



The 5 Drivers of Your Bottom Line

The Equation For Business

Building a successful company requires hard work, patience, and a positive attitude. The SBDC's formula for success is

Attitude + Aptitude + Amplitude = Altitude in Business

Building your Aptitude is the second step in our formula. The more knowledge and information you gain, the easier your climb to the top will be. Entrepreneurs need aptitude in four major areas:

- The Equation of Business
- The Elements of Business
- The Enterprise of Business
- The Economics of Business

In this article we will discuss the importance of understanding and developing a Business Equation for your company.

There is a basic equation for business that breaks down your financial goal and dictates the basis of your business model.

Every business operates on this equation. In our opinion, the difference between those who survive and those who do not are those who understand and utilize this equation. The equation and an example are illustrated in *Exhibit 1*.

Exhibit 1

Equation for Business

M A R K E T I N G	NUMBER OF PROSPECTS	O R G A N I Z A T I O N A L
	X	
	CONVERSION RATE	
	=	
	Number of Customers	
	X	
	AVERAGE PURCHASE AMOUNT	
	X	
	AVERAGE TRANSACTIONS	
	=	
Total Revenue	OPERATIONS	
X		
PROFIT MARGIN		
=		
Total Profit		



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Many business owners do not know their current equation. After you determine your current equation, you can develop strategies to increase the “Business Drivers”, those areas that you can impact. The 5 drivers are:

Number of Prospects: These are businesses and/or individuals that you define as potential customers. These are your target customers that could purchase your goods or use your services.

Conversion Rate: This is the percentage of prospects that become customers.

Average Purchase Amount : Retail stores and restaurants typically use the average dollar amount spent by customers during a visit. Service businesses usually use either a contract amount or a billing rate.

Average Transactions: This is the number of transactions per customer per year.

Profit Margin: You determine your profit margin by dividing net profit (sales less expenses) by net revenue. If your profit margin is 12%, for every one dollar in revenue received, 88 cents goes to expenses and 12 cents is profit. This percentage is

Drive All Five Equally

A key aptitude taught at the SBDC is that you should develop strategies to make small increases in all five drivers equally as a means to increase profits.

The traditional approach is to invest largely in one driver. *Exhibit 2* demonstrates that a 5-driver approach increases profits greater than a 1-driver approach. (NOTE: Numbers and rates are examples, not any standards)

If you increase “One Driver” by 50% you get a 50% increase in profit. If you increase “Five Drivers” by 10% each (just dividing your effort), you get a 61% increase in profits. **WHY?**

You learned in in the 5th grade. The power of the multiplier effect. Be smarter than a 5th grader and use a basic math principle to grow your business. Plus, it is easier to make minor improvement in five areas of your business. than make major changes in one area.

Exhibit 2

One-Driver Approach vs. Five-Driver Approach			
	Current Year Example	One-Driver Approach Increase one by 50%	Five-Driver Approach Increase five by 10%
NUMBER OF PROSPECTS	5,320	7,980	5,852
X	X	X	X
CONVERSION RATE	7.0%	7.0%	7.7%
=	=	=	=
Number of Customers	372	559	451
X	X	X	X
AVERAGE PURCHASE AMOUNT	\$180	\$180	\$198
X	X	X	X
AVERAGE TRANSACTIONS	6	6	6.6
=	=	=	=
Total Revenue	\$402,192	\$603,288	\$588,849
X	X	X	X
PROFIT MARGIN	12.0%	12.0%	13.2%
=	=	=	=
Total Profit	<u>\$48,263</u>	<u>\$72,395</u>	<u>\$77,728</u>
Percentage Increase Over Current Year		50.0%	61.1%

Your Next Step

Developing and understanding your company’s business equation is critical for the survival of any company. By utilizing the “Five Driver Approach” and developing strategies to increase each driver equally rather than singularly, you can greatly improve your total profit.

Lets select “Average Purchase Amount” as an example. Begin to brainstorm strategically. Ask yourself, “What can I do to increase the amount spent by customers per visit / order?” McDonald’s asked that question to themselves back in the 1970s. They began to have the people ask one question, “Would you like fries with that?” In the marketing world, this is known as the billion dollar question. McDonald’s has generated billions in new revenue over the years with 6 words.

Break apart your business into these 5 areas and statically make small improvements. Ready, take workshops, talk with customers, and look at what other business colleagues (especially your competition) are doing. If you expand your business “Aptitude,” it will definitely help you reach your desired “Altitude.”

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