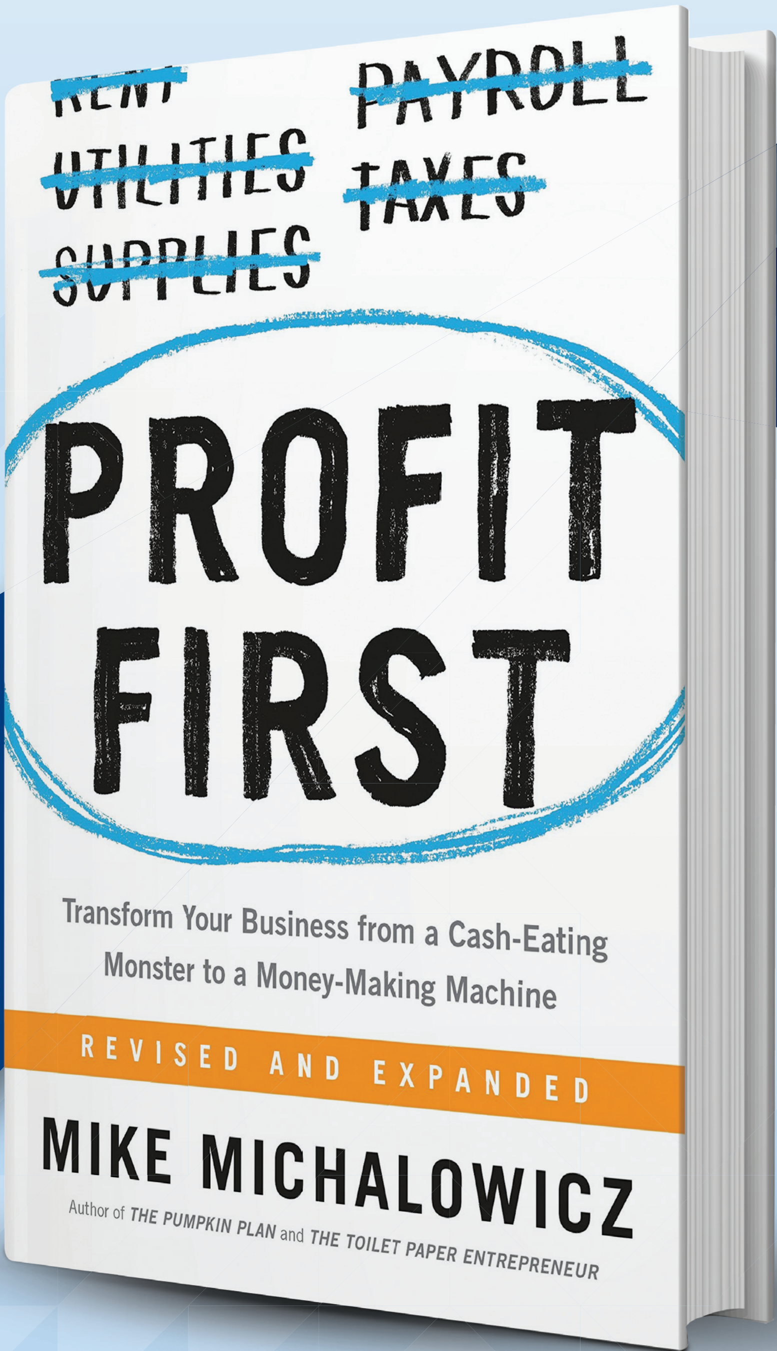
thebestofeastbourne

OVERVIEW OF



Summary

Foreword

Here at thebestof Eastbourne, we're dedicated to help your business grow through effective marketing and business growth ideas.

But all of that is pointless if you don't tie it in with effective "numbers" management. Looking after your profits from all the marketing you should be doing is equally as important as the marketing and selling itself.

The Profit First system has helped numerous entrepreneurs across the globe to gain a profit from their business. Some of these businesses had been operating without a profit for more than a decade before their owner implemented the Profit First system.

Some experienced success within as little as four weeks of adapting the system.

The following are summarised portions of the book that capture the essence of what the Profit First system is and how you can get started.

