

Assess Organization-Wide Productivity to Maximize Profit

The basics of business are not very complex. Institutions, organizations and individuals have a virtually insatiable need for “stuff.” The concept of business is simply to “make the stuff” and sell it to them for more than the costs you incur. Similarly, the basics of business management are pretty simple. Find ways to continually sell more at a profitable price and cost structure.

Oversimplified? I don't think so. There's value in keeping a focus on the big picture. Organization-wide productivity analysis is a “big picture” analysis of the overall productivity and profitability of a business. It's easily performed using information that's readily available. Just gather the following:

- Annual Revenue
- Annual Gross Profit
- Annual Operating Profit
- Number of Employees
- Total Annual Payroll Expense
- Total Annual Non-Payroll Operating Expense

Once you have these data, just make seven calculations:

- Revenue per Employee
- Revenue per Payroll Dollar Spent
- Revenue per Non-Payroll Operating Expense Dollar Spent
- Gross Profit per Employee
- Gross Profit per Payroll Dollar Spent
- Gross Profit per Non-Payroll Operating Expense Dollar Spent
- Operating Profit per Employee

Here's an example. Stunner Rumlbers, LLC manufactures noise machines. They're like Harley-Davidson motorcycles without the wheels. Just put your Stunner in the back of your pickup or park

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- Good Works Can Be Good Business
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- Enhancements Coming to *The Business Owner Journal!*
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- Business Basics: Gross Profit and Gross Profit Margin
- Companies Whack 401(k) Benefit Programs
- Do You Have the Eyes of a Leader?

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From the Editor

Dear Subscriber:

Are you ready to make some money? Signs of a broad economic recovery abound. For the past year or so, you've been finding ways to reduce costs, add profitable revenue and improve your business. You're now poised for record profits, which are coming. We hope our ongoing series on cost reduction and profit enhancement has provided some easy-to-implement strategies.



David L. Perkins, Jr.

The cover article of this issue is organization-wide productivity assessment. It's a management tool with a value-to-cost ratio — just like we like it. We urge you to make it a regular part of your performance evaluation process. It'll make yours a better, more profitable company.

This issue also announces exciting improvements to our information service! Our mission is to help you make more money and succeed. The improvements — described in detail on page 9 — will allow you to get the information and answers you need faster and more tailored to your needs.

We think you'll find good use for all the information in this issue, and also find value in the enhanced *The Business Owner* information service. As always, it's a pleasure to serve you. Contact us anytime and never forget — you can succeed as a business owner. We can help.

Regards,

A handwritten signature in black ink, appearing to read 'D.L.P.', written in a cursive style.

David L. Perkins, Jr.
Publisher and Editor

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PROFIT ENHANCEMENT

Assess Organization-Wide Productivity to Maximize Profit, continued from cover

it in any pedestrian area of your choosing and for one-fourth the cost of a Harley you can disturb the peace just the same. Stunner's owner, Curtis Stunner, gathered the following data on his business:

Annual Revenue:	\$1,500,000
Annual Gross Profit	\$750,000
Annual Operating Profit	\$250,000
Number of Employees	6
Total Annual Payroll Expense	\$280,000
Total Annual Non-Payroll Operating Expense	\$220,000

At our suggestion, he then made the seven calculations:

Revenue per Employee	= \$1,500,000 / 6	= \$250,000
Revenue per Payroll Dollar Spent	= \$1,500,000 / 280,000	= \$5.4
Revenue per Non-Payroll Operating Expense Dollar	= \$1,500,000 / 220,000	= \$6.8
Gross Profit per Employee	= \$750,000 / 6	= \$125,000
Gross Profit per Payroll Dollar Spent	= \$750,000 / 280,000	= \$2.7
Gross Profit per Non-Payroll Operating Expense Dollar	= \$750,000 / \$220,000	= \$3.4
Operating Profit per Employee	= \$250,000 / 6	= \$41,667

Now these calculations by themselves don't reveal a lot, but put in context they're immensely revealing. Two contexts, really — historical/trend and peer comparison. So we sent Mr. Stunner back to gather prior-year data. We then loaded it into a spreadsheet, made the calculations and created charts to provide a graphical depiction. See the results on page 4.

The table and graphs clearly show the progress Stunner has made the past five years. The business is really hitting its stride. And by maintaining these data in future quarters and years, Curtis will be able to keep a close watch on the productivity of his business. Stunner should share these data regularly with his employees and post the table and graphs on the wall. Make improvement a game that everyone plays.

Peer data are essential

Just knowing your own performance can become immensely valuable. That is, if you put it to use in an effort to improve performance. But a critical question is, what are other companies similar to yours achieving? Maybe if you know that other firms were operating more productively, you'd be even more focused on improvement? Maybe it'd give you more confidence that you could improve? Maybe even vastly improve?

To be sure, Stunner would not be able to find another company that makes the same products, but virtually any specialty manufacturer of gas-powered consumer recreational equipment would provide a

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PROFIT ENHANCEMENT

Assess Organization-Wide Productivity to Maximize Profit, continued from page 3

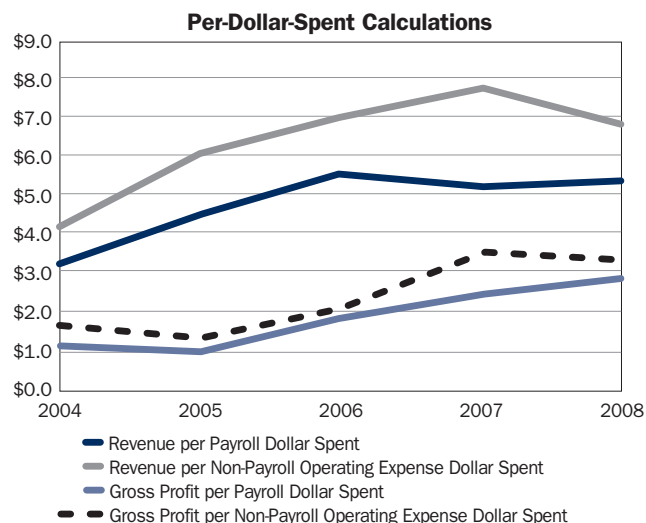
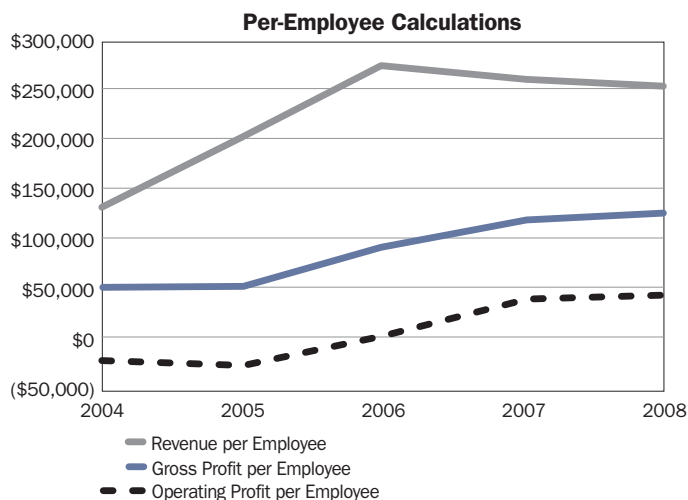
meaningful comparison. And Stunner would want to compare itself to others of similar size. The best place to look for these types of data is your trade association.

