I was mentoring a small business owner recently who was trying to increase sales and I reminded the owner that increased sales don't always mean increased profits. In fact there are several common income issues that a small business needs to remember.

So, why doesn’t increased sales always mean increased profits? There may be several reasons. First, remember that a sale one month may not mean a payment until several months later. Maximizing income becomes even more difficult when the revenue is seasonal, or only from one customer. In the next few columns, I will address some of these issues.

Today, I will deal with the distinction between profits, income and pricing and how that relationship affects your cash on hand. But I will follow up in future columns with discussions of extending credit, dealing with a situation where the vast majority of your business income comes from a single customer, seasonal income, income from an insurer, and the need for diversifying your business income.

For now, let us consider the relationship between profits, income, and pricing. My observation is that many small businesses withdraw cash from the business under the mistaken impression that they are paying themselves with the profit. But there's a big difference between making a profit and having cash.

You can avoid this misunderstanding, and better determine your actual net profits, by generating and reviewing an income statement. An income statement identifies your gross profit (income minus direct cost of goods sold or "COGS") and your net profit (your income minus all costs). The local SCORE Chapter will be offering a very important seminar on this topic in a few weeks.

Consider this example. Maxine operates a candle shop and also offers candle making lessons. She's priced her lessons lower than her competitors because she considers the lessons to be pure profit. After all, there are no direct costs except her time. Yet, for some reason, when she does her annual audit, her business never seems to make as much money as she expects.

When Maxine runs an income statement she sees that although there are no direct costs
for her lessons, there are operating or fixed expenses associated with them, specifically insurance and her classroom in one end of her business. She had been associating the insurance policy with the retail business but the biggest chunk of the insurance payment was actually attributable to liability insurance for the lessons. When she subtracted the annual liability insurance costs directly from the annual revenue from the lessons, she realized she needed to price them higher in order to justify the insurance expense.

How does this relate to profit? As you can see from the example, one of the benefits of distinguishing profits from income is that it allows you to revisit your pricing. If you see that you're barely profiting from one item or service, you may want to reconsider whether to re-price the item (or discontinue it entirely). In addition to competition, your pricing may be affected by elements such as value, demand, and costs.

One of my SCORE mentor colleagues, Jerry Dallman commented about this topic and said that "A common mistake made by small business owners is pricing too low.” He added that "I've never known a business to go south due to high prices, but I've known a few that did fail due to their prices being too low. Don't sell your product or service short. If you can deliver, charge accordingly.”

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