How to Increase Profit without Increasing Sales?

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Increasing profit has always been the primary concern of the business owners.The first step that comes to the mind of a new CEO, when he or she joins a new company, is to develop strategies for increasing sales in order to increase profit at the quickest time possible. What, perhaps, they may not know is that ***increasing sales is much more difficult than reducing cost.*** Further, the main problem with the "increased-sales" approach is that any increase in sales increases the cost and sometimes decreases the profit.

Why increased sales is not always good?

For example, if a project-based company's current sales / turnover is $100 million and if the new CEO wants to increase the sales by 10% in next 2 years, then he/ she asks the marketing / sales / bid-proposals' team to bid for more projects than now. Assuming the company currently, on average, bids for 20 projects in a year and the order-conversion ratio is 10:1, then the number bids won would be 2 out of 20 and the cost of sales for the 20 bids (assuming 3 % of total sales = $3 million) should be recovered from (or distributed to) these two projects' margin only.

Now, if the sales team has to bid for 30 projects, in order to meet the new CEO's increased sales target of 110 million, then the additional 10 bids will increase the cost of sales at least by additional 3% there by decreasing the profit. This means, increase in sales need not always result in increased profits. Further, the increased sales of $10 million will need extra human resources, office space, construction equipment etc to execute the additional orders.

Another problem with this approach is that the company needs to maintain the new sales figure every year or else it will be required to retrench the additional resources added. Neither route is a bed of roses. When the order-level goes down drastically in the ensuing years, which is more likely to happen due to the ever increasing competition, the burden on the company increases further with decreased sales but without any decrease in the overhead cost.

Conventional /Traditional methods :

The conventional techniques normally practiced are :

- Activity-Based Cost monitoring. Have a close look at all line item expenses and cut costs wherever possible.
- Increase marketing budget in areas that seem to be more profitable to increase sales.
- Reduce high-cost items, perks,allowances etc to employees.

However, if your goal is to increase profit w/o increasing sales, above initiatives increase expenses, decrease the profit or decrease quality or increase attrition.

Alternate Approach to increase profit :

If there is one area that has not been given the attention it deserves in many companies, to achieve our goal of " increased profit without increasing the sales", would be the ***Cost of Poor Quality (COPQ).*** It has been estimated that , on an average, in most companies, the cost of poor quality ranges from 25-35 % of sales. This is an untapped "goldmine" almost all companies are sitting-on unknowingly, but at the same, wondering how to increase profit.

A small reduction in COPQ, say 15%, can result in, on average, increased profit of 4.5% without any increase in sales.

What does COPQ constitute?

COPQ , in short, is the money spent during and after the project or product development because of failures.

Cost of Poor Quality = Internal Failure Costs + External Failure Costs

While the Internal Failure Costs (IFCs) are the failures found by the project team, the External Failure Costs (EFCs) are the failures found by the customer.

Examples of Internal Failure Costs

Rework
Scrap

Examples of External Failure Costs

Liabilities
Warranty work
Product recalls
Lost business
Set-up time

In fact, the **COPQ** is an ***Iceberg*** waiting to destroy the ship (company). What the traditional quality approaches see and address are only the tips of such icebergs in most companies. Larger the company, bigger the iceberg. You can see the iceberg as a threat or as an opportunity . It depends on how you steer the ship off the iceberg.(Picture source courtesy: marketing.com)

Cost of preventing mistakes is always much less than cost of correcting them, hence prevention is always better than inspection. Quality must be planned in not inspected in.

Business recovery through more aggressive marketing might take a little longer time to gain traction and may have short-term negative cash-flow impact but, in the long run, may prove to be effective if the COPQ is first reduced to bearable level.

Talking of a CEO, one needs both, an entrepreneur's skill of "business development (marketing & sales)" and a quality consultant's skill of "cost control (mainly COPQ) through process efficiency (Lean) " in order to increase the profit without increasing the sales during tough times.

Additional sales is not a bad thing at all. It is welcome. However, the cost of sales is of immense importance to the CXOs. If the cost of additional sales outweigh the benefits we get after executing / delivering those additional sales orders, then those additional sales are not worth. Sometimes, sales managers may not be aware of the ***"weak links"*** (constraint) in other silos that limit the throughput of the company, even if they are able to increase the sales figures. The in-executed orders go into backlogs resulting in order cancellation or dissatisfied customers or delivery penalties. Do we want such additional sales?

Instead of looking always ***external*** to increase profit, a CXO may learn to look ***inward*** first, within the company, to tap the goldmine called the cost of poor quality in order to increase the profit for the same level of sales? It is a known fact that most organizations are not in good control of their cost, product mix or processes.

The Sigma Level of most companies is expected to be mostly between 3 and 4 and there is a great scope for implementing Lean Six Sigma concepts to improve profit without increasing the sales by bringing their cost of poor quality down, product mix to right combination, and performance of ***Critical-to-Quality (CTQ)*** process characteristics *stable and capable*.

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