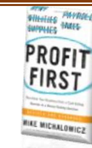
PROFIT FIRST

by Mike Michalowicz



Overview

Most small business entrepreneurs focus on sales and growth, then they subtract out their expenses, and look at whatever profit is left afterwards. If, instead, they took their profit first and set it aside, they would be naturally inclined to look for efficiencies. Such a method works with people's natural habits and tendency to spend what's in their pocket.

Chapter 1. Your Business Is An Out-Of-Control Cash-Eating Monster

While many small businesses and startups fail, many more are taking on massive debt. After his first company, the author bought some luxury cars, and believed he had the golden touch with business. Eventually the next companies he invested in ended up as just piles of bills due to arrogance and overspending. Sales go up, and we raise our expenses to match. We believe that our best month is the new normal.

*"Sustained profitability depends on **efficiency**."*

Growth is, indeed, half of the equation. But focusing exclusively on growth misses the point that if you grow too fast, expenses can rise up and become a vicious monster, while the profits never arrive. Profits should instead be a habitual process, not one-time events to occur at some far-off future time. Don't focus on sales, sales, sales, maybe taking a profit one day.

Most people rarely look at their cash flow and profit/loss statements as often as they look at their bank accounts. We tend to focus elsewhere when the bank account is flush with cash, and then go into panic mode, drastically cutting costs or taking on debt when it dips. We move from crisis to crisis, and every time we solve a crisis, we think we're getting closer to our goals.

It's human nature to look at our bank accounts. It's "top-line thinking" to focus on your revenue first. We are trained to look at revenue, then subtract expenses, then taxes, then salaries, and consider whatever's left over as our profit. Yet humans aren't logical creatures; focusing on revenue and growth tends to make us forget about the expenses which naturally rise to meet that growth. Put another way: we spend what's in our pockets. Profits are an afterthought. We need a system that's simple, and has been designed with human nature in mind. frequent analysis of cash flow and other accounting documents does *not* fit that criteria. The truth is we make many gut decisions based on how much cash is in our bank accounts; that's our habit. And as The Power of Habit says, we regress to our core habits when stressed.

*"We don't want to admit we've been **wrong** in how we've been growing our business."*

Chapter 2. The Core Principles of Profit First

The author was down and depressed after losing his money, and while watching late night infomercials, heard that simply using smaller plates can be enough to lose weight. He realized that smaller plates works *with* our ingrained habits. And similarly for business, we must leverage our existing habits.

Right now, you probably have every dollar in your business going into a large plate, a single checking account, and you're gobbling it up. More money came in, and more was spent (on better office furniture, or better equipment). Sales go up, and expenses rise. Sales dip, and your expenses are still high. In the book "Nudge", the author explained how people who automatically set up their 401(k) deductions tend to stick with them over the long term. It's the same principle here: take your profit first. Create smaller plates, and remove the temptation to spend.

It's like that old toothpaste tube that you use liberally when it's full, but you become extremely clever and frugal when you're down to the last quarter tube.

You want to remove your profit first out of sight, on a consistent rhythm. It doesn't mean to ignore growth.