We highly recommend that you explore it and open your mind to the magic that can happen in your business when you simply take your Profit First.

David Ruddle
thebestof Eastbourne

Chapter 1

50% of businesses fail within the first five years. Many of these businesses fail because of over emphasis on growth which leads to debt.

The truth is that growth without financial health will kill your company.

Money enables the business to function; without it, nothing is possible. With the overemphasis on growth, there is often no money left after covering operational expenses and the bigger the business gets, the more expenses there are to cover. This leads to money problems. These problems either happen when sales slow down or when they speed up almost too fast to keep up with them.

You need a mindset shift where the focus is not on growth, but on profit.

Profit is not an event. Profit is a habit. Focusing on profit will give you an opportunity to find ways to grow but focusing on growth rarely, if ever, gets you to profit, even when that is the ultimate goal.

You can't grow out of your profit problem.

Most entrepreneurs do ‘bank balance accounting’ meaning we constantly check our bank accounts and depending on the balance we react. If we don’t have enough to cover our bills the reaction is usually to start scrambling to source the funds even if we have to incur debt to achieve this. This type of behaviour is well ingrained and hard to change. It is called **the Survival Trap**.

The Survival Trap is ineffective because it is reactionary. It is not about going toward the vision; it’s about taking any action to get out of a perceived crisis.

Generally accepted accounting principles support this type of behaviour and logically, the principles make sense. You are supposed to start with sales (the top line), subtract business expenses and then what is left over is your profit (the bottom line).

But that approach places profit as an afterthought

Profit First puts profit first. To implement it, you don’t have to stop checking your accounts. Infact, Profit First taps into this very habit and will show you at a glance where you are with your finances. **The Instant Assessment** is the first step on the Profit First journey.

Chapter 2

Several behavioural principles and practices help explain why Profit First works.

The Profit First system has an alternative formula:

Sales-Profit=expenses.

We are all familiar with Parkinson's Law which basically states that the demand for something expands to match its supply. This law applies to our adjusted behaviour when we see the almost empty tube of toothpaste, and even a full plate *(that we almost don't realise is a smaller plate than we normally use.)* We simply change and adjust based on what is available.

With the Profit First system, less money will be available for other functions which will encourage innovation.

The Primacy Effect states that we place most significance on what we encounter first. In the normal business we encounter sales and expenses first and profit as an afterthought. We therefore unconsciously see profit as an afterthought.

With Profit First, it is the opposite. You take your profit first and that is where your focus is directed. If there is not enough left after the deductions, it means there needs to be some changes in efficiency as you can't afford some of your expenses.

The saying ***'out of sight, out of mind'*** applies to temptation. If our weakness is out of immediate reach, we can usually resist it. As you generate profits with the Profit First system, this is the approach you are going to take. Make it as difficult as possible to get to your profits once you disburse them.

Establishing a pattern is another behaviour that will help keep you on track. It works for forming habits and it will work for the Profit First system. You will do allocations and payables twice for the month, (on the 10^{th} and 25^{th}).

The first step you should take in implementing the system is to set up a bank account at your bank and nickname it Profit. From the start, transfer 1% of every deposit you make to your profit account. Trust the process. It seems small but the goal is to win over your mind. Your journey has begun.

Chapter 3

Most entrepreneurs find accounting systems complicated.

Profit First is designed so that you can quickly see what your bank balance is like.

There are five accounts that you need to set up for it to work. They should all be current accounts. These are:

1. **INCOME**
2. **PROFIT**
3. **OWNER'S COMP**
4. **TAX**
5. **OPEX: This can be your existing main bank account.**

The next step is to set up two **"no-temptation accounts"** at another bank to keep the funds out of sight.

These can be savings accounts and should be named **TAX HOLD** and **PROFIT HOLD**. Transfer funds to these accounts only from their corresponding main accounts.

Do not accept convenience options for these accounts.

If you have not been profitable in the past, do not be deterred and **do not try to do this with spreadsheets.** Your past practices have not been working. It is time to take action.

Chapter 4

Profit First is a cash management system.

It is really simple:

Did you get the cash or not? And did you spend the cash or not?

That's it.

