

# Profit Secrets for Small Businesses

*CONFIDENTIAL*

Mark Stevens



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# **Profit Secrets for Small Businesses**

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# LET THERE BE LIGHT

Introduction to  
Profit Secrets

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The best definition of an *entrepreneur* is someone who spends 16 hours a day working for himself so that he doesn't have to work eight hours a day for someone else. Above all else, the entrepreneurial spirit is a determination to go it alone—to single-handedly make the key decisions, assume the risks, and reap the rewards. However, this effort to fly solo can be counterproductive.

Without the give and take of managers and staff, entrepreneurs may fail to question their own policies and practices. Established procedures are followed blindly; there is no attempt to find superior alternatives. In a classic case of pretzel logic, the company does things the way it does them simply because that is the way they've always been done.

Certainly, that's not good enough in today's hotly competitive and demanding markets where major corporations think and rethink every move and where Fortune 500 strategic planners are paid to do nothing but peer into the future. In this environment, emerging ventures can grow and prosper only if the most savvy and sophisticated ways are used to achieve their objectives. They must learn the "profit secrets"—the little-known ways of making and saving money that can propel small firms into the major leagues. By incorporating these "secrets" into their activities, the firms can bolster their bottom line and help assure their survival in an age where Lindbergs are considered eccentrics and multinational corporations measure their earnings in billions of dollars.

## WHAT ARE PROFIT SECRETS?

“Profit secrets” are so called not because of a CIA-type effort to keep them classified but because those in the know keep hush hush about them and because most entrepreneurs don’t bother to ferret them out. The vast majority of business owners are too busy tending to daily crises to introduce and test new management techniques. That’s a mistake. Spending as little as an hour a week test driving updated procedures can cut down on those 16-hour days—or certainly make them more productive.

Sometimes, entrepreneurs are too close to their businesses to notice what’s happening. It’s the old case of seeing the forest but not the trees. For example, a partner in the small business practice of a Big Eight accounting firm tells the following story:

We performed an audit for an aggressive little outfit in the entertainment business. When I came to the chief executive’s office to discuss the initial review, he put on a non-stop bragging exhibition about his wonderful company, that it was the fastest growing outfit in its field, that it had opened twice as many new units as its closest competitor, and that its growth projections were second to none. The guy was central casting’s version of the Lone Ranger entrepreneur, so caught up in his own ego and so convinced of his genius that he never bothered to question his business practices. So it shocked him white when I interrupted his monologue about the greater glories of his company to say, “Pardon me, what you say is all well and good, but do you realize that your firm isn’t making a dime. It’s flat broke.”

Put simply, the auditors found that the ambitious little company was strong on grandiose plans but weak on carrying them out. No one tended to the nuts and bolts of running the business. Invoices were mailed but rarely paid and even the most delinquent accounts kept seeking and gaining additional credit. Debt piled on debt, costs skyrocketed, and expensive and inefficient procedures robbed the firm of potential profits. According to the accountant:

If there was a way to overpay for things, this company found it. Money was being wasted on everything from utilities to debt service. For just about each of the firm’s procedures, I could think of at least three better ways of doing things. But the entrepreneurs

never bothered to look for these options and therefore never benefitted from them.

Lay part of the blame on old-fashioned skepticism. Many entrepreneurs—crusty and cynical as they are—refuse to believe that there really are any little-known business techniques waiting to be discovered. They like to say that “there’s no free lunch and no substitute for experience” and, although that’s true, there are “better ideas” and combining them with experience can make for a more skilled and successful business owner/manager.

The truth is that there are two ways of doing things: the way most people do them and the smart way. *Profit Secrets* is concerned only with the latter.

## WHO HAS THE PROFIT SECRETS?

Where do the “profit secrets” originate? Who conceives of the better ideas? How can we learn of them? Most of the true inspirations come from the minds of top professionals in all the business disciplines—finance, marketing, law, advertising, and administration—and we can share their knowledge by turning to them for advice.

For example, the story is told of the business owner who decides his firm needs the clout and the talents of a world-class accounting firm—one of the so-called Big Eight (Peat Marwick Mitchell, Coopers & Lybrand, Arthur Andersen, Arthur Young, Touche Ross, Deloitte Haskins & Sells, Price Waterhouse, and Ernst & Whinney). He’s heard that the Big Eight are financial miracle workers who can dream up ingenious schemes to save clients bundles on taxes.

