Buy this toothbrush and get this tube of toothpaste at half price."
5. Offering larger quantities or sizes at advantageous prices.
6. Offering ranges and collections that encourage your customers to want the complete set.

And you could also experiment with:

1. Offering tempting special upgrades, offers, promotions and bonuses *at the point of sale* – since once they have decided to buy, many people are willing to pay a little bit more for an even better deal.
2. Offering customers all the extra items – like batteries – that they need to enjoy the full benefit of their main purchase.
3. Offering other low price, unrelated items at the point of sale, such as the sweets and magazines that most supermarkets display near the checkout – many customers will buy them on impulse.
4. Testing different scripts to find out which words give you the best results when inviting customers to "trade-up", and spend more money in all these sorts of ways.
5. Producing standard documents, such as flyers and special offer forms, which your team can also give to customers to invite them to trade-up.

Questions to ask yourself about getting customers to spend more

- How many "getting customers to buy more" systems do you currently have?
- Which systems currently work best? And how can you capitalise on this?
- Which systems aren't working well? How can you improve them? And, if you can't, what should you replace them with?
- How can you create bundles of your products or services which encourage customers to spend more?
- In how many ways can you create incentives for customers to order larger quantities or sizes?
- How can you make it incredibly easy for customers to try other products or services which you offer?
- Have you seen other businesses' "getting customers to buy more" systems? And how can you adapt what they do so that it works for your business too?

How to get customers to buy more often

A great way of growing your business is not only to get customers to buy more, but to have them buying more, *more frequently*! This is the fourth growth driver – getting customers to buy from you more often – which, as we will discover, can be very cost-effective, very powerful and very profitable for you.

Let's look at an example of a very simple but powerful "getting customers to buy more often" system that a hairdresser could implement.

I'm one of those people who forget to book my next haircut, or keep putting it off. So, although I should go every six weeks to keep my hair looking at its best, I probably go only once every 8-10 weeks.

What the hairdresser should have is a simple "getting me to buy more often" script that goes something like this: "Are you happy with your haircut? You are. That's great. Well, to keep it looking at its best, if I were you, I would get it cut again in six weeks' time. Would you like me to book you an appointment now?" And they might even add, "I know you prefer lunch times – so we can fit you in at one o'clock on Friday 20th? Is that ok, or would you prefer the Thursday?"

Now, if they did that, I would fix an appointment there and then – because they've explained the benefits to me of coming back, they've given me one less thing to have to organise later, and they've made it easy for me to say "Yes" by offering me a choice of lunchtime dates.

It sounds incredibly simple. However, that system – in this case, a script – would ensure that I get my haircut every 6 weeks rather than every 8 -10 weeks. If you do the maths, that would result in me increasing my haircuts from 6 to almost nine times a year. In other words, that simple but powerful system would increase the number of times I buy from that hairdresser by 50%.

For the hairdresser, that 50% increase in sales to me comes without having to spend a single penny on any kind of marketing, and without adding a single extra customer. That's the power of having great "getting customers to buy from you more often" systems.

Notice that word yet again – *system – as* I've said many times, it's no good leaving things to chance. It is also no good hoping your customers or colleagues will do it, spontaneously. Finally, it's no good hoping that your team will be able to make up the right words on the spot. If you want to get the best possible results, you've got to have a plan and a script. You've got to create a system – in this case a script. You've got to keep testing different scripts to see which work best, and you've got to train your team so that they can use those scripts.

You've got to measure the results.

If a hairdresser can do this and increase sales from one customer by 50%, what impact would this kind of increase have on *your* business?

Here is a version of this strategy that I recommended to a ladies' hairdresser. Rather than just offer to book the next appointment they went one stage further and offered a package of six monthly appointments, plus a free treatment of their choice, booked in advance, for a one-off payment made up front. Not only did this increase the number of times the customer bought from them, it also improved their cash flow.

More strategies you can use

Once again, this is just one possible strategy. There are dozens of other strategies that we can use to help you get your customers to buy *more often,* from you. For example:

1. Increasing the *number of times* you ask your customers to buy something from you – since it's the simplest way of getting customers to buy from you more often.
2. Launching a loyalty scheme that encourages your customers to buy from you more often.
3. Setting up long-term systematic buying agreements – such as selling your products under licence, charging ongoing royalties, or a subscription service for annual upgrades.
4. Developing a regular customer contact programme – since the more systematic you are about keeping in touch with customers in a way that they value, the more often they will buy from you.

5. Making it so easy for customers to buy from you again that they don't even consider going anywhere else.

And there are strategies for:

1. Developing new products or services that make it easier, and more practical, for your customers to buy from you more often.
2. Making it more attractive, or convenient, for customers to buy from you at times when they wouldn't normally be "in the market".
3. Making it easier – perhaps even free – for your customers to try some of your other products and services, so that they end up buying more often from you.
4. Telling your customers about other people's products – since if your customers trust you, they will probably buy what you recommend. So, why not strike a series of deals to systematically tell your customers about other people's products that you think are good? You should be able to earn a modest commission for every sale made.

And of course, these are only a few of the possibilities you could explore. So, how many "getting customers to buy more often" systems do you currently have? How many more do you think you should have? How many new systems are you going to test? And what impact do you think that this could have on how many times your customers buy from you?