The Instant Assessment is one of the first steps to take and can be very eye-opening. A printable version is available from our website.

It is designed to give you an idea of where your business is at this point in time.

	Actual	T.A.P. (Target Allocation Percentage)	Profit First £	DELTA (Actual - P.F. £)	FIX (Increase or Decrease
Total Sales Revenue	A1				
Materials & Sub-contractors	A2				
Your 'Real' Revenue	A3	100%	C3		
Profit	A4	B4	C4	D4	E4
Owner's Comp.	A5	B5	C5	D5	E5
Tax	A6	B6	C6	D6	E6
Operating Expenses	A7	B7	C7	D7	E7

In the columns fill in as follows:

A1: Top line revenue for the past 12 months.

A2: Materials and Subs.

A3: Real Revenue (Top line revenue- materials and subs).

A4: Actual profit for the last 12 months.

A5: Regular payroll distributions you paid yourself.

A6: Tax paid by your company on your behalf.

A7: Total expenses for the last twelve months.

N.B: A3 should be equal to A4+A5+A6+A7

A3+ A2 should be equal to A1

If something is off, adjust the operating expense number up or down (A7) to get the real revenue to balance.

The next rows will include your target allocation percentages or TAPs. These are targets and not the actual figures you are starting with. These are typical ranges and can be adjusted for your specific business.

	A	B	C	D	E	F
Real Revenue Range	£0-£250K	£250K-£500K	£500K-£1M	£1M-£5M	£5M-10M	£10M-£50M
Real Revenue	100%	100%	100%	100%	100%	100%
Profit	5%	10%	15%	10%	15%	17%
Owner's Comp	50%	35%	20%	10%	5%	3%
Tax	15%	15%	15%	15%	15%	15%
Operating Expenses	30%	40%	50%	65%	65%	65%

B4-B7: Enter the profit first percentages in the TAP column based on your real revenue range.

C3-C7: Multiply the real revenue by the TAP for each row and enter the figure in the PF$ row.

D4-D7: In the Delta column, take the Actual number and subtract the PF$ number. A negative number means that category is losing money.

E4-E7: If the number in the Delta section is negative, put increase in the corresponding FIX cell. If it is a positive number, put decrease. This cell gives a quick look at what needs to be done to correct any problems, whether it is increase or decrease the amount being spent in a particular area. You were able to get to this point by being frugal. It is possible to do it again by being innovative.

If your business is brand new, it is the perfect time to start developing good habits.

Use the percentages given but use 1 percent for profit allocations, 50% for OWNER'S COMP and 15 percent for the TAX account. Completing this vital action step can be overwhelming but it is the beginning of forming a habit.

Chapter 5

Since the Initial Assessment is based on ranges, the numbers are not perfect but they are a good starting point.

One of the main problems entrepreneurs face is getting bogged down in the details in these initial stages. This is analysis by paralysis and the pursuit of perfection means nothing actually gets done.

If you want to get more accurate TAPs for your industry, you can average the statistics from the annual reports of five top companies in your industry for a profit TAP.

On the other hand, you may start by taking action too big and too fast.

The TAPs are not and should not be your starting point. They are goals. Your business may even have better numbers at this point. This is where current allocation percentages (CAPS) come in. This is where your business is today. For instance, your business might be at a zero percent profit CAP. The approach is to start with taking 1 percent and then gradually increase by percentage points each quarter.

Your profit allocation will also serve as your rainy day fund so it is in your interest for it to grow as quickly as possible.

For your Owner's Comp TAP, your salary should be on par with the going rate for the work you do, in other words, the salary you would have to pay your replacement.

For your Tax TAP you can either average the amount you have paid in recent years, get an estimated YTD from your accountant or use the average prevailing rate for individual taxes at your income rate in the country you reside.

After you allocate the amounts into your PROFIT, OWNER'S COMP and TAX account, the amount left is for expenses. Adjust the numbers in your Initial Assessment chart if necessary, and then set your CAPs.

Your CAPs should be 1 % better than you have done historically. This means you "increase your profit, Owner's Comp and Tax all by 1 percent and cut your operating expenses by 3 percent.

Chapter 6

The Profit First system is something you implement day by day, month by month.