Yes, there are other ways to assess organization-wide productivity, but the revenue and profit-based methods are the easiest. This is because we all already track revenue, profit, employee counts, labor and operating expense. Furthermore, revenue and profit get us close to that king of kings — cash.

Productivity can also be assessed using non-financial means, such as the number of units produced per employee per hour. We've chosen to use this article to focus elsewhere.

One could also assess productivity directly by simply observing and recording the percentage of time that employees actually work as opposed to sitting idle, fixing a problem, taking breaks and handling personal matters. The next issue of *The Business Owner* will address this topic — work sampling. □

	2004	2005	2006	2007	2008
Annual Revenue	\$400,000	\$800,000	\$1,100,000	\$1,300,000	\$1,500,000
Annual Gross Profit	\$150,000	\$200,000	\$350,000	\$600,000	\$750,000
Annual Operating Profit	(\$75,000)	(\$115,000)	(\$10,000)	\$180,000	\$250,000
# Employees	3	4	4	5	6
Annual Payroll Expense	\$125,000	\$180,000	\$200,000	\$250,000	\$280,000
Non-Payroll Operating Expense	\$100,000	\$135,000	\$160,000	\$170,000	\$220,000
Annual Revenue per Employee	\$133,333	\$200,000	\$275,000	\$260,000	\$250,000
Revenue per Payroll Dollar Spent	\$3.2	\$4.4	\$5.5	\$5.2	\$5.4
Revenue per Non-Gross Profit Dollar Spent	\$4.0	\$5.9	\$6.9	\$7.6	\$6.8
Gross Profit per Employee	\$50,000	\$50,000	\$87,500	\$120,000	\$125,000
Gross Profit per Payroll Dollar Spent	\$1.2	\$1.1	\$1.8	\$2.4	\$2.7
Gross Profit per Non-Payroll Operating Dollar Spent	\$1.5	\$1.5	\$2.2	\$3.5	\$3.4
Operating Profit per Employee	(\$25,000)	(\$28,750)	(\$2,500)	\$36,000	\$41,667



The Business Owner Series on Cost Reduction and Profit Enhancement Strategies

January-February 2009 Issue:

- > Profit Enhancement Through Cost Reduction: The Time Is Now
- > First Step Toward Profit Enhancement? Break Down Employee Resistance
- > Cost Drivers and Where to Look to Lower Cost
- > Want to Improve Profit? Everything's Negotiable

March-April 2009 Issue:

- > Optimize Your Organizational Structure

- > Cost Reduction: Setting Priorities and Where to Look First

May-June 2009 issue:

- > Peer Benchmarking: Compare Your Company to Others, Find Out What's Possible

July-August 2009 Issue:

- > Internal Benchmarking: Use Historical Performance Data to Enhance Profit

► This Issue, September-October 2009:

- > Assess Organization-Wide Productivity to Maximize Profit

November-December 2009 Issue:

- > Work Sampling: An Inexpensive Way to Assess Employees

January-February 2010 issue:

- > Using ABC Inventory Control to Carve Tax-Free Cash out of Inventory

March-April 2010 issue:

- > How to Improve Your Sales Forecasting

May-June 2010 issue:

- > Product and Service Pricing: Get It Right to Maximize Profit

Opportunity in the Economic Downturn

The big issue today is the economy. Revenue is down for most of you. For most of us. Here are four ways you can seize the opportunity in this downturn.

- 1. Improve your business.** During slow times you have more time on your hands. Ditto for your employees. You're also concerned about the future. So, change the game. There's never been a better time. Take the gift of added free time and devise ways to improve your business. Maybe for you it's a cost reduction effort such as a way to lower the cost of your raw materials. Maybe it's to improve your product or service or create new breakthrough products and services. Maybe it's just a cleanup of your building and facilities or to finally overhaul your website.
- 2. Locate and hire a key player or two.** A poor economy means layoffs. But take heart, some of these unemployed workers could do wonders for your business. When times were good, stealing top talent was difficult, time-consuming and expensive. Not today. The future of your business rests in getting smart, educated, experienced and motivated people to join in. Just one good hire could make a big difference. Now's the time.

- 3. Make that capital investment.** Talented vendors such as software developers and creative agencies are also experiencing the slowdown. As a result, today you can secure them for a much lower price. In addition, you probably have more time to conduct the search, obtain bids and oversee the project. Sure, spending money today might be hard to justify, but keep in mind — now's the time to get more for less.
- 4. Negotiate and lock in low long-term rates.** Whether it's the rental of a facility, network support or an advertising program, consider negotiating a long-term contract at substantially reduced rates. Keep in mind that now's not the time to cut back on advertising. Studies show companies that continue to invest during economic downturns enjoy future growth rates that exceed those that pull back on advertising and marketing.

Rest assured, this recession — like all others — will soon pass. Heed our advice and you'll be a better company — larger and more profitable — when the good times return. □

MARKETING

Good Works Can Be Good Business

from *The Business Owner Blog*

Kudos to The Coleman Company. They're "doing good," staying true to who they are and building a valuable company. They're raising money for Camp Mak-A-Dream — a camp that provides weeklong wilderness experiences for children with cancer. The Coleman Company is a manufacturer of camping equipment. Coleman believes that "spending time in the outdoors benefits body, mind and spirit."

To raise support for Camp Mak-A-Dream, a Coleman senior vice president — Scott Henrickson — will be running the Leadville Trail Ultramarathon (100 miles) and attempt to do it in 30 hours. The event will be held August 22-23 in Leadville, Colo.

"It's going to be torture, but it's nothing compared to dealing with cancer," said Mr. Henrickson, prior to the event. "I'm hoping that we can help make a difference for a cause that we at Coleman are very passionate about."

Kudos to Coleman and Henrickson, and all the companies that find ways to "do good" while also building a successful company. If every company had values like this — and found ways to marry their need for marketing with ways to make the world a better place — the world would be a better place. □

INVESTMENT

You'll Do Well to Heed Our Advice

from *The Business Owner Blog*

The stock market swooned late 2008 and early 2009. In the January/February 2009 issue of *The Business Owner Journal* we urged you to NOT sell your public equity investments. In fact, we argued that it was time to buy, in our article titled "13 Rock-Solid Reasons It's Time to Buy, Not Sell, Public Equities."