So the entrepreneur, armed with a list of the Big Eight firms, sets out to interview each and make his selection. It will be based on a single question which he poses to the managing partner of each firm: “How much is two plus two?”

Arriving at the first of the Big Eight, he asks, “How much is two plus two?” And, quickly, the answer is fired back. “Four.” As this is far from miracle working, he travels to the next firm on his list and then the next, each time asking the now-familiar question and hearing the same uninspired response.

As he is about to give up and write off the Big Eight mystique as just another hype, he visits the last of the firms and once again asks, “How much is two plus two?” This time he knows the effort has paid off. The partner looks up from his polished mahogany desk, cocks his head, and says, “How much is two plus two? How much did you have in mind?”

The moral here is that skilled professionals can be invaluable sources of information when they are willing and able to find the angles—to uncover the clever ways of doing things that go the extra mile, beat out the competition, and arm entrepreneurs with the tactics they need to become profitable and to stay that way. Anyone can add two plus two to get four. It's those who figure out how to make the calculator read five that father the profit secrets.

Says a prominent CPA specializing in Tax Court cases:

You can come up with profit secrets—with adding two plus two to get five—without doing anything even slightly illegal or unethical. Let's say the owner of a small business needs to raise capital. He wants to attract lenders and investors all of whom demand to know the value of the company. The entrepreneur wants to come up with the highest figure possible. Well, he may have a choice of methods in conducting the valuation—a choice that can boost the firm's stated worth and in turn substantially increase its capital raising power.

For example, if the entrepreneur uses the "adjusted tangible book value" method, he takes assets less liabilities (which can be adjusted for intangibles such as good will and deferred financing costs). But, if he uses the "adjusted tangible book value" method, he automatically accounts for increases in the firm's assets, thereby giving the firm a higher price tag. For example, an office building purchased for \$20,000 when the firm was founded, and subsequently depreciated to an even lower value, may have a current market value of \$200,000. "Adjusted tangible book value" reflects the increase. This "asset play" can even make money-losing firms attractive to capital sources.

According to Herbert C. Speiser, a Touche Ross partner,

People think that small companies always want to show they're worth a lot of money but that's not necessarily true. Management wants to report low value when making gifts of stock to children and when appraising shares for estate tax purposes. It wants to show high value when selling the business and when raising capital through the sale of common stock or warrants. The key point is that the owners can influence the stated value by directing how the appraisal is performed.

To show how different appraisal methods can produce different values, take the case of a company with \$1 million net worth,



fully depreciated machinery and equipment with a market value of \$200,000, and an average net earning of \$100,000. The tangible book value is \$1 million, adjusted tangible book value is \$1.2 million, and multiple of earnings value is \$670,000.

The caveat is that the Internal Revenue Service may question widely varying appraisals. A low value set for estate taxes followed soon after by a higher value for stock sales may pose audit problems. The company must consider all of its objectives when deciding on the type of valuation it uses and must be prepared to compromise with the IRS should the figure be challenged. Quite often, the entrepreneur comes up with one value, the IRS with another, and the final figure is a compromise between the two.

Clearly, one must be a practicing professional to be acquainted with the finer points of commercial valuations as well as with the other areas of business expertise. Fortunately, entrepreneurs do not have to hire these professionals in order to pick their brains. Because the leading professional firms want to be known as “sources of information,” they reveal many of their best ideas in trade journals and newspaper stories. Alert entrepreneurs will clip and save these articles, incorporating many of the strategies into their management procedures. One informal study has revealed that cover-to-cover reading of the *Wall Street Journal* during a three-month period produced more than 20 excellent money-making and money-saving strategies for small and midsize businesses. Had the chief executive of our afore-mentioned entertainment firm been taking notes, his auditors may have found more money in the company’s coffers.

Entrepreneurs should not necessarily shy away from hiring professionals. Fees for tax accountants, attorneys, advertising agencies, and the like can generate a bottom-line return many times their cost. By retaining skilled professionals, clients get customized services not generally available through mass-circulated press articles. Profit strategies can be tailored to the entrepreneur’s unique needs and circumstances. For example, Speiser notes,

For tax purposes, one of my clients wanted to put a ceiling on his company’s earnings—a ceiling he could set in advance. To accommodate his needs I came up with a plan that called for switching to the LIFO system of inventory accounting and for establishing a separate company to purchase the firm’s raw materials. Once the plan was in place it worked very simply and had the potential of saving thousands of dollars over the years.