1. Tell your people

Try to get your accounting team on board. Introduce your accountant/bookkeeper to the Profit First method. If they are not supportive and cannot give accurate reasons why it will not work, try to find a new team. If your accountant tries to dissuade you, change accountants.

2. Set up your accounts

You should have the five main accounts and the two accounts at your no-temptation bank. Rename each account by adding the CAP next to the account name and also put the TAP in parenthesis. For example: "PROFIT 8% (TAP 15%)". This should be done for all accounts.

For your first day, we start at our Day Zero contribution levels. These are your historical percentages but then you increase your profit, Owner's Comp and Tax all by 1 percent and cut your operating expenses by 3 percent. These are designed to make the transition as easy as possible.

3. Make your First Distributions

From the amount in your OPEX account (original primary account) subtract any outstanding checks and payments and transfer the remainder into your INCOME account. Divide the money in the INCOME account into all the other accounts based on the CAPs.

Any future deposits you make should be immediately divided in this way.

4. Our First Day, Our First Celebration

Congrats! This is the first step and you have taken it.

Week One: Cut Expenses

Now that you have a clearer view on your finances, you can see that sales need to increase and expenses need to be cut. Both are possible.

In order to start decreasing expenses, print out your expenses for the last twelve months, and your recurring expenses; then calculate the ten percent of the total that you need to cut.

Ten percent is an adequate number and not just the three percent target because you likely won't see the benefit of the cuts as it will take time to streamline expenses.

Based on the lists, cancel what you don't need for efficiency or customer happiness; negotiate the remaining expenses, except payroll.

Begin to set aside time on the 10th and 25th of each month for paying expenses. Deposit all revenue in the INCOME ACCOUNT and use the 10th and 25th to make the allocations to other accounts, paying your profit and tax first, then your salary to your Owner's Comp account. The remaining amount should be used to cover expenses. If there is not enough to cover expenses, this should be a wakeup call.

Quarter Distributions

At the beginning of every quarter, take 50 percent of what is in your profit account as a bonus. This should not be transferred back to the company in any way. It is for your own personal purposes.

Every quarter, with every profit you celebrate, you will fall more and more in love with your business.

Each quarter, evaluate your current percentages and move them closer to your TAPs. The suggested amount is three percentage points each quarter. It is better to move forward than backward when making these adjustments.

At the end of the first year, if your taxes due are short, this is when you take from the profit account to make sure it is cleared. Also re-evaluate the percentage quarter estimates you were paying.

The remaining fifty percent should accumulate in your PROFIT account as a rainy day fund.

Profit First is a way of life.

It starts with small steps and recurring actions.

Be sure to come up with a "celebration list" with ideas on how to spend your quarterly distributions and profits.

Also make sure to make a habit of clearing the expenses on the 10^{th} and 25^{th} of each month.

Chapter 7

Start adapting the Profit First lifestyle as quickly as possible.

If you are in a position where you have debt, the Profit First system can still work for you. You just have to develop a habit of enjoying saving more than you enjoy spending. Reward yourself each time you are able to meet your targets. Do not be short sighted.

Always keep in mind your twelve-month averages of your best and worst month.

If your numbers fluctuate, especially negatively, it is a sign that things are not yet stable. This is the reason why percentages are so helpful because things change from one month to the next.

The first step is to stop accumulating debt. Get your income statements, you regular monthly payments, credit card statements, loan statements and any other statements related to debt and classify line by line expenses according to the following designations:

P - any expense that directly generates profit

R - expenses that can be replaced with an alternative

U - unnecessary expenses

Also highlight all recurring expenses.

Determine the difference between your current monthly operating expenses and what it should be according to your Instant Assessment.

Evaluate each category and start cutting and renegotiating what you can.

If you have to cut staff after extensive re-evaluation, you must do so.

Stop direct debits that are not profit generating and pay by cheque or BACS instead

Small actions can have big rewards over time.

When you have debt, initiate a debt freeze and cut your expenses by ten percent.

At this point you can use 99 percent of your profits to go towards debt, but do not sacrifice that 1 percent for yourself.

Pay off your debt from the smallest one to the largest until you are debt free.