Today the S&P 500 is 22 percent above where it stood on February 1.

We cannot know for sure where the U.S. public equities market is headed, but we hope you heeded our advice in the earlier part of the year. And I still urge that, for money you don't plan on needing for more than five years, leave at least part of it in public equities. At least today, we think the downside risk remains low compared to the upside potential. □

"When the passions become masters, they are vices."

Blaise Pascal

The Key to Enduring Business Growth and Success

There is but **one** absolute key to growing an enduringly successful business: continuous investment.

Investment should be in new and improved products, new and improved marketing programs, new technologies, new and improved processes, new and improved methodologies, enhanced skill sets and competencies.

Inherent in investment is sacrifice. When one invests, one delays gratification and forgoes the enjoyment or use of something — typically dollars — in exchange for potentially higher rewards in the future.

When you started your business, what did you do? You sacrificed. You went without a paycheck for a few years. You took risk. You worked day and night in hopes of a future return. In short, you invested.

Inherent in investment is sacrifice. When one invests, one delays gratification and forgoes the enjoyment or use of something — typically dollars — in exchange for potentially higher rewards in the future.

Similarly, think about the time in which your business enjoyed breakthrough growth. No doubt, it followed a period of innovation, sacrifice and investment.

So the question is, are you still investing?

Are you still sacrificing?

I see a LOT of businesses in which all of the income is taken out each year. That is, little is invested toward future growth. The owners take all the profit out to support their “lifestyle.”

This is OK. There’s nothing wrong or immoral about it. My only suggestion is that the business owner(s) be cognizant of the trade-off they are making. They are making a choice, and the choice they are making will result in the slow and steady erosion of the business.

Too harsh? I don’t think so.

If a business’ products and services are not improving, they’ll fall behind to those who ARE investing and innovating. Ditto for marketing methods, sales methods, operating efficiencies, etc.

Look, Microsoft has one of the most dominant products of all time, right? If it were run like many a private company I see, it’d be harvesting lots and investing little. But that’s not the case. Microsoft is run by people who are committed to making sure Microsoft is the leader in 10, 25 and 50 years just as it is today. And so Microsoft continues to invest heavily. In 2008 alone, Microsoft invested \$19.4 billion in research and development, property, equipment and the purchase of other companies. That’s 32 percent of Microsoft’s 2008 revenue and 1.1 times its net income! It invested more in 2008 than it earned in the entire year!!

How about Intel? In 2008, Intel invested \$11.1 billion in research and development, property, equipment and the

continued on next page

Great Companies Invest Heavily in Future Growth, Profit

(All dollar amounts below are stated in billions)

Microsoft

Revenue	\$60.4
Net Income	\$17.7
Research and Dev.	\$8.2
Investment in Prop. and Equip.	\$3.2
Purchase of companies	\$8.1
Total Investment	<u>\$19.4</u>
Patents Granted, 2008	2,030

32% of revenue,
110% of total
annual profit! →

Intel

Revenue	\$37.6
Net Income	\$5.3
Research and Dev.	\$5.7
Investment in Prop. and Equip.	\$5.2
Purchase of companies	\$0.2
Total Investment	<u>\$11.1</u>
Patents Granted, 2008	1,776

29% of revenue,
209% of total
annual profit! →

Caterpillar

Revenue	\$51.0
Net Income	\$3.6
Research and Dev.	\$1.7
Investment in Prop. and Equip.	\$4.0
Purchase of companies	\$0.0
Total Investment	<u>\$5.8</u>
Patents Granted, 2008	430

11% of revenue,
162% of total
annual profit! →

Nike

Revenue	\$18.6
Net Income	\$1.9
Research and Dev.	\$0.5
Investment in Prop. and Equip.	\$0.3
Purchase of companies	\$0.5
Total Investment	<u>\$1.2</u>
Patents Granted, 2008	450

7% of revenue,
65% of total
annual profit! →

Business Owner Imperative: Ensure Continuity

As a business owner, your number one priority is to ensure the ongoing existence of the business. This is why you work each day to earn a profit and produce positive cash flow.

A less obvious but very real threat to the survival of your business is catastrophe — the sudden and unforeseen event that puts you out of business or inflicts long-term damage. Fire, flood, data breach or events that damage your public image or reputation. Or the loss of a vital customer, vendor, license, employee or representative.

Just as the business owner must work each day to secure profit and liquidity, he or she must protect the business from loss due to sudden, unforeseen events.

Here's how:

Step 1: Identify Your Most Critical Assets

Begin by listing the assets you use in the creation and delivery of your goods or services and in the operation of your business. The primary asset categories are facilities, inventory, equipment, personnel, data, network/connectivity, voice, hardware, software, licenses, agreements, relationships and reputation. Add to the list items necessary to prove ownership of valuable assets, rights or interests, such as titles and insurance policies. Rank each asset or asset class from most valuable and/or critical to least valuable and/or critical. Estimate the impact that each asset would have if lost. Gauge the impact in dollars, customer relationships, public perception and contingent liability.

Step 2: List Things That Could Damage Each Critical Asset

Brainstorm about all the things that could damage each critical asset and/or sever you from full access. For an asset such as your website, it could be a failure of your server by fire or flood. For a key employee or vendor agreement, for example, it could be an erosion of a personal relationship or a fire or other natural disaster. For a license, it could simply be non-renewal for unknown reasons. For something such as a patent, it could simply be the passage of time. Whatever it may be, list the things that could cause damage or separation.

Step 3: Develop Mitigation Plans

For each “thing” that could cause loss, develop a mitigation strategy. For example, if a key asset is a relationship with a person or organization, your plan might include:

- i. strategy to reduce reliance on the relationship
- ii. multi-point strategy for keeping the relationship
- iii. development of contractual protections, such as non-compete, non-solicitation or cancellation notice provisions
- iv. transfer of risk, such as the purchase of a key-man life insurance policy

If the key asset is, for example, “inventory,” you might work to:

- i. reduce the risk of fire by installing a sprinkler system and/or updating the wiring in the facility

- ii. ensure full loss coverage with insurance
- iii. develop a strategy for quickly sourcing inventory and securing a temporary place for operations (in case of a loss of the facility)

Step 4: Periodic Review of the Plan

Over time, your business will evolve. Your risk exposures will evolve as well. To be sure you're doing what you can to ensure the continuity of your business, periodically pull out your continuity security worksheets. Go over them thoroughly and update them. Spot new risks and develop and implement strategies for mitigating exposure.