Questions to ask yourself about how to get customers to buy more often

- How can you adapt the "next sale script" idea and use it in your business?
- In how many different ways can you ask your customers to buy something from you (since increasing the number of times you ask the same basic question is the simplest way of getting customers to buy from you more often)?
- If you don't already have one, how could you launch a loyalty scheme that encourages your customers to buy more from you more often?
- Could you set up long-term systematic buying agreements – such as selling your products under licence, charging ongoing royalties, or a subscription service for annual upgrades?

- How can you develop a regular customer contact programme (since the more systematic you are about keeping in touch with customers – in a way that they value – the more often they will buy from you)?
- How many other "getting customers to buy more often" systems do you currently have?
- Which systems currently work best? And how can you capitalise on this?
- Which systems aren't working well? How can you improve them? And, if you can't, what should you replace them with?
- Have you seen other businesses' "getting customers to buy more often" systems? And how can you adapt what they do so that it works for your business too?

How to get your customers to stay as customers for longer

The first two growth drivers we looked at – how to get more customers and how to convert more of your sales leads into customers – are the two areas that most businesses concentrate on.

However, research shows that it costs a business typically seven times more to get a new customer than it does to keep an existing one. After all, advertising and direct mail are rarely free – and neither is employing a sales force. So those two growth drivers can also be expensive.

So, let's look at the fifth key growth driver – one that is frequently overlooked. It's so often overlooked because the financial implications are less obvious. We're talking about *keeping your customers as customers for longer* – in other words, increasing your customer loyalty – which, as we will see, can be even more cost-effective, even more powerful and even more profitable for you.

Research has shown that for the average UK business, about one in five customers don't come back. This average 20% customer defection rate may not be the norm in *your* business or your industry – but every business I've ever met has lost customers at some time. Yours is probably no different.

Now, there's another major piece of research that I need to tell you about – one that looked at WHY those customers leave. And it found:

1. 4% die or move out of your geographical area
2. 5% are referred to another supplier
3. 9% move to a cheaper supplier
4. 14% are unhappy with your product or service

None of these reasons are surprising, or are they?

Ask most businesses why they lose customers and they'll say "price". They think customers go to someone cheaper down the road. Not so.

You can see that only 9% of customers move to a different supplier because of price. In fact, far more (14%) leave because your service or products aren't good enough, and that's something you can usually fix quite simply.

But the amazing thing is that all of those reasons combined – including cheaper prices – only account for one third of all the customers that leave.

The other *two thirds* leave suppliers for one crucial reason. And that crucial reason is "perceived indifference", but not their indifference – yours!

In other words, seven out of every 10 customers who leave, leave because they feel you don't care about them, they feel that they are being taken for granted and they feel that they aren't important to you.

If that surprises you, imagine this scene.

Imagine going out for an evening and having a drink at two wine bars that are next door to each other. Both serve the same wine at the same prices, both are furnished to the same standard, and both have the same type of ambience and clientele. In the first wine bar you are welcomed by the bar staff with a smile, eye contact, and fast and attentive service. In the second, the staff seem to be more interested in talking to each other than serving you. They avoid eye contact with you, until they have finished telling each other a joke. When they finally get round to sauntering over to you, they don't look at you, don't use the common courtesies, speak in gruff monosyllables, and make it obvious that they would rather be somewhere else.

Now, you've finished your one drink in each wine bar, you go for a meal. After the meal, you have time for one more drink in one of the two wine bars. Which one are you going to go back to? In other words, which wine bar are you going to be loyal to?

Most people prefer to feel wanted, valued and appreciated – and most people don't like to feel unimportant. So very few people will choose to go back to the second wine bar – the one where they are made to feel unwanted. However, because the first wine bar made them feel wanted, welcome and important, they get the loyalty – and that's where you return to buy your last drink.

It's your job is to show that you *care*.

I'm sure your business isn't rude to its customers in the way the second wine bar was. However, it's not only rudeness that makes customers feel you don't care about them. It might be, for example, that you haven't been in touch with them for a while. Or that there's no answer on your phone, or that their calls aren't returned quickly. It may be that you keep them waiting too long, or seem to be breaking your promises to them.

It may be that they get the impression they are being fobbed off or that they are being served by your most junior people because they aren't important enough to be looked after by anybody else. Or that you turn up late to meetings with them – and haven't prepared for the meeting in advance.

There are 101 ways that they could get the impression that you don't care. So, your job is to do everything possible to show that you do care; to do everything possible to give them sensational service; and to do everything possible to make the whole experience of dealing with you better than they can get anywhere else.

And to do that, you need great "keeping customers for longer" systems:

- Systems for showing that you care
- Systems for delivering sensational service
- And systems for transforming the experience of dealing with you.

Now – let's go back to the wine bar! The one that got it right and doubled its drink sales to us on our night out; but the benefits last for much longer – we're far more likely to go back there in the future, so it makes more sales now, and more sales in the future. As for the wine bar that got it wrong – well I, for one, wouldn't go there again if I could possibly avoid it!

So, what kind of business model would work best for you? One where your customer defection rate is where it is now… or one where your customer defection rate is much, much lower because your customers are much, much more loyal to you?

OK, how many different "keeping customers for longer systems" can you introduce to reduce your customer defection rate and increase your customer loyalty?