Chapter 8

Money is everywhere. You can streamline and innovate your business by asking yourself how you can achieve the same or even better results with less or more efficient effort.

You can find a way to do more with fewer resources.

The Pareto Principle is useful in understanding how this can work. In a basic sense, 80 percent of results come from 20 percent of efforts. Twenty percent of your clients are likely responsible for eighty percent of your revenue.

Focus your efforts on the twenty percent of your business that is making you money and try to duplicate those. This applies to your clients, employees and your systems.

Chapter 9

Profit First Techniques can be customised for your business. The strategy is simple, when in doubt, add an account.

When you can clearly see how much is available to you, you can make more accurate decisions.

Examples of Additional Accounts:

- **Stock Account**
- **Materials Account**
- **Subcontractor/Commission Accounts**
- **Employee Payroll Account**
- **Equipment Account**
- **Petty Cash Account**
- **Prepayment Account**
- **VAT Account**

It is important that you document your process for your accounts so that your accounting team can take over the process.

In adapting, don't think about totals like monthly operating costs. This shifts your focus from profits back to expenses. Focus on your required income for allocation twice per month on the 10^{th} and the 25^{th}.

Chapter 10

The Profit First lifestyle allows you to implement restrictions, which, if done properly affords you freedom in each area of your life, both business and personal.

Your approach to personal accounts can be the same, just do the allocations for retirement, holidays, debt and day to day expenses along with any other designations you see fit. Cut off the expenses you do not need. After you have cleared off your debt, lock in your lifestyle.

Organise your finances so that your expenses do not increase to match your new financial freedom. When your income increases, put away 50% of the increase.

We know of a gentleman who runs a hotel with his wife and they are a real-life example of a business who took control of their expenses and saw a huge difference in their profits...

"We have needed to improve our Cash flow for some time but it has been a real struggle recently. The Head Chef leaving made us realise that if I go back in the kitchen for the quiet periods and got a part-time Head Chef in for the busy nights, we can save £575.00 Per week!

However, in conjunction with this I have been taking a large dose of Profit First by Mike Michalowicz and amongst other things he talks about reviewing your costs so encouraged by the salary saving we started looking elsewhere to see where else we can save money.

We looked at the little things that we use a lot of. What if we review suppliers but don't forsake quality?

- Biscuit packets for guests in hotel rooms Saving £8.00 Per week
- Bacon supplier saving £3.00 per Kilo = £30.00 Per week
- Telephone Supplier £15.00 Per week
- Toilet Rolls £5.00 Per week
- Milk jiggers Saving £2.00 Per week
- Strawberries Saving £4.00 per Kilo = £8.00 Per week
- Jam £1.50 per jar = £9.00 Per week
- Marmalade £1.50 per jar = £7.50 Per week

Total (+ £575 wage) £659.5
Per Week = £2,638
Per month = £31,656 per year!"

So without any extra customers or bookings, he's bagged nearly £32K that goes straight to his bottom line!

Chapter 11

The Profit First system requires discipline and consistency.

It would be good if you can get an accountability partner, someone to keep you in check in those moments when temptation gets difficult. A good accountant can play this part really well. Going through the process alone is one of the biggest mistakes entrepreneurs make. An accountability partner can make the process so much easier.

Another mistake people make is allocating a large amount of profit that is unrealistic and unsustainable. The system is designed for small changes over time.

The next common mistake is prioritising growth over profits. What usually happens in this scenario is that the business never adjusts to its own self-correcting size which is what it is forced to do with the profit first method.

One of the next mistakes is cutting the wrong costs.

Reinvesting is another mistake people make. This is really just a cover-up for spending money you do not have. Avoid it at all cost.

Taking money from the tax account for any reason before all taxes for the year are cleared is dumb & ill advised. Bear in mind that the more money your business makes the more taxes you are required to pay.

Do not add any complexity to the system and do not miss out by not creating the accounts. You may be sceptical attention at first but it will benefit you in the end.

You now have all the information you need to start implementing the system, so go ahead...Just do it.

And if you need a partner that can help you create more leads, enquiries and sales to give you more profits to implement the Profit First technique then we'll be delighted to help.

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September 2021