Keep in mind that identifying your critical assets can take some time. List them yourself and then periodically revisit the list. Some key assets/risks can be difficult to spot. Persons of different vantage points and experiences can be of great help, so put some of your employees and advisors on the task. Ditto for the list of risks to each critical asset.

Your most important job, as a business owner, is to ensure the survival of your business. Profitability is essential, but don't forget about the risk in unforeseen events. Identify your critical assets, the events that could damage them, and then develop a mitigation plan for each. □

Just as the business owner must work each day to secure profit and liquidity, he or she must protect the business from loss due to sudden, unforeseen events.

MANAGEMENT

The Key to Enduring Business Growth and Success, continued from previous page

purchase of other companies. That's nearly 29 percent of Intel's 2008 revenue and twice its net income!

Caterpillar? Invested \$5.8 billion in 2008, or 11 percent of total revenue and 1.6 times its net income.

Nike? Something on the order of \$1.2 billion invested in 2008 in research and development, property and equipment and the acquisition of companies. That's 7 percent of 2008 revenue and 65 percent of 2008 net profit.

These companies have been on top for a while. They got there by investing heavily. They'll likely stay there — given their levels of investment.

Are you really committed to enduring growth and success? Are you continuously investing a large portion of your profits? □

“There is no freedom without financial freedom.”

David L. Perkins, Jr.

States Raising Tax Rates

State revenues are down. Many are running deficits. To compensate, some are raising taxes, largely through increases in personal income rates (mostly at higher income levels) and excise taxes (i.e., special taxes on items such as tobacco, alcohol, gasoline, hotel room fees, airport fees, etc.). Some are temporary, or at least are being called temporary right now, and some are permanent.

According to the Tax Foundation, 10 states have increased cigarette taxes (an excise tax) in the first half of 2009: Arkansas, Florida, Hawaii, Kentucky, Mississippi, New Hampshire, New Jersey, Rhode Island, Vermont and Wisconsin. Rhode Island passed New York, New Jersey and Massachusetts this year to take the number one spot with a tax of \$3.46 per pack. Rounding out the top 4 are New York at \$2.75, New Jersey at \$2.70, Hawaii at \$2.60, and Wisconsin at \$2.52.

Massachusetts removed its sales tax exemption for beer, wine, and spirits, subjecting it to its new 6.25% rate. New

York increased its beer excise tax from 11 to 14 cents per gallon and its wine excise tax from just under 19 cents per gallon to 30 cents per gallon. New Jersey increased taxes on wine and spirits, estimated to raise the cost of an average bottle of wine by around 3.5 cents.

Four states have increased their sales tax rates this year: California (7.25% to 8.25%), Massachusetts (from 5% to 6.25%), Minnesota (from 6.5% to 6.875%) and Nevada (from 6.5% to 6.85%).

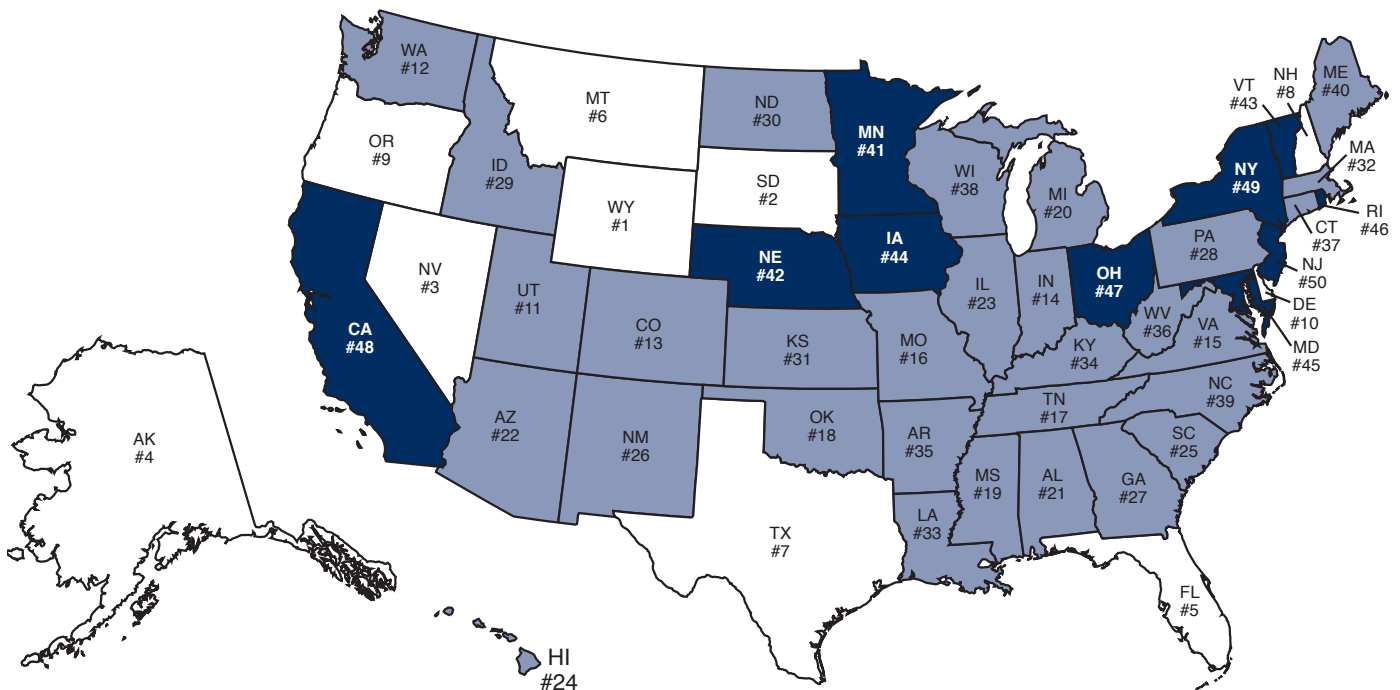
Seven states have raised personal income tax rates. California added 0.25% to each income tax bracket, retroactive to January 1 and expiring on December 31, 2010. Delaware increased the state's top income tax rate by one percentage point, from 5.95% to 6.95%. Hawaii added three new income tax rates on high-income earners, retroactive to January 1: 9% on income over \$150,000, 10% on income over \$175,000, and 11% on income over \$200,000 for single filers. In a ranking of states with the highest top statutory income tax rates,

Hawaii now ties Oregon for first place. New Jersey enacted temporary income tax increases on individuals making over \$400,000 — 8% on income over \$400,000, 10.25% on income over \$500,000, and 10.75% on income over one million. New York added two income tax brackets, 7.85% on income over \$200,000 and 8.97% on income over \$500,000. The new rates are temporary and will be in effect for three years. Oregon enacted two new income tax rates on high-income earners: 10.8% on income over \$125,000 and 11% on income over \$250,000 for single filers. Wisconsin legislators added one high-income tax rate to their rate structure — 7.75% on income over \$225,000 for single filers. Notably, two states actually lowered their income tax rates this year — North Dakota and Vermont.