Once again, there are dozens of strategies you can use in this area. For example:

1. Identify the little things that annoy customers… and then *stop doing them*! If you don't, they may well stop being your customers before long.
2. Identify the little things that customers love… and start doing them systematically. It's the little things that can be the most powerful, so start giving sensational service by systematically delivering many, many little extra service touches.
3. Use customer surveys to find out what your customers like, and don't like. Online survey tools such as Survey Monkey are a quick and easy way of doing this… and it demonstrates to your customers that you care.
4. Do *what* you said you were going to do, *when* you said you were going to do it, and at the *price* you said you would do it for.
5. Under-promise and over-deliver. Customers are always impressed if you give them more than they expected, or deliver quicker than expected. Conversely, they are always bitterly disappointed if you break your promises.
6. Make sure that every member of your team has the right attitude when dealing with customers at every point of contact. It isn't just what you do, but also the way you do it.

And there are strategies for:

1. Making sure that every point of contact with your business is distinctive, memorable and valuable – with the aim of dazzling and delighting the customer.
2. Handling complaints brilliantly – when things go wrong, make sure your systems handle complaints brilliantly. Research shows that customers who have their complaints handled quickly, honestly and fully are *even more loyal* than customers who have nothing to complain about!

3. Adding the "personal touch" by making your key people more visible, approachable and accountable – especially to customers with complaints.
4. Continually educating your customers about the benefits to them of dealing with you – the more they learn this, the more likely they are to stay with you.
5. And reducing your "no-show" rate by creating systems and scripts for, gently, reminding customers about meetings and appointments.

And, of course, these are just a few of the possibilities you could explore.

Questions to ask yourself about how to get customers to stay for longer

- What are the little things that annoy customers? These are the things you need to stop doing. If you don't, they may well stop being your customers before long.
- What are the little things that customers love? It's the little things that can be the most powerful, so start giving sensational service by systematically delivering many, many little extra service touches.
- How can you use customer surveys for finding out what your customers like and don't like?
- How can you make sure that every member of your team has the right attitude when dealing with customers at every point of contact? It isn't just what you do, but also the way you do it.
- How many other "keeping customers for longer" systems do you currently have?
- Which systems currently work best? And how can you capitalise on this?
- Which systems aren't working well? How can you improve them? And, if you can't, what should you replace them with?

Have you seen other businesses' "keeping customers for longer" systems? And how can you adapt what they do so that it works for your business too?

How to use pricing to increase your profits

Price is unquestionably the most powerful growth driver. You absolutely must get this one right. The wrong price is the single biggest reason why small businesses struggle or even fail.

However, when you get the price *right*, you'll transform your business overnight. It's instantaneous. However… you might be surprised at how, and why, this happens. When you put aside some time to explore strategies and ideas for growing your business, you should start here. Start with price.

When you work with me, it's the first place I'll start. So let's look at price…

Cutting prices can be disastrous. Most businesses are in competitive markets, so they will often say something like, "We can't increase our prices we'll lose customers" or "We need to reduce our prices to stay competitive and win more customers." After all, that'll bring in more customers, won't it?

Well, yes it might well do that. But wait a moment: before you rush off to change your prices, you must first understand your numbers. It's absolutely vital. You see, for most businesses **cutting prices is disastrous**.

Let me show you an example:

To increase sales a business owner decides to cut his prices by 10%. Let's say this works and he gets 20% more sales. See what happens to his profit!

Impact of cutting prices by 10% and increasing sales by 20%		
	Before	**After**
Sales	50,000	54,000
Cost of sales	(35,000)	(42,000)
Gross profit	15,000	12,000
Gross profit percentage	30%	22%
Overheads	(10,000)	(10,000)
Net profit	5,000	2,000

Even with a 20% increase in sales the business is worse off. So how many customers will it need to win just to make the same £5,000 of profit as before the price cut?

30%? 50%? 100%?

Take a look at this table. To earn the same profit after a 10% price cut the business would need to sell a whopping 50% more!

	If your present margin is...								
	20%	**25%**	**30%**	**35%**	**40%**	**45%**	**50%**	**55%**	**60%**
And you REDUCE price by	**To produce the same exact profit, your sales volume must *increase* by**								
2%	11%	9%	7%	6%	5%	5%	4%	4%	3%
4%	25%	19%	15%	13%	11%	10%	9%	8%	7%
6%	43%	32%	25%	21%	18%	15%	14%	12%	11%
8%	67%	47%	36%	30%	25%	22%	19%	17%	15%
10%	100%	67%	50%	40%	33%	29%	25%	22%	20%
12%	150%	92%	67%	52%	43%	36%	32%	28%	25%
14%	233%	127%	88%	67%	54%	45%	39%	34%	30%
16%	400%	178%	114%	84%	67%	55%	47%	41%	36%
18%	900%	257%	150%	106%	82%	67%	56%	49%	43%
20%	–	400%	200%	133%	100%	80%	67%	57%	50%
25%	–	–	500%	250%	167%	125%	100%	83%	71%
30%	–	–	–	600%	300%	200%	150%	120%	100%

EXAMPLE: If your current margin is 30% and you ***reduce*** the price by 10%, in order to maintain the ***SAME*** profit you must increase sales by 50%.

Even if it did achieve 50% more customers, that will yield no extra profits, or growth at all. It's just to stand still. It would also need all those new customers right away, because once prices are cut, your shortfall is instant.

The exact percentages here vary according to the business cost structure. So for you, the equivalent figure will probably not be 50%. Of course, a good accountant can show you what your percentage is. In our experience, for almost every business, it is a far bigger number than they thought. In order to make rational pricing decisions, it is therefore imperative that you know your business numbers work with the correct information.

So, ask yourself this… Are you remotely likely to win that minimum number of extra customers? If the answer is "No" – or even "Probably not" – then cutting your prices is not a good idea.

