Chris's Corner: Demand versus capacity?

I know a lot of what I have to say on this blog probably comes across as common sense and maybe it is. I do think even the most worn out saws of business wisdom are easier repeated than executed, however.

Two closely related factors in business volume are demand for your product or service and your business's capacity to meet the demand.

In a perfect world you would want an ever increasing or growing demand for your product or service. Increased demand, means increased volume, increased revenues and, hypothetically, increased profits.

But what drives demand? Are you driving increased demand with a larger advertising outlay? Or are you getting more competitive on your pricing and therefore attracting more price sensitive customers? Are you making a better mouse trap, offering a better-quality product, a more satisfying customer experience or atmosphere?

Most of these examples of bumping up demand come along with some offsetting decrease in margin, whether by lowering unit price or increasing cost or overhead. You have to pay attention and look at your numbers to make sure at the end of the year, you haven't doubled revenues and halved your profits.

Let's say you sell something for $100.00 and make a $25.00 profit per unit. You sell 100 units at $100.00 each or $10,000.00 gross sales for $2500.00 gross profit (before overhead).

Your college grad nephew comes to work for you and says, "we'd sell a lot more widgets if you knocked 10% off the price.". You probably would sell more. How many more would you have to sell to make the same $2500.00 gross profit? Well do the math and you will find you'd have to sell another 66 unit or a total of 166 to get back to where you started. Only when you sold more than that would your gross profits go up.

This remains the same whether you are buying something wholesale, manufacturing and reselling or making food. It just math. Now look at capacity.

How much more labor, time and effort are required to get those units out the door? Yes, your material costs may be the same, or even go down if you buy on volume, but what are you going to do about the labor.

If you are a manufacturer then you've already factored in your labor costs to the product cost, or you should have. What if you need to buy another machine? That costs money and that machine uses energy, that machine needs maintenance and repairs. That is not free.

One of the biggest misconceptions in business today is that gross sales and growth over prior year are the most important bench marks. I disagree. The most important factors in my opinion is, at the end of your year, look at your net profit margin and compare it to last year; it should be close. If your net profit margin is down, I hope your net profit dollars are at least higher than previous years. Which would mean you played the volume game and won; it is a dangerous game to play. That is why so many companies that got into bed with Walmart are no longer with us. They played the game and lost their companies to bankruptcy.

It is all about making a profit. You can make a profit a penny at a time or a quarter at a time, it is your choice.

Call me conservative.