Marketing Automation

Practical Steps to More Effective Direct Marketing

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CHAPTER 1

Profit and Loss Fundamentals

Business *profit and loss* (P&L) is an easy topic to introduce:

- Revenue – Expense = Profit.
- If Revenue > Expense, then Profit > 0; this is the goal.
- If Expense > Revenue, then Profit < 0, which is not Profit but Loss; this is to be avoided.

Achieving profit goals means winning the game, maxing out on the bonus, and going home from the office early while enjoying a sense of satisfaction. Missing the goals is frustrating and followed by even more work in an already-full day: *Managing* to achieve profit goals is very challenging.

Beneath the apparent simplicity of business profit and loss is a relationship that can be leveraged to increase profits. This relationship is fundamental to the business process, which means it can be leveraged now and in the future to provide a continual source of incremental profit and protection against loss. The relationship is

Gross Profit/Marketing Expense = Return on Marketing Investment

The relationship says that increasing the return on marketing investment will increase gross profit. Understanding and utilizing the relationship requires a solid understanding of the P&L—business profit and loss—which is the topic of this first part.

Profit and Loss Goals: Actual, Forecast, Plan, and Variance

"P&L" stands for profit and loss and "the P&L" is a reference to the *Management* Profit/Loss Statement presented monthly at business performance

meetings. "P&L Goals" are monetary business targets captured in the operating business plan or forecast and the focus of discussion in performance meetings. Paying close attention to these figures, and managing to the "Plan" or "Forecast" is essential to achieving the targets, which is a significant—if not the primary—goal for management.

Management typically prepares a business plan in advance of a fiscal year. The business plan is presented to senior management for agreement and approval. This proposed business plan should contain sufficient detail to substantiate and defend the proposed goals—profit—as realistic and achievable.

The proposed profit goal may be adequate and accepted as presented. However, it may also be increased—"tasked"—by senior management: The business may be asked to provide a plan that is "more than" realistic and achievable, and be asked to meet the new goal. Large corporations with multiple divisions may need to ask their more successful divisions to reach a little higher to compensate for less successful divisions, in order to meet an overall goal for the corporation itself.

Once the business plan is accepted and the new year begins, it becomes "The Business Plan." Managing "to the Plan" involves recurring review of business conditions, revenue achievements, expense ratios, and a comparison of actual revenue, expense, and profit to revenue, expense, and profit in the Plan.

One focus of operational review meetings is the presentations that compare actual profit to Plan. Later in the year, particularly if the division is significantly ahead of or behind the plan, the focus may shift to a comparison of *forecast* revenue, expense, and profit.[1] The primary goal of the division in this case will then be to achieve the forecast, which could be higher or lower than the plan.

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[1] A forecast is used to manage expectations: A large positive variance to a business plan early in the year, + 20% for Q1, for example, creates an expectation for similar performance (+20%) for the duration of the year. The forecast will clarify whether such an expectation is valid. A single large order or a shipment delayed from the prior year could create a one-time positive variance in Q1, which would set an invalid expectation for the remainder of the year. Management would need to communicate that this is a one-time variance; the forecast could be used for this purpose.

EXHIBIT 1.1 **JULY P&L SUMMARY**

$ooo	Actual	Forecast	Variance	Var%	Plan	Variance	Var%
July Profit	2,576	2,400	176	7.3%	3,000	(424)	−14.1%

The presentation of actual profit compared to the management goals can be seen in Exhibit 1.1.

Here there are two comparisons for July Actual Profit: Forecast and Plan. The first comparison is to Forecast; the company has earned $2.576 million for the month of July, while the forecast was for $2.4 million. Therefore they have a positive variance of $176,000, which is 7.3% above the forecast (176/2400 = 7.33%).

The second comparison for July Actual Profit is to the Plan, which was $3.0 million. July Profit is well behind the Plan: $424,000 or −14.1%.

The comparison in this example is for the month of July only. A business year is 12 months long; therefore a second performance comparison is made to year-to-date performance: From Exhibit 1.2, July Year-to-Date to Forecast is $176,000 ahead, the same figure for the month of July, while Year-to-Date Profit is ($2.524) million behind Plan.

Showing the same variance for both the month of July and July year-to-date against dismal performance in prior months (compared to Plan) suggests a forecast was prepared starting with the month of July. The forecast may have been requested by senior management to establish a new full year profit goal, as the plan does not appear achievable at this point. The forecast answers the question: If management admits to the fact the plan target is not achievable, what then is management's commitment for the year?

This same information is frequently presented in a bar chart (Exhibit 1.3), which makes the profit gap to business plan (year-to-date) more clear.