Furthermore, cutting price doesn't just affect your profit; price-cutting is obviously not a good idea for your profitability. It's not a good idea for your cash flow either. To make more profit at lower prices, your sales must be higher than they are now. That means more money tied up in stock, work in progress and debtors – and more strain on your cash flow.

So, think very carefully before you cut your prices. Check the consequences, because they could be devastating. You must understand your numbers. You must also understand the maths behind it all.

In addition, that's not the *only* downside! What sort of customers would you attract as a result of your cheaper prices? Many of them wouldn't be the sort of customers that want a really good quality supplier – they'd be customers looking for a cheap supplier, wouldn't they? But are they the sort of customers that you really want? Are they the best customers? Or are they the ones that moan and whinge a lot? For most businesses, the answer is simple.

So instead of cutting prices, let's say the business owner puts up his prices by 10% and as a result loses 15% of his customers.

Impact of increasing prices by 10% and losing 15% of existing customers		
	Before	**After**
Sales	50,000	46,750
Cost of sales	(35,000)	(29,750)
Gross profit	15,000	17,000
Gross profit percentage	30%	22%
Overheads	(10,000)	(10,000)
Net profit	5,000	7,000

Total sales actually fall slightly because the business has got fewer customers, despite prices going up. Because it's got fewer customers, however, its cost of sales will fall by even more than its sales, so profits (the important thing) will actually be £2,000 (40%) higher!

Getting the price right can transform your business. *Raising* prices can have the single biggest impact of all of the growth drivers we've looked at so far. It's transformational.

What's more, there are extra benefits: with 15% fewer customers, you're less busy. You have more time to spend on the 85% of more profitable customers that have stayed with you, so you can do a better job all round for them, so they buy more, more often, stay with you longer, refer you more frequently and so on. You also have less money tied up in debtors, stock and work in progress, so cash flow is better.

Think about the type of customers that you will lose. Are they going to be your best customers, who value what you do? Instead, will they be your least favourite customers, who always want a cheap price?

What difference would it make to your life, and the amount of pleasure you get from your business, if you didn't have to deal with some of those "least favourite" customers again?

So, there are, also, a lot of great side-effects from putting your prices up. Price is the most powerful driver. Understand it well, and it's your key to success.

Losing 15% of your customers after a 10% price increase is unusual. In reality it'd be surprising, in my experience, for a business to even lose as much as 5%. So, how do you put up your prices and not lose customers?

I specialise in helping businesses find ways of increasing their prices *without* losing customers. I have a whole range of strategies and tools available for doing this, such as:

1. Focusing on adding value – in other words, what extra value could you give to your customers so that they would be happy to pay more money?
2. Making the value of what you do much, much more obvious.
3. Creating brand names and unique selling propositions.
4. Translating the features of what you do into benefits – so that your customers really understand the benefits they will get from buying at a higher price from you rather than your cheaper competitors.
5. Removing the risk from your customers – so that they are happy to spend more money because it's safer to deal with you than your competitors.

Remember that the research I quoted in an earlier chapter said: only 9% of your customers will move for a cheaper price. Price is a much bigger factor in the business owners mind than it is in your customers'. There are dozens of strategies, resources and tools that you can use to help you increase your prices, but without losing customers.

Notice I said "*without losing customers*". In the example above, I shared with you the results a business owner would achieve if he increased his prices by 10% and lost 15% of his customers. But when you do things the right way, it's possible to do even better by increasing prices *without losing any customers*…

Let's explore this briefly. Here's a very simple – but very important – series of questions for you. Just think for a minute about a hundred of the most useful or favourite things you buy on a regular basis. How many of them would you stop buying if the price went up by one percent?

For example, would you stop drinking your favourite pint of beer if the price went up by 3p from £3.00 to £3.03? How about your favourite bottle of wine, if it went up from £10 to £10.10? Would you stop reading your favourite Sunday paper, if it went up from £1 to £1.01?

If your answer was "No", then what you're saying is that, as a customer, if the product is good, a really small price increase won't stop you buying it. So tell me, are your products and services good? If they are, then following your own logic means that you could increase your prices by an average of 1% without losing any customers, couldn't you?

You could, of course, simply put your prices up straight away. That **may** be a great thing to do. Unfortunately, it may also result in you losing some customers and harming your business. So, while it is likely that putting up your prices would be a great strategy, you need to think about it alongside some of those other strategies I mentioned earlier – increasing perceived value and benefits, and reducing the consumer's sense of risk, when buying from you. This will help make sure that your customers are *happy* to pay your higher prices.

Earlier in this chapter, I said that the price driver is arguably the most powerful driver in your profit equation. Get this right and you make a profit. Get this wrong and you make a loss.

It's as simple as that. So the trick – of course – is to make sure you get it right more often than wrong.

Customers care about price. Despite this, it is certainly not the only thing they care about – and your entire business and marketing strategy should reflect that fact. In other words, you should never compete on price alone. Instead, you should start by making sure that what you are offering exactly meets the needs of your ideal customers. Then you need to make sure that you compete on the basis of giving those customers "maximum value" rather than the "lowest price".