Only Oregon raised its corporate income tax rates, from 6.6% to 7.9% on corporate income that exceeds \$250,000. Kansas actually reduced its corporate rate a bit, from 7.1% to 7.05% on income over \$50K. □

State Business Tax Climate Index, Fiscal Year 2009

■ 10 worst business tax climates □ 10 best business tax climates



Enhancements Coming to *The Business Owner Journal!*

By David L. Perkins, Jr.

One year ago we set out to find ways to provide more meaningful support to you in your efforts to succeed as a business owner. Through considerable thought, research and study, we found several. Now, after substantial capital investment, we're excited to introduce the enhancements to you. We think you'll find the value of your subscription has been substantially enhanced.

First, we're adding color and going glossy. Beginning with the January/February 2010 issue, *The Business Owner Journal* print edition will be redesigned. Brighter, bolder, and more colorful and interesting to read.

All readers are encouraged to go to www.TheBusinessOwner.com and share their comments and perspectives on our articles and peruse the comments of their peers.

Second, you'll notice — in the print edition — that we'll be working hard to entice you to use our new online services, which are described below.

Third, our entire library of articles is now available online, searchable and no password required! Simply visit www.TheBusinessOwner.com 24 hours per day, 7 days per week.

Fourth, we're publishing content in video and audio formats. By clicking in your e-newsletter or going to

www.TheBusinessOwner.com you can now download *The Business Owner* content to watch on the airplane or listen on your MP3 player.

Fifth, we've begun offering more casual, current-event and opinion/editorial-type articles. The vehicle for this type of content is our blog, which can be found at www.TheBusinessOwner.com/blog. All blog articles will be accessible via our main website. Selected blog posts will begin appearing in *The Business Owner Journal* (both hard copy and electronic) and we encourage you to share your comments and perspectives on each (directly on the website).

Sixth, the ability to share information with your business owner peers. Ponder, for a moment, the knowledge and experience in the collective minds of the thousands of business owners who subscribe to *The Business Owner*. We want to unlock it and provide you with access for no more than the cost of a subscription. Here's how:

Fast and easy article commenting online. Our website will now accept and display comments to every article, video, audio and blog post. All readers are encouraged to share their comments and perspectives, and peruse those of their peers.

A confidential place for business owners to converse and share. We've set up a place called *The Business Owner Forum* and it's accessible via www.TheBusinessOwner.com. All subscribers are invited to post questions, respond to questions, and share ideas and experiences with other subscribers in a password-protected, members-only environment.

Monthly boardroom meetings. At no additional cost, all subscribers will have access to monthly "boardroom" meetings facilitated by staff of *The Business Owner*. Each one-hour meeting will be accessible via telephone and computer, and will include:

- expert presentation on the pre-announced feature topic (approximately 20 minutes)
- open discussion on the topic (20 minutes) among all attendees/subscribers
- open discussion on any topic of interest to an attendee/subscriber

How does this sound to you?

We're excited, to say the least. We hope you'll be open to these new services and avail yourself of them. They were developed with you in mind. □

About the Publisher



David L. Perkins, Jr. owns, writes and publishes *The Business Owner Journal*, the newsletter of

choice for more than 25,000 business owners who are serious about building wealth through successful private business ownership.

Perkins draws editorial ideas and inspiration from his own life as a business owner and investor, and his daily work as a mergers & acquisitions consultant, where he has advised on more than 100 purchase/sale transactions involving both private and public companies. His M&A consulting firm is Acquisition Advisors, which he founded in 1997 and which specializes in transactions valued between \$5 million and \$75 million. Visit AcquisitionAdvisors.com to learn more.

Perkins holds a bachelor of arts degree in psychology from the University of Oklahoma and an MBA from the University of Notre Dame, and has completed the executive education course titled "Mergers and Acquisitions" at The Wharton School, University of Pennsylvania. He also pulls editorially from prior experience in commercial real estate leasing and brokerage, commercial bank lending and private company financial management.

Perkins is the author of *A Concise Overview of Business Valuation* and co-author of *The Business Sale, An Owner's Most Perilous Expedition*. You can buy the former at www.TheBusinessOwner.com.

Contact him at 800-634-0605 or DPerkins@DLPerkins.com.

Smartly Choose Your Modes of Communication

What do you know about the different ways to communicate? Every communication mode — in-person visit, telephone call, hard-copy letter, email — has distinct attributes and deficiencies. As you strive for everyday effectiveness, be aware of their strengths and weaknesses, and select the mode that best serves you.

In-Person Visit

Want to make an impact on someone? Make a personal, unscheduled visit to his/her office or home. The power of the

As you strive for everyday effectiveness, be aware of their strengths and weaknesses of each mode of communication and select the one that will serve you best.

personal visit can be advantageous if you use it wisely. For example, stop by a customer's, vendor's, or old friend's office. Few things can more effectively convey respect, rekindle a relationship or clear up a misunderstanding.

Think someone is being unreasonable? Not taking you seriously? Try a personal visit to his/her office (or home, if it's a personal matter). Conduct yourself in a polite, professional manner, even if tensions are high. Even if he/she does not agree with your message, it will be heard loud and clear.

Phone Call

I know, you're absolutely slammed with obligations and activities. That's a business owner's life. So you use the fastest, easiest way to communicate: email. As a business owner, you can go for a long time without actually talking to people live. Vendors and customers work with your firm through other employees and representatives. Over time, these people lose track of where they stand with you (and you with them) and how you view them. You need to pick up the phone and actually have a conversation now and then. Maybe even arrange to meet in person, just to reconnect. It's OK to have no set agenda — just reconnect and see how things are going. They'll be flattered.

Here's another reason to occasionally pick up the phone — you don't like surprises. No business owner likes surprises. Surprises come when you have not kept in touch with people who are important to you and when you've failed to keep abreast of what's going on with the relationships you count on.

Well-Written Letter

Handwritten letters are nearly a thing of the past, so much so that if you want to stand out from the crowd today, write a letter! A professional, beautifully written letter on quality stationery can make a positive impression. It can also go a long way toward helping you and your message be taken seriously.

It's easy for people to discard emails and delete voice mail messages. If you find yourself being ignored, consider a professionally written letter. In certain situations, cc'ing the letter to your attorney might be just the thing that gets the recipient off high-center. But be sure you're ready and willing to follow through if the recipient calls your bluff.

Email

Email is wonderful. It's also absolutely terrible. We use it impulsively. We misspell. We send hasty messages when our emotions are high. We write incomplete sentences and unclear messages. Do yourself a favor — use email less. Pick up the phone more. Make personal visits.

