So you own your own business, and you’re pretty much the senior management team. You’ve looked at the economy and your company’s marginal bottom line, and decided you need some preventive medicine if not a full shot. You decide to call a management meeting to see what your team thinks can be done to keep you out of trouble. Your sales manager, plant manager, controller, and CFO are all with the best ideas, and you have to evaluate those ideas before you decide what strategy to follow. Here are some suggestions:

• your sales manager thinks you should lower prices so the sales team can sell more.
• your plant manager thinks you should borrow money and acquire the latest technology in manufacturing equipment in order to boost productivity.
• your controller thinks you should cut costs so that you spend less (although it may not be clear on where those costs should come from).

You know in your heart that none of these strategies is the magic bullet, but you don’t have any strong answers of your own because you’re too busy running the business. Let’s see if we can help to focus your thinking. Here’s how we suggest you evaluate your sales manager’s idea:

Your sales manager’s suggestion: Many sales people would rather see lower prices because it makes their products easier to sell—at least if they’re selling based on price and competing based on price. But that strategy without careful thought can seriously dilute gross margins and damage the company’s profit invisibly. Competing on price with an uncompetitive pricing strategy will eventually reduce your products to a commodity where only the lowest price wins.

A better idea: Most surveys of customer buying motivation put price down the list of reasons why customers buy. Instead of focusing on price, sales managers should focus on selling the attributes of a product that are unique to your business. These attributes are the intangible attributes that you believe your customers will find compelling. They are the benefits that will add value to the company’s bottom line that comes from making a sale. Until you know that number, approach any sales price reduction with great caution, and only as a last resort.

Your plant manager’s suggestion: A dedicated plant manager who sees production efficiency as the ultimate path to profitability—not necessarily a bad idea when taken in context—may think the key to improved productivity is to acquire the latest technology in manufacturing equipment, even if it means borrowing money to buy the equipment. A good plant manager will want to acquire the best production equipment to boost productivity and the latest equipment. They will not typically grasp the amount of profit improvement or time it will take to pay for the investment. Instead, a good plant manager will conduct an analysis that you would expect from your plant manager. But if you can’t afford to analyze your finance staff you shouldn’t buy the equipment, and a good banker is unlikely to lend you the money in any case, because they want to know that too.

A better idea: Effectively managing a capital acquisition program for your business requires an understanding of Return on Investment (ROI) and its more advanced cousin Discounted Cash Flow (“DCF”). These tools will tell you whether or not that new equipment will pay for itself in 3 years, or 5 years, or 20 years (by which time you may not care). A comparison of what you’ll pay out with what you’ll save in productivity gains, adjusted for the time value of money, is the magic that should guide such decisions. If you know it, your banker will be impressed and likely glad to lend the money. If you don’t, your banker will try to estimate it for you, and it’s likely you’ll add something to the interest rate to compensate for the added risk of lending to someone who doesn’t realize how important such decision making tools are to your business.

Your controller’s suggestion: Controllers and analysts in general are trained to look for the value in terms of a bottom line way to ways to boost the bottom line. They will tell you that a dollar in added sales will add only a fraction of a dollar to your profits, while a dollar in cost reduction adds a full dollar to profits. And they’d be right. But that doesn’t make it always the right answer, and often it’s actually the wrong answer. Cost cutting solely to avoid spending money is likely to cause more damage than good because it’s focused on the wrong problem.

A better idea: A client company we worked with some years ago had avoided replacing collection department staff turnover in order to lower labor costs and thus raise reported profits in preparation for selling the company under a profit-based formula. Yikes! A good example of a bad cost cutting idea. Instead we supplemented the remaining collection staff with strong collection professionals and in short order raised revenues so much that we added $5 million to the ultimate selling price.

Cost cutting must be selective and be best planned in advance. Even in challenging times, e.g., a recession, prudent investing is often better than ill-advised cost cutting. Developing a budgeting system that allocates your resources in the best possible manner, making spending decisions and setting key targets ahead of time, not when you’re trying to improve next month’s profits “on the fly.” Put your money where your magic thinking is, and what would be best for the company. Budgeting is not about cutting costs, it’s about allocating resources in the best possible manner, based on thoughtfully considered choices.

It’s sound management to get your team’s views about important decisions. But recognize their thinking is based on plant work not to product level. This is why you might want to mold them to where you feel your company needs to go.

If you want an independent opinion from a outsider’s who’s done a lot of profit improvement programs over the years, call us at 312-645-1091 or 888-788-6534. Or e-mail us for more information.

Gene Siciliano, CFO for Rent®