Value is the gap between the benefits a customer *perceives* he is getting and the price he *perceives* he is paying. So, offering "maximum value" means offering a bigger 'value gap' than anyone else. There are four key factors to offering maximum value:

1. To make sure that your products and services are exactly what your customers, especially your ideal customers, need and want – i.e. they offer the best and most appropriate combination of benefits.
2. To make sure that your customers fully understand those benefits – because unless they understand that what you have to offer is special, they will assume it is average, and that means that you'll only be able to charge an average price. So, managing their perceptions is vital.
3. To make sure that your price structure is designed and calculated in the best possible way.
4. To make sure that your prices are presented, explained and defended in the best possible way.

It's these last two points that I want to concentrate on next: designing, calculating, presenting, explaining and defending your prices in the best possible way – in other words, in the most profitable way.

Let's start with a few questions: how much profit would you make by giving your products, or services, away for free? Well, your sales would be zero – and you wouldn't make a profit, would you?

How much profit would you make if you sold your product or services at, say, 1,000 times their current price? Well, the chances are that nobody would buy them. So again, your sales would be zero – and, again, you wouldn't make a profit.

So, at those two extremes – a ridiculously low price and a ridiculously high price – you don't make profits. At somewhere in between those two extremes, you will make a profit. At ONE particular price, somewhere on that spectrum – let's call it the magic price – you'll make the most profit.

So, here's the really important question for you… Is the price you currently charge exactly that magic price? And that's not a rhetorical question. It's either yes or no. Yes, the price we charge is exactly the magic price. Or no, the price we charge isn't exactly the magic price.

If your answer was "no", that's great – it means that when you discover your magic price, you will definitely be able to improve your profits, probably by a huge amount.

If your answer was "yes", how do you know that you are charging the magic price? How can you be sure, absolutely sure? What proof do you have? How strong and how up to date is your evidence? How many other prices have you tested? What is the precise impact on your short-term and long-term sales, on your short-term and long-term profits, of your current price and all the other possible prices?

So, how do you find your magic price? In one sense, it's really easy. For every possible price, work out:

1. The quantity you will sell at that price
2. The money value of those sales
3. Your costs
4. And, by deducting your costs from your sales, your profits

Then, simply pick the price that gives you the highest profit. Simple in theory, not in practice. Once you know how many units you are going to sell at each price, calculating your sales costs, and profits, should be fairly straightforward arithmetic. The big problem, of course, is in knowing how many units you can sell at each price. There is only one way to do this:

Testing.

The only thing that matters is what *actually* happens when customers are asked to part with money. The only thing that *actually* matters is how much they *actually* spend at different prices.

So, you need to find ways of testing different prices. Be creative. Find ways to test different prices safely. For example, you could change the price for a small group of customers – perhaps only through one of your distribution channels or shops. Alternatively, you could use a variety of different value coupons or discount vouchers to see how much you sell at different net prices. Or even use daily special offers to charge different prices on different days. The list of possibilities is enormous.

However you decide to test, always remember the two golden rules of testing:

1. Only change one thing at a time – since if you change more than one thing, for example the price and the packaging, you won't know whether it is the price change or the packaging change that causes customers to change how many they buy.
2. Always measure the results *before* and *after* the change very carefully indeed.

Observe both of these rules and you will discover what your magic price is. Or, at the very least, you'll get a much better idea of your magic price than you've ever had before, although that's not the end of the story. You see, your magic price isn't something handed down from on high – and neither are the profits you earn at that magic price.

They are both something that you actually choose. Pricing at your magic price is a great thing to do; it means you will earn the maximum you possibly can without changing anything else in your business. You get more profits without changing your product, service, marketing, packaging or overheads. Everything stays exactly the same… except your prices and profits. You can make even more profit if you go *one step further*. That further step is to consciously choose your magic price, and the profits you earn at that magic price.

So, now you've got to your magic price…..let me burst your bubble. If you have a *single* price for your product, then that single price is wrong… no matter what that single price, actually, is.

One of the most profound principles in the field of pricing is this: different customers value things differently. We all value things differently. We all have a different perception of the value of any product or service. So, we all have a different maximum amount we are willing to pay for a particular product or service. It's our personal judgement call – and it's entirely subjective.

"So what?" you might be thinking. Well, this seemingly tiny observation has a profound implication. You see, it means that whatever price you are currently charging, that price is wrong! Actually, I probably need to clarify that statement. Let me be more precise. If you have a *single* price for your product, then that single price is wrong.

You see, having only a single price causes you to lose out in two different ways... For some customers that price is too *high* – so they don't buy, and you lose them as a customer; while for other customers that price is too *low* – so you end up charging them less (and earning less profit) than they are willing to pay. This means you lose again.

So the secret is to charge different customers different prices. It sounds difficult, but in fact there are lots of ways to do this, such as:

- Offering trade-ins
- Creating different versions of your products and services at different prices
- Charging different prices in different distribution channels
- Charging different prices at different times
- Creating bundles that will appeal mostly to price-conscious customers
- Giving concessions to groups of customers who can't afford as much as your ideal customers
- Having a 'lite' version of your product for cost conscious customers
- Having a premium version of your product for customers who want a 'better' product.

Let's examine the idea of a premium product for a moment. In his book "80/20 Sales and Marketing – the Definitive Guide to Working Less and Making More" Perry Marshall uses the Pareto principle to show how in any market, 20% of your customers will opt for your premium product if one is available.

> "The 80/20 principle says that if 10 people will pay $1 for a cup of coffee, two of the 10 will pay $4 for a better cup of coffee, as long as the superior cup of coffee is perceived as being 'just as good a deal' as the ordinary one."