To be sure, I've suffered gaping wounds from my own poor and impulsive email communications. I'm sure you have, too. We should never use email to discuss, argue, criticize, correct, negotiate or "work things out." It's just not fit for these uses. Use email to transmit factual information, copies of documents and very short snippets of information. That's all.

The table below and the one on page 11 summarize the pros and cons of the four main modes of communication: in-person meeting, telephone call, hard-copy letter, email. Take time to review them and carefully consider your use of each. Choose them and use them wisely, and you'll be more effective — personally and professionally. □

Which Mode of Communication Is Best?

		Communication Method			
		Personal Visit	Phone Call	Letter	Email
Communication Priority	Introducing Oneself	Great	Good	Fair	Poor
	Making an Impression	Great	Fair	Good	Fair
	Trying to Resolve a Misunderstanding	Great	Good	Terrible	Terrible
	Evidence/"Legal trail"	Terrible	Terrible	Terrific	Good
	Selling or Persuading	Great	Good	Poor	Poor
	Showing Respect	Great	Good	Good	Poor
	Gaining Insight and/or Opinion	Great	Fair	Terrible	Terrible
	Conveying Preference/Suggestion	Great	Good	Poor	Poor
	Thank You or Congrats	Good	Good	Good	Poor
	Document Request or Demand	Terrible	Terrible	Great	Good
	Be Taken Seriously	Great	Good	Good	Poor
	Mass Communication	Terrible	Terrible	Good	Great
Economies of Scale	Terrible	Terrible	Good	Great	

PROFESSIONAL DEVELOPMENT

Smartly Choose Your Modes of Communication, continued from previous page

	Personal Visit	Phone Call	Letter	Email
Attributes	<p>Very personal and high impact/impression.</p> <p>Offers the initiator exceptional opportunities for assessing the target's receptiveness/response (verbal and nonverbal).</p> <p>Offers the initiator exceptional opportunity to meet and communicate with persons who could influence the target (e.g., assistants, associates, superiors, etc.).</p> <p>Offers the initiator the opportunity to gather more information and impressions about the target and his/her organization and environment.</p> <p>Gives the target full and immediate ability to respond, and for the initiator to hear such and respond in kind.</p> <p>Allows the initiator to hand-deliver things/goods.</p> <p>Allows the initiator superior ability to craft the impression by multiple communication forms (voice, handshake, business card, brochure, quality of dress, video presentation, gift, smile, etc.).</p> <p>Lowest degree of risk that the message could be misunderstood.</p> <p>The message is not easily copied and distributed.</p>	<p>Very fast (immediate).</p> <p>Somewhat personal and high impact/impression.</p> <p>Quick and low-cost.</p> <p>Gives the target the ability to respond (so long as the initiator does not hang up or leave a message without a return phone number).</p> <p>Offers initiator modest opportunity to assess the target's receptiveness/response (verbal and nonverbal).</p> <p>Gives the target full and immediate ability to respond, and for the initiator to hear such and respond in kind.</p> <p>Low degree of risk that the messages could be misunderstood.</p>	<p>Low-cost (but more costly and time-consuming than the phone call and email).</p> <p>Great efficiencies available as volume increases.</p> <p>Offers the initiator perfect control over the exact words conveyed.</p> <p>The letter itself offers an opportunity to make an impression (e.g., quality of the paper, ink, logo, etc.) over and above the message itself.</p> <p>Additional items could be included in the letter/envelope/package.</p> <p>Protects the initiator from "getting into a live conversation with the target."</p> <p>Exceptional ability to communicate factual data with clarity.</p> <p>Good "record trail."</p> <p>Identical copies can be sent to many people efficiently at virtually the same time.</p>	<p>Very fast (almost immediate).</p> <p>Almost no cost.</p> <p>Incredible volume efficiencies available.</p> <p>Offers the initiator near perfect control over the words conveyed.</p> <p>Offers some ability to make an impression beyond the words themselves (logo, colors, graphics, links, video, etc.).</p> <p>Protects the initiator from "getting into a (live) conversation with the target."</p> <p>Exceptional ability to communicate factual data with clarity.</p> <p>Good "record trail."</p> <p>Identical copies can be sent to many people efficiently at virtually the same time.</p>
Deficiencies	<p>Time-consuming (and thus costly).</p> <p>Lacks total control over the messages conveyed (relative to letter or email).</p> <p>Almost no volume efficiencies (i.e., as the number of visits is increased).</p> <p>If meeting not set in advance, can be intrusive, insensitive, and inappropriately personal.</p> <p>Very poor record trail. No factual evidence of events.</p> <p>Not good for communicating to large numbers of people in dispersed locations.</p>	<p>Fairly easy for target to ignore/screen.</p> <p>Modest volume (i.e., number of calls) efficiencies available.</p> <p>Audio-only medium does not allow for one to see and interpret nonverbal communications.</p> <p>Not as good at making and impacting/building a relationship as in-person.</p> <p>No other communications besides the voice itself (i.e., no clothing, smile, brochure, logo, quality paper, etc.).</p>	<p>Not immediate (several days of delay).</p> <p>Not very personal.</p> <p>Offers no opportunity for the initiator to assess the target's receptiveness/response (verbal and nonverbal).</p> <p>Offers virtually no opportunity to meet and communicate with persons who could influence the target (e.g., assistants, associates, superiors, etc.).</p> <p>Offers no opportunity to gather more information and impressions about the target and his/her organization and environment.</p> <p>Higher degree of risk that the message could be misunderstood by target.</p> <p>Can be copied and distributed widely.</p>	<p>Not personal.</p> <p>Offers no opportunity for the initiator to assess the target's receptiveness/response (verbal and nonverbal).</p> <p>Offers no opportunity to meet and communicate with persons who could influence the target (e.g., assistants, associates, superiors, etc.).</p> <p>Offers no opportunity to gather more information and impressions about the target and his/her organization and environment.</p> <p>Higher degree of risk that the message could be misunderstood by target.</p> <p>Can quickly and easily be forwarded to the masses.</p> <p>No ability to simultaneously deliver high-quality, hard-copy documents.</p>

Business Basics: Gross Profit and Gross Profit Margin

Every business owner must know how to organize his/her revenues and expenses. Why? It will improve his/her odds of success.

Take the analogy of the golfer. Why hold the golf club a certain way? Well, you can hold it any way you want, but over hundreds of years golfers have tried virtually every technique conceivable, and the best results are generally garnered from one particular grip.

The same concept holds true for the financial management of a business. You can organize the financial data any way you wish, but you might want to express your creativity elsewhere.

The accepted “best practice” for the organization of a business’ financial data has evolved and been refined over thousands of years. The concepts are embodied in what we call Generally Accepted Accounting Principles (GAAP).

