Driving Profitability

Matthew Wilson
Pitcher Partners

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Driving profitability

'Operating for a profit today and tomorrow'

an independent member of
BAKER TILLY
INTERNATIONAL

Matthew Wilson

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At Pitcher Partners Consulting we seek to help our clients grow and develop their businesses. We seek to enable decision making and assist with problem solving.

Our value comes from our deep commercial experience and in seeking to truly partner with our clients to support them growing a great business.

I have been involved with bus operators across the eastern states of Australia and have provided advice to businesses of all sizes since 1998.

Skills

- Accounting and Advisory
- Budgeting and Forecasting
- Financial Analysis
- Strategic Analysis
- Commercial Advice
- Negotiation Advice

Industries

- Passenger Transport Industry
- Manufacturing
- Government
- Telecommunications
- Health and Aged care
- Information Technology

Qualifications

- MBA, CA, ASIA, B.Com
- Member of the Institute of Chartered Accountants

Driving profitability

Operating for a profit today and tomorrow

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1. **Growth Strategies**
   The importance of revenue
2. **Pricing strategies**
   Have you set your price right
3. **Customer value**
   CVP and WTP
4. **Cost management**
   Keep your eye on costs

Questions
???? ????

Growth Strategies – *Focusing on Revenue*

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- There are two types of revenue:
  - Good revenue
  - Bad revenue

  → Only one leads to profitability

- Revenue strategies focusing on expanding sales, increasing price, or exiting from bad revenue streams

Financial strategies – *Focusing on Revenue*

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Products and services

Focus on what your customers wants and needs and how you can expand to meet them.

Understanding your brand, your skills, your assets, and how you can deliver new products/services

Leverage what you have

Diversification is a strategy that takes you away from both your existing services and into new markets.

High risk, high reward: knowing what you are good at is important… often about mergers and acquisitions.

Diversify your business

This is where you focus on increasing the value from your existing services

Its about understanding value, pricing strategies, and revenue management

Strengthen your bottom line

This is where you seek to offer your existing products into new markets.

Understand the market dynamics: Competition, customers, regulation etc.

Expand into new markets

Market place

Financial strategies – *Focusing on Revenue*

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Products and services

THE Rental STORE

Leverage what you have

Progress Rail
A Caterpillar Company

PRENTICE

Solar Turbines
A Caterpillar Company

Diversify your business

ANCHOR

ASIATRAK

Strengthen your bottom line

SEM
A Caterpillar Brand

Expand into new markets

Market place

Financial strategies – *Focusing on Revenue*

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Products and services

Market place

Financial Strategy in Action…

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New Product

Existing Product

Value and cost: (Profit and Loss focus)
- Where are you going to focus on?

Financing growth (Balance Sheet focus):
- What balance sheet elements are important?

Stakeholder expectations:
- What are your stakeholders expectations?

Reporting requirements:
- What will you need to report on?

Risks and issues:
- What are some risks and issues that you may face and need to manage?

Other comments:
- What other things might you need to consider?

Existing Market

New Market

Financial Strategy in Action…

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New Product

Existing Product

Value and cost: (Profit and Loss focus)
1. Pricing strategy, Sales strategy,
2. Advertising, Marketing
3. Cost control measures

Financing growth (Balance Sheet focus):
1. Working capital
2. Employee provisions
3. Debt

Stakeholder expectations:
1. Dividends
2. Reinvestment
3. Capital

Reporting requirements:
1. Margin analysis
2. Trend and variance analysis
3. Covenant and ratio analysis

Risks and issues:
1. Competition - pricing
2. Stock build up / obsolete stock
3. Increasing debtors turnover

Other comments:
What other things might you need to consider?

Existing Market

New Market

Pricing Strategies

A couple of pricing strategies employed to drive profitability

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Revenue Management

Pricing to capture maximum value for your services

- Unmet demand
- Buying habits
- Understanding customers price sensitivity
- Competitors pricing

Important – requires constant management, monitoring of the market and adjusting pricing to suit circumstances

QANTAS

Loss Leaders

Good/services sold below cost to encourage sales elsewhere

- The loss leaders needs to lead to other more profitable sales
- Often done to encourage key Customers
- Does not mean overall loss – it should drive profitability
- Consider complimentary goods/services

Important – if you cut the good/service and there is no loss of sales elsewhere – its not a good loss leader!