Charging different customers different prices will increase your profits… and probably by a lot! Does this mean that finding and using the magic price is a mistake? No, it's not. There may be instances where it is not possible to charge different customers different prices. When you are able to charge different customers different prices, each of those different prices can be the magic price for a particular segment of customers.

Key questions to ask yourself about how to use pricing to increase your profits

- Could you increase your prices by just 1% today (since in every business I have ever seen, this has had absolutely no effect on the volume of sales, and so the extra amount charged has all been pure profit)?
- What extra value could you give to your customers so that they would be happy to pay more money?
- How can you make the value of what you do much, much more obvious?
- How can you create brand names, and unique selling propositions, that highlight the big benefit of what you do, so that your price is less significant?
- How can you remove the risk from your customers so that they are happy to pay higher prices because it's safer to deal with you than your competitors?
- How can you test your prices to find out how much you can sell at each price – and then work out which price maximises your profit?

- How can you better educate your customers about the benefits, to them, of dealing with you (since the more you educate them, the more likely it is that they will be prepared to pay you a higher price)?
- How can you use creative price structures so that you can charge each customer what they are willing to pay?
- How can you differentiate your business from your competitors in ways that your customers value? You'll be able to justify charging higher prices, increase your profits and increase the value of your business.
- What *extra* could you give customers – something that is worth a lot to them, but costs you little (since this will not only make them happy to pay your current prices, but it will also make them happier to pay an even higher price)?
- Have you set the price of everything you sell at its "magic price"?
- If the answer is yes, how were you sure that they were the magic prices when you set them, and how can you be sure that they are still the magic prices today?
- When did you last test your prices? How did you test them? Lastly, what did you learn?
- How many different ways of testing your prices have you used in the past, and which have been the most useful?
- How else could you test your prices using special offers, promotions, sales, coupons, vouchers, discounts, auctions or any of the other methods discussed in SSTW?
- What proportion of your ideal customers complain that your prices are too high?
- What other methods could you use to estimate how much you will sell at each price?
- How many customers can you afford to lose when you increase your prices?
- What does the evidence suggest will actually happen to your sales when you increase your prices?
- How can you re-engineer your costs so that you earn even higher profits at your magic price?
- How can you make your business more compellingly attractive, and dramatically different, so that you earn higher profits at your magic price?

- How can you use the fact that the more expensive some things are, the more some people want them?
- How have you seen other businesses tackle pricing? Can you adapt what they do so that it works for your business too?
- In how many ways do you currently charge different customers different prices?
- How can you use the idea of trade-ins to charge different customers different prices?
- What can your price-conscious customers trade in, or do something for you, in order to qualify for a lower price?
- Can you launch several different versions of your products and services – some at higher prices than others?
- Can you charge different prices in different distribution channels?
- Are there some times when your customers might be willing to pay more than at other times?
- What high value bundles of products and services can you create that will appeal to your price-conscious customers? Remember, you can also bundle in other people's goods and services.
- How can you use those bundles to encourage your price conscious customers to spend more money with you?
- How many different kinds of price lists can you offer to your customers?
- Looking at all the different types of customers your business has, or could have, which types are not willing, or able, to pay as much as your best customers?
- How can you make sure that your other customers can't also qualify for those concessions?
- What are your business' equivalents of a hotel's empty rooms, or a grocer's perishable stock, at the end of the day? How can you use pricing ideas like late availability clubs and end of day sales to sell them to price-conscious customers, before they become worthless?
- In how many ways can you get feedback about what your customers regard as fair? For example, can you use questionnaires, telephone interviews or focus group meetings?

- How else can you involve your customers in designing a fair pricing structure?
- Have you seen other businesses charge different customers different prices? If so, how can you adapt what they do so that it works for your business too?
- What systems do you need to be able to charge different customers different prices?
- How can you test your range of different prices to make sure that you really are charging customers what they are willing to pay?

How to systemise your business for growth

This final growth driver is the glue that holds all of the other drivers together: **turning all of your growth drivers into efficient systems.** In the E-Myth Revisited, Michael Gerber reminds us that if you don't have proper systems in place to run your business, you're operating on luck. When you create and use great systems, then growth just happens automatically.

As we saw earlier, if you want to get the best possible results, you've got to *have a plan* and you've got to create *systems* – so that you do the right things, every single time. Then you've got to keep testing different systems to see which work best, and train your team so that they can use those systems. After that, you've got to measure the results.

As we have looked at each of the growth drivers, I have continually stressed the importance of turning every idea into a system. As a result, you have already seen the immense benefits of having growth-orientated systems such as:

1. Referral systems
2. Other lead generating systems
3. Lead conversion systems
4. Systems for getting customers to spend more
5. Systems for getting customers to spend more often
6. Systems for getting customers to remain as customers for longer; and
7. Pricing systems

You don't only need systems for growth though. You also need systems for everything else. And these systems need to be *excellent* systems. You see, when you have excellent systems for everything that matters:

1. Everybody will be able to do everything to the same high standard by following those systems.
2. The business will do things consistently well – which means far fewer problems, hassles and complaints.

3. You will generate a consistently better result – which means you'll earn more every year, and your business will also be worth more when you eventually come to sell it.
4. Its success won't be dependent on you, or on anyone else – since it will be systems-dependent rather than people-dependent.
5. You will, personally, be able to choose what you do (perhaps the things you enjoy the most) and how much time you spend doing them.
6. You will be able to enjoy the lifestyle that is exactly right for you.
7. The business will be very much easier to sell – as they always are when they can be run just as easily by the new owner because they are not dependent on the previous owner's personal input.