Maintaining a Healthy Gross Margin Is Mission-Critical

Business owners and managers would also be wise to know which part of the income statement is the most important. That is: “Get this one thing right and you’ll be well on your way. Get this one thing wrong and you’ll have a very hard time ever finding success.”

This one thing is — the gross profit margin.

Keeping with the golf analogy, the universally accepted #1 swing tip is: Keep your head still. The “keep your head still” of business financial management is: Watch your gross profit margin.

That is, make sure you earn a healthy margin. Don’t let it erode, and make sure you at least match what is earned by your most successful peers. Peer gross profit data can be obtained through your industry association.

Your Gross Margin Provides the Cash Your Business Needs

But to explain why the gross profit margin is so important, let’s use some more analogies.

You run on food and water. Your car runs on gasoline.

Run out of food and water, you die. If your car runs of gasoline, it becomes worthless.

Your business runs on cash. It needs cash to buy raw materials, pay the rent and employ the employees who create the products and services, market and sell them, collect the cash and deposit it in the bank. A healthy business will generate more cash than it consumes. If it does not, it will die.

So the stream of cash that flows into your business is the gross profit. The higher the gross profit MARGIN, the larger the stream. The lower the gross profit margin, the smaller

the stream of cash available to fund your operations and investment in future growth.

Revenue Is Important, Gross Profit Is More Relevant

One could argue that revenue is the most important number, but this is simply foolish. Every product or service you sell has expenses directly associated with it. Let’s say you publish books. For every dollar you take in from the sale of a book, you have direct costs in the printing, payment of author royalties, salesmen or broker commissions, shipping fees, etc. So the only relevant number is the profit (cash) that remains after the direct expenses are paid. Right?

The gross profit is all you get to keep to pay the rest of your bills (i.e., operating expense, also referred to as sales, general and administrative expenses). You don’t get to keep revenue; just what’s left over after you’ve paid the direct expenses you incur in the production, sale and delivery of the product or service.

The gross margin is the ratio of gross profit to revenue. For example, if you make \$50K gross profit on \$200K in revenue, your gross margin is 25% (\$50 divided by \$200). Of course, this would mean your direct expenses (i.e., cost of goods) were \$150K.

$$\begin{aligned} \text{Revenue} - \text{Cost of Goods Sold} &= \text{Gross Profit} \\ \text{Gross Profit} / \text{Revenue} &= \text{Gross Margin} \\ \text{Example: } \$50,000 / \$200,000 &= 25\% \end{aligned}$$

Gross Profit Margin Drives Bottom Line

To further drive home the critical nature of the gross profit margin, let’s take a look at how changes in the gross margin impact the bottom line. Take a company that has a 40% gross profit margin (i.e., cost of sales takes 60% of revenue) and a 10% operating profit margin (also referred to as pretax profit) — a healthy income statement by most standards.

Now let’s say that the owner fails to closely manage his gross profit margin and, either through a rise in cost of goods or a lowering of the price they get for their products or services, gross margin dips from 40% to 34%. This 10% increase in the cost of goods reduces operating profit by 60%. Here’s the math with percentages:

	<u>Pre(\$)</u>	<u>Post(\$)</u>	<u>% Change</u>
Sales	\$100	\$100	—
Cost of Goods	\$(60)	\$(66)	10%
Gross Profit	\$40	\$34	(15%)
SG&A	\$(30)	\$(30)	—
Operating Profit	\$10	\$4	(60%)

continued on next page

The lessons?

1. Without a healthy gross profit margin, bottom line profit is almost impossible.
2. A small erosion in gross profit margin can wipe out bottom-line profit.

Sell Quality, Not Price; Wring Direct Costs Out

How does one manage gross profit effectively? Unfortunately, there’s no magic potion. It’s just a matter of:

- a. resisting the temptation to win sales by lowering prices.
- b. wringing direct cost out at every turn.

It’s very hard to run a profitable company by competing on price. Only the firm with the lowest cost structure can win with such a strategy. The low-cost strategy is typically viable only for the firm with the highest volume, and virtually every industry has a firm that competes on price. To succeed, they must go for volume, “no frills” service and merely “acceptable” quality. The only logical and viable competitive strategy for the firms with lower volumes (most everyone) is to offer higher levels of quality and service at higher prices — prices that will more than offset the added expense incurred in the delivery of the higher levels of product and service quality.

Just a Few Low Margin Sales Can Devastate Overall Profitability

Business owners should also keep in mind how sensitive the overall profitability of the business is to the profit margins earned on individual sales. That is, the impact a few money-losing products and services can have on a company’s overall profitability. To illustrate, let’s look at a consulting firm that has 20 types of consulting projects. Peerless Consulting tracks the labor hours and direct costs required to deliver each of its project types. Peerless also knows the income that each job brings. Here’s the simplified 2008 data:

- Total annual revenue was \$1,000,000.
- Each of the 20 project types generated \$50,000 in revenue.
- Fixed overhead costs were, and will continue to be, \$205,000 per year.
- Operating profit was a negative \$5,000.

A look at the data revealed that two of the 20 project types lost money. In fact, the money-losing two together cost \$50,000 more than the \$50,000 in income they generated (i.e., together the two products brought in \$100,000, cost \$150,000 and therefore lost \$50,000). If Peerless were to eliminate these offerings altogether and the labor associated with the delivery of such projects, revenues would decline to \$900,000, but operating profit would increase from negative \$5,000 to \$45,000 in the black. Here is the comparison.

Income Statement — Peerless Consulting

	<u>2008 Actual</u>		<u>Pro Forma</u>	
Revenue	\$1,000,000	100%	\$900,000	100%
Cost of Goods Sold	\$800,000	80%	\$650,000	72%
Gross Profit	\$200,000	20%	\$250,000	28%
Fixed Expense	\$205,000	21%	\$205,000	23%
Operating Profit	(\$5,000)	(5%)	\$45,000	5%

By simply eliminating 10% (two of the 20) of the project types and 10% of overall revenue, Peerless becomes a profitable company at a respectable operating profit margin of 5%. If fixed expenses could also be reduced, then the bottom line would rise dollar-for-dollar and the operating profit margin would increase sharply.

Now, another alternative would be for Peerless to find a way to keep the two money-losing offerings but make them profitable. The average gross profit of the 18 profitable offerings is 28%. If we assume that the two losers could also earn 28% or \$14,000 gross profit each, then Peerless’ Pro Forma Income Statement would look like this:

Revenue	\$1,000,000	100%
Cost of Goods Sold	\$720,000	72%
Gross Profit	\$280,000	28%
SG&A Expenses	\$205,000	21%
Operating Profit	\$75,000	7.5%

By turning around the two money-losers, Peerless’ operating profit has increased to a respectable 7.5% margin. And that, compared to a net loss, makes all the difference in the world.