Pricing analysis – Top Down

Analyse and seek to understand – price for maximum profitability

Willingness to pay

If you don't understand willingness to pay… you leave profit on the table

"A customer's willingness to pay is the maximum price a customer is willing to pay for your service. Knowing how you can increase this will help to drive value, competitiveness and profitability"

- **Contrast the willingness to pay for health insurance for a 35 year old single person versus a 35 year old with a family?**
- **How much are you willing to pay for a coffee in the morning?**

Customer value proposition

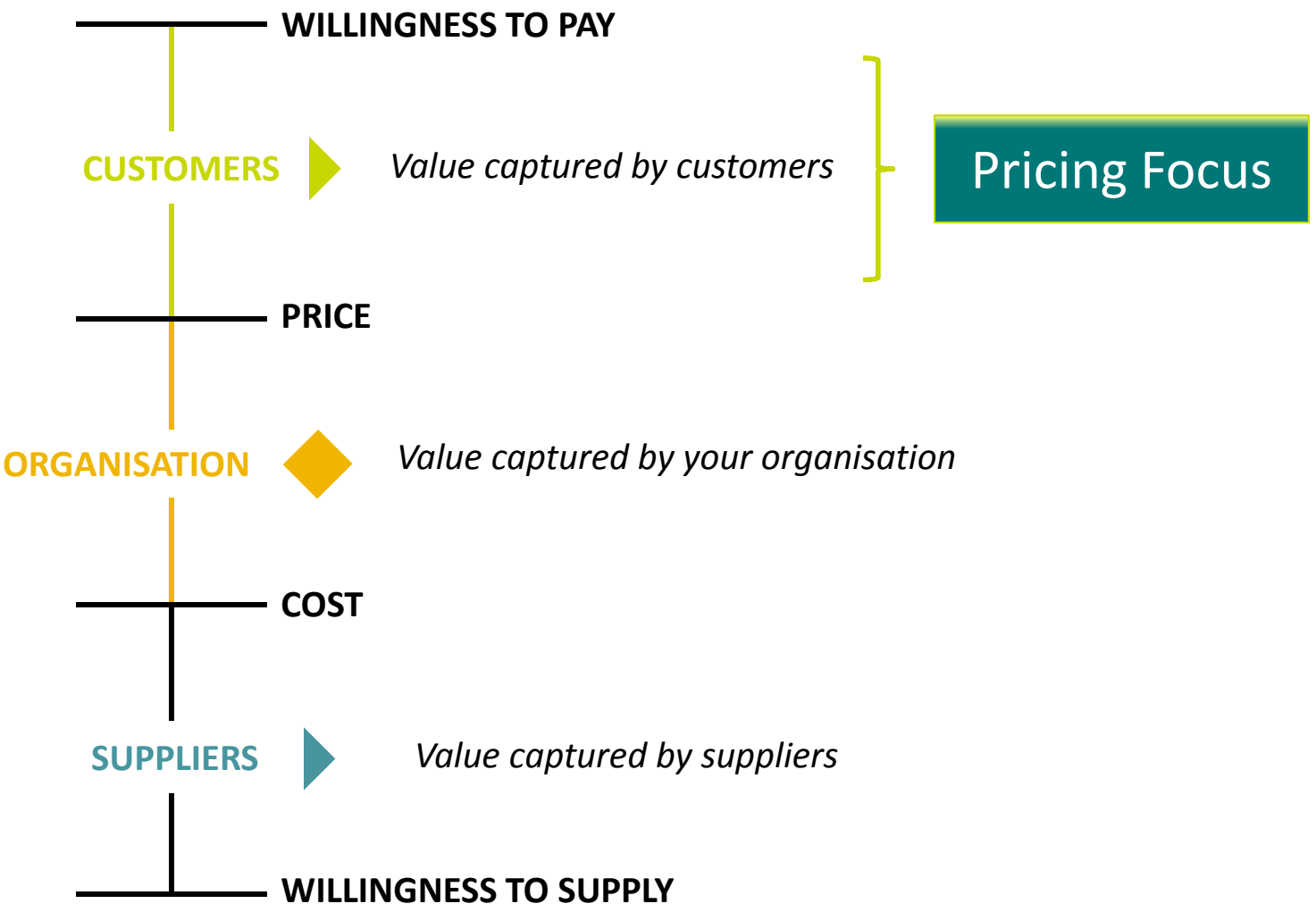
Its not just about cost plus a mark-up!