Part 3
Cash is King

The key business drivers that affect cash flow

Generating more sales is only worthwhile if you collect the cash. There are seven (again!) key business drivers and all seven impact on cash flow. Some of them we have discussed already in earlier chapters, but here I am going to specifically consider how they can become the cause of a cash flow problem and what you can do about them to improve cash flow.

Key Business Driver	How to improve cash flow
Sales (growth or decline)	Know your break-even point; Prepare a budget and cash flow forecast; Invoice regularly (preferably every day); Create clear terms of business on invoices; Ask for deposits; Don't discount; Make 'offers' self-financing.
Pricing	Review prices at least quarterly; Link prices increases to cost increases; Analyse sales and margins to determine most your profitable products and services; Compare industry benchmarks on prices and margins; Price by customer type or area; Use pricing strategically to demonstrate value; Don't discount.

Cost of goods/services sold	Regularly review your margins by product and service; Develop a costing system; Create a process to review supplier pricing and get comparative quotes; Create a purchase order system; Automate a process to choose the 'best' cost; Compare industry benchmarks on costs and margins; Join a buying group; Understand the difference between costs and overheads; Allocate overheads in your costing system; Review your labour recovery and utilisation rates.
Overheads	Prepare a budget and cash flow forecast and update monthly; Create a process to review supplier pricing and get comparative quotes; Report actual v budget in your monthly accounts and take action on variances; Create a purchase order system and sign off each order; Don't allow staff to make buying decisions in excess of their budget; Create competitiveness amongst suppliers; Ask for loyalty discounts and bonuses.

Accounts receivable (debtors)	Provide excellent service; Create clear terms of business on invoices and statements; Ask for cash up front or deposits; Carry out credit checks; Invoice regularly (preferably every day); Include payment due date on invoices; Provide as many payment options as possible, including credit card; Set up a direct debit facility via GoCardless; Automate a process for identifying overdue amounts; Follow up overdue amounts immediately; Send statements once a month; Send thank-you notes to on-time payers.
Inventory	Develop an inventory management system that integrates with your accounting system; Develop a costing system; Record all goods in and out; Reconcile your inventory management system to your physical stock monthly and investigate discrepancies; Monitor wastage and depletions; Create a quality control system to eliminate re-work; Rotate stock regularly; Follow up purchase orders.

Accounts payable (creditors)	Negotiate terms and discounts; Take advantage of settlement discounts; Respond to short deliveries promptly; Reconcile statements from suppliers; Match invoices with purchase orders and goods in notes; Automate a process for identifying amounts due for payment.

This is by no means an exhaustive list, but I have found that businesses that implement as many of these processes as possible have fewer cash flow crises.

Appendix 1 – About the author

Noel Guilford is a Chartered Accountant, entrepreneur and author. After leaving University he joined Arthur Andersen & Co. with whom he trained and qualified before joining Spicer& Pegler (now part of Deloittes) as Managing Partner of their Chester office. After moving to Manchester as a partner in Deloittes in 1990, he specialised in Corporate Finance acting as lead advisor on numerous acquisitions, disposals and management buyouts.

In 2002 he left and set up Guilford Accounting, a small business accountancy practice specialising in advising owner-managed businesses on current accounting, finance, and tax matters. He is the author of the *Figure it Out – an Entrepreneurs Guide to Understanding your Business Numbers* (2014) and *How to Build a Successful Business and Achieve the Lifestyle You Want* (2018).

His next book, *Journey into Freedom – How to start and run a sustainable business*, will be published later in 2018.

In 2015 he co-founded My Business HQ Limited which creates business opportunities for people for whom fitting into a conventional 9-5 job may not be an option because they want flexibility in their day to day lives.

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Appendix 2 – Why accountants use estimates and assumptions in accounts

'Accounts' is actually a misleading word, because there is no such thing as one set of *accounts* for a business. The fact is that different types of accounts can be prepared from the same information for different purposes.

So for example the following are all '*accounts*' that can be prepared from your 'books':

- Receipts and payments accounts: these are just a summary of receipts into and payments from your bank accounts;
- Income and expenditure accounts: these take the receipts and payments accounts one step further and include debtors and creditors;
- Full (accrual) accounts: these take the income and expenditure accounts one stage further and include accruals, prepayments, provisions, taxes and any other adjustments. Although they are rarely called *accrual* accounts in practice. If your business is relatively straightforward there is no reason why you cannot prepare these yourself.

So, how do you know which is which, when you are presented with a set of accounts? The answer is you don't unless the person who prepared them has been kind enough to tell you!

"But there must be" one client once said to me" because my previous accountant did my VAT return from my *accounts*".

"So which VAT basis are you on?" I asked "Because there are several, and it depends which basis you are on which set of accounts he used"

Even more confused, I explained that:

- If he is on the cash accounting basis then all he needed was the receipts and payments accounts;
- If he is on the accruals basis he only needs the income and expenditure accounts; and

- If he is on a flat rate scheme he doesn't need either – just his sales figure.
- He actually didn't need the full accounts to prepare his VAT return at all!

This is why finance and accounting seems to be complex when it really isn't, and why your accountant may well confuse you with jargon when he doesn't (or shouldn't) mean to.

There are a couple more things you need to know about accounts (and, when we use that term, from now on, we will be referring to the **full** accounts, which include the accruals, prepayments, provisions and taxes).