A small number of money-losing products or services can have a devastating impact on the overall profitability of a company. Peerless lost money in 2008 though 90% of its products were profitable!

The lesson: Analyze your per-product profitability. Use the information to create profitability across your entire product line. The impact of losers is too great to ignore.

In conclusion, the business world is complex, but business management, at its heart, is pretty simple. To manage and grow a profitable business, your most important task is to find ways to sell more and more at healthy profit margins. The most critical number is the gross profit margin. Deliver a consistently healthy gross profit margin and the rest of your job will be a heck of a lot easier. □

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Companies Whack 401(k) Benefit Programs

Companies are killing 401(k) matching programs to cut expenses. The Pension Rights Center in Washington, D.C. lists 264 large companies that have announced a change in their 401(k) matching policies since June 2008. You can find the list at www.pensionrights.org. We contacted 30 of the highest-profile companies on the list and found that 28 had discontinued their 401(k) matching. The other two — Starbucks and Pep Boys — said they will match only if they hit their profitability targets for 2009.

Interestingly, one of the companies we looked into was Whole Foods Market. Its employees were given a choice of health care benefits or 401(k). They chose health care insurance.

Health Care Reform Hindering Retirement Benefits Programs?

U.S. legislators are floating proposals to require employers to provide health care benefits to employees or pay a penalty. One proposal in the U.S. House of Representatives would penalize employers if they do not provide employee health insurance. Companies with payrolls of more than \$400,000

When a company cuts benefits it may start to lose the war for top talent. Which begs the question, how is an already marginally profitable company going to make a comeback with employees who are not the cream of the crop?

would be forced to pay a penalty of 8 percent of their total annual payroll. Employers with payrolls ranging from \$250,000 to \$400,000 would pay a lesser penalty, and firms with payrolls under \$250,000 would be exempt.

Where's the money going to come from? You have to wonder if companies might just kill other benefit programs — such as the 401(k) match — to pay for any new health care mandates.

To be sure, many companies are struggling just to keep their doors open.

Contingent Matching in Our Future?

Maybe Starbucks and Pep Boys are on the forefront of what's to come — retirement plan matching programs contingent on company profitability. A type of incentive compensation? Maybe it'd entice employees to work harder and smarter — to think more like owners — while giving businesses a built-in cost reduction mechanism during downturns.

Uncertain Future

It's impossible to know what the future holds. Employers have little choice but to be very conservative. Cash is the lifeblood of the business, and managers must conserve cash at every turn. Thank goodness that employers have the ability to cut expensive programs when they feel they must. But what if the

government mandates health insurance? Will they also mandate retirement programs? Could these mandates hinder a company's ability to survive tough times?

Nancy Hwa, spokeswoman for the Pension Rights Center, says the companies have the discretion to cut these programs. "Unfortunately, we've seen this trend over the past 20 years, where companies are increasingly getting out of contributing to their employees' long-term well-being plan, whether it's a pension or retirement income or health benefits," said Hwa.

The Rich Get Richer

U.S. employees are immensely mobile. They can change employers at will, and they do. They choose where to work based on important things such as pay and benefits. When an organization cuts pay and benefits, it's a given that some employees will depart for greener pastures.

Where are the greener pastures? Companies making money and able to pay full benefits such as a 401(k) matching program.

So, in a way, when a company cuts benefits, it may start to lose the war for top talent. Which begs the question, how is an already marginally profitable company going to make a comeback with employees who are not the cream of the crop? Does a cut in benefits spell the beginning of the end?

Only One Way Out

As the owner of a business during a downturn, you have tough calls to make. Run out of cash and it's game over. Fail to retain top talent and it may also be game over.

This dilemma leaves us with only one real option — find ways to raise revenue and profit. And so, even if it means running some losses in the near term or raising additional equity from investors, we have to invest in improving our business. □

Are you dealing with these issues? Have you? If so, what are you doing? What have you done? Let us and your peers know by writing to us at editor@thebusinessowner.com. We would like to share with others how you handled the situation.

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Do You Have the Eyes of a Leader?

Effective leaders and communicators make good eye contact.

Legendary UCLA professor Albert Mehrabian discovered that up to 93 percent of communication is nonverbal. In other words, there's a lot more to communication than the spoken words.

When you're communicating, you might as well assume the audience can see into your soul. Recall the ancient proverb: *The eyes are the window to the soul*. If you don't believe what you're saying, your eyes will betray you. So, before you communicate, ask yourself: Do I believe my own message? If not, your audience won't either. So if you aren't sure what your convictions are, find them before you communicate. If you are not sure where next to lead your troops, decide now so you don't have to fake it.

With Decisiveness, Conviction and Passion

People won't listen and believe unless they SEE something of importance. They want to see decisiveness, conviction and passion. They also want to SEE if they trust you. They want to know if you're a person who really cares about them and the issue at hand.

So how do you communicate this way? As we said above, it's more in HOW you communicate than WHAT you say.

Research shows that people of higher status and dominance show equal eye contact when talking and listening. People of lower status and dominance look away while listening more than they do when speaking. Additionally, when we look people in the eyes, we feel better about ourselves. We actually rate our own self-esteem higher.

Moreover, business owners should keep in mind that employees want to follow confident men and women.

Powerful people. Whether breaking bad news or conveying a new strategy, inconsistent messages (verbal and nonverbal) will undermine your effectiveness and create uncertainty, doubt, even lack of trust. Don't let this happen to you. Make good eye contact with everyone in the room.

Convey Care Through Your Eyes

All people long to be truly listened to — especially by those in positions of high status and authority. Providing consistent eye contact while listening to an employee demonstrates we value him or her as a person. Most employees simply want to know that you care enough to truly listen to their needs, even if you don't solve their problem. Recall Egyptian Pharaoh Ptahhotep's proverb:

If you are a man who leads, calmly hear the speech of one who pleads, (and) do not stop him from purging his body of that which he planned to tell. A man in distress wants to wash his heart more than that his case be won.

In our Western culture, eye contact conveys status, confidence and care. Good eye contact — especially while listening — is also the trait of the effective leader and communicator. Not many people master the skill, but we sure notice those who do. The good news is that you can be one of these people. Just make it a priority and begin to do it today — one personal engagement at a time. □

Chris Zervas provided his expertise for this article. He is a communication expert who coaches, teaches and speaks on communication and leadership. You can reach him at chris@summitsolutiongroup.com.

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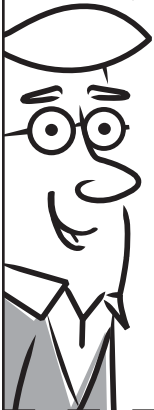
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