"A customer value proposition is a statement that describes why a customer should by your product or service. It should seek to identify all the costs and benefits that a customer derives from your service… NOT JUST the Costs but also the Benefits"

- **It is in the Benefit that the Value exists… focus just on cost and you often give up the additional value.**
- **Consider value of a single transaction versus life time value**

Capturing Price – Willingness to Pay

Know what your customers value – know what value you provide!



Taking stock of the value statements

Keep an eye on finding where value is delivered and retained

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Understand the customer perspective

- What are their needs, wants – look outside the box
- What are their costs to use your services

What is in it for the customer

- Understand the benefits they derive
- Understand why they care about your service
- What problems do you solve

Why do customers choose you

- What is your customer value proposition
- How does this differ from your competitors
- How can you increase your value and differentiation

Proof, Trust, Relationship

- How do you communicate with customers
- What is the level of trust in your services
- How strong are the relationships you form

Pricing Analysis – Bottom Up

Know your costs, set your targets – calculate your price (bottom up)

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Profit and Loss	
Net Income	1,838,000
Variable expenses	
Drivers Wages	363,000
Distance Variable Costs	656,000
Total Variable Expenses	1,019,000
Gross Profit	819,000
Overheads	
Stepped expenses	28,000
Fixed overheads	325,000
Total overheads	353,000
EBITDA	466,000
Depreciation	250,000
Interest	70,000
Pre-tax profit	146,000

Number of buses		7
Average Vehicle Price		350,000
Annual Kilometres Per Bus		75,000
Total Annual Kilometres		525,000
Total Annual Hours Per Bus		2,071
Total Annual Hours		14,500
Price - per kilometre	$	3.50
Price - per hour	$	126.76

What is your customer willing to pay?

Profit Required plus Total Costs
divided by Total Annual Kilometres

Profit Required plus Total Costs
divided by Total Annual Hours

Cost Control Measures

Focusing on cost can significantly increase profitability

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Variable costs

Variable costs | Cost management is often focused on

- *Achieving incremental efficiencies*
- *Increasing asset utilisation*
- *Reducing downtime through multi-skilling*
- *Focusing on streamlining process*
- *Reducing transaction costs*

"Variable cost management is one of largest areas of competitive advantage in transport industries… "

Stepped costs

If you are increasing assets and sales, don't forget stepped costs…

Important to consider the impact on:

- *Cashflow,*
- *Working capital requirements, and*
- *Pricing*

"Pricing often results in the under-recovery of stepped costs during growth and the over-recovery as utilisation increases beyond a point… "

Cost Control Measures

Focusing on cost can significantly increase profitability

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Fixed costs

Fixed costs are all about right-sizing the organisation

- *Undertake an annual review of fixed costs within the business*
- *Manage variances tightly*
- *Consider the validity of unbudgeted costs*
- *Review asset utilisation – not just buses*

"Ensuring that the size of the organisation is appropriate for the revenue streams and the ensuring flexibility and delivery"

Lazy costs

Lazy costs, "let's just look at last year and add a bit… "

- Review your historical costs and consider how they add value to your business or your customers
- Often builds up on the balance sheet…

→ Leave provisions

→ Non-utilised assets

→ Spare capacity

"Each year that leave sits on your balance sheet it reduces profitability in the years ahead"

Cost Control Measures

Focusing on cost can significantly increase profitability

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Contribution margin

Understand contribution margins – by service line / by customers

1. *Revenue*
2. *Less Direct Costs (Variable, Direct Fixed and Stepped Costs)*

= Customer or service line Contribution Margin

IF – a positive contribution margin then they are contributing to the profitability of the business.

Customer / service profitability

Analyse your services and customer profitability

- *Revenue*
- *Less Direct Costs (Variable, Direct Fixed and Stepped Costs)*
- *Less allocable Indirect Costs*

= Customer or service line profitability

IF – a negative value then you they are detracting from profitability and action needs to be taken.

Some resources to consider

Looking for new ways of doing things

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1. Cost control booklet
    - We provide a cost control booklet to our clients – email me if you want a copy.
2. Pitcher Partners Institute of Entrepreneurship and Innovation
    - PP runs a collaborative institute that provides courses for both PP staff, our clients and more broadly to key stakeholders.
3. Design thinking workshop
    - If you are attending the BusVic maintenance conference we are talking on design thinking, a great way to look at the world through your customers perspective

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Questions & Answers

Thank you

For your attention

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Thank You!