Accountants use estimates and assumptions

Accounting is not an exact science; in fact it is more of an art than a science because the accounting records only get you so far. In fact, we like to say that they don't show the whole picture. Like all good artists, however, we want to show the clearest picture we can, so we add bits here and there to do just that. These *bits* are estimates and assumptions about what the accounts would look like if the accounting records had all the information at the time we needed it. But this is rarely the case.

So what you see and read isn't all fact, and where the accounting people have made estimates and assumptions they may have done so without asking, or telling, you. This doesn't matter so much now that you know that there are estimates (and can ask what they are), but it may be that you could have a better estimate than the accounting people, particularly if it relates to your department, or area of expertise. The message is: don't assume the accountants get it right just because their reports look like they should be right.

Accounting rules and regulations

By now, you may be wondering what the accountants get up to all day adding all those bits and making estimates and assumptions, or you may be thinking I am being critical of accountants. Far from it. As I said accounting is more of an art than a science, and the accountants are trying their best to get it right by painting as clear a picture as possible.

To help them accounting does have some rules; these are known as *concepts and pervasive principles,* but like most things in accounting, accountants' *rules* are not quite like other people's rules. Let me explain. If you drive a car, you are used to the rule that on some roads there is a speed limit and a sign which tells you how fast you can drive: 30mph for example. In accounting, that rule would just tell you not to drive too fast without being specific about how fast that is!

There are several of these rules, but the overriding 'rule' is the one stating that *'the objective of financial statements is to provide information about the* ***financial position***, ***performance*** *and* ***cash flows*** *of an entity that is useful for economic decision making by a broad range of users.'*

To achieve this accountants employ two principles: **prudence and matching**. A full explanation of accounting principles if beyond the scope of this book, but it is useful to understand that accountants are required to make judgments and in doing so they need to be cautious and prudent. Prudence is a key accounting principle which makes sure that assets and income of a business are not overstated and liabilities and expenses are not understated.

The matching principle requires that income and any related costs and expenses be recognised together in the same accounting period. Thus, if there is a cause-and-effect relationship between income and the costs, they should be recorded at the same time and in the same accounting period. This is one of the most essential concepts in accounting, since it mandates that the entire effect of a transaction be recorded within the same accounting period.

Despite these principle being quite easy to state, there remains a great deal of judgement required – and debate amongst accountants – as to their precise application in given circumstances.

Financial position

The financial position of an entity is shown in its balance sheet (sometimes called the statement of financial position) and is the relationship of its **assets, liabilities** and **equity** at a specific date.

- An **asset** is something owned by the entity as a result of past events, and from which an economic benefit is expected to flow.

- A **liability** is an obligation owed by the entity, the settlement of which will give rise to an outflow of resources, usually cash.
- **Equity** is the residual interest in the assets after deducting its liabilities.

So	Assets minus liabilities	= Equity
or	Assets	= Equity + liabilities

Hence the name *balance sheet*; the amount an entity owns (its assets) must equal the amount it owes (its liabilities plus equity). The reason equity is an amount it owes is because it owes this amount to its owners.

The reason the statement is drawn up to a specific date is because it is changing all the time; in a vibrant, ongoing trading business assets and liabilities are being generated, and settled, respectively, and equity (the amount the entity owes to its owners) is, hopefully, increasing, as the business makes a profit.

Financial performance

Financial performance is the relationship of the **income** and **expenses** of an entity during a period of time; put more simply, the difference between income and expenses is either the profit or loss made during a period of time (such as a week, month quarter or year). The profit or loss either increases or decreases the equity in the business. The reason is (and let's assume that income exceeds expenses and the entity earns a profit) that the profit must belong to someone. That person is the owner and we have already seen that equity is the amount owed to the owner of the business. So if, over a period, the business earns a profit then equity must go up.

We can now add to the balance sheet equation:

Previously	Assets = Equity + liabilities
Later on	Assets = (Equity + profit) + liabilities
Can also be expressed as	Assets = (Equity + income - expenses) + liabilities

The final statement is the **statement of cash flow**; fortunately this one is the easiest to understand because it does what it says. It states the cash that has flowed into, and out of, a business during a period of time.

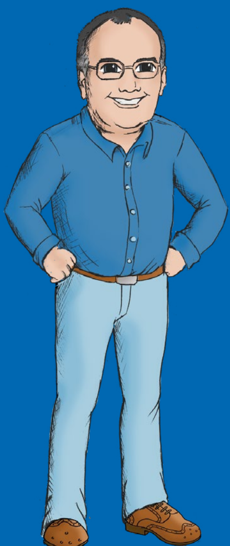
If this seems confusing, don't worry. It is not essential for the understanding of your business numbers, but it is fairly simple, and logical, and about as complicated as accounting gets. Often when I explain this to people they look at me and say "Is that it? We thought accounting was complex: why do accountants surround something that straightforward in mystery?"

Why are the vast majority of business owners no better off than they would be in a job? Why are financial certainty and financial independence only a reality for such a small minority?

Compared to an equivalent salaried job, most self-employed people earn 20%-30% less than their salaried counterparts, while some earn as little as 50% of their salaried counterparts.

This seems to make no sense until you realise that **some** people who are self-employed earn ten to twenty times more than their salaried counterparts. There **must** be something they are doing differently from everyone else to get these results.

In this book I'll show you the business numbers you need to know to increase your profits and cash flow and the seven strategies you can learn and adopt to build the successful business you imagined when you started your entrepreneurial journey.



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