EXHIBIT 1.2 **JULY P&L SUMMARY**

$ooo	Actual	Forecast	Variance	Var%	Plan	Variance	Var%
July Profit	2,576	2,400	176	7.3%	3,000	(424)	−14.1%
July YTD Profit	18,032	17,856	176	1. 0%	20,556	(2,524)	−12.3%

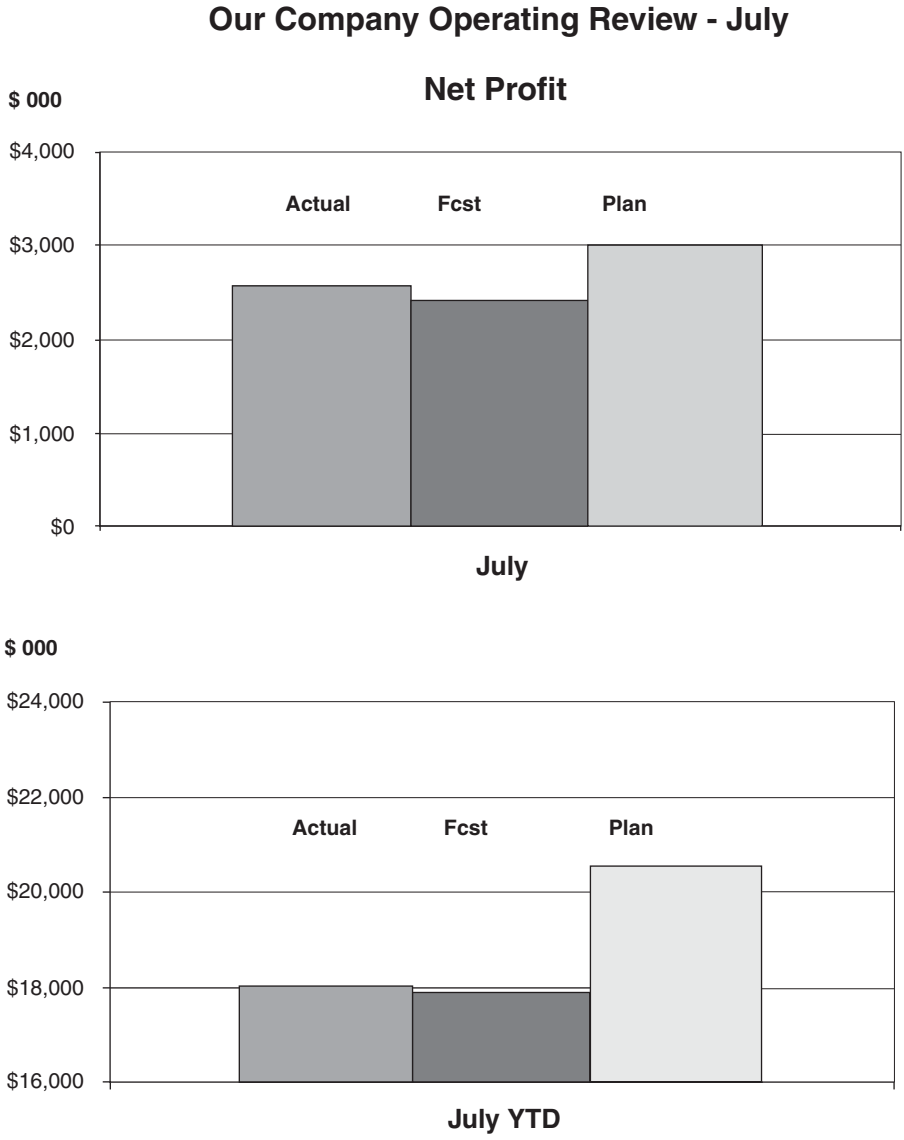

EXHIBIT 1.3 **July P&L Bar Graph Presentation**

The remaining items to be shown to complete the management Profit view are the Full Year figures. Management will use the Forecast and Plan figures, together with the Year-to-Date Actual figures to present a Full Year view of expected company performance (see Exhibit 1.4).

EXHIBIT 1.4 **JULY P&L SUMMARY**

$ooo	Actual	Forecast	Variance	Var%	Plan	Variance	Var%
July Profit	2,576	2,400	176	7.3%	3,000	(424)	−14.1%
July YTD Profit	18,032	17,856	176	1.0%	20,556	(2,524)	−12.3%
Full Year Fcst	45,080	44,904	176	0.4%	51,027	(5,947)	−11.7%

A "Full Year Forecast" is based on the year-to-date actuals for each month, plus the forecast (or Plan) for each of the remaining months. For OurCompany, the full year forecast done prior to July incorporated actuals for January to June; therefore the only variance July YTD is attributable to the positive, $176,000 variance in the month of July (see Exhibit 1.5).

For the full year, comparisons will always be made back to Plan. In a large corporation consisting of many divisions, the plan becomes the basis for many longer-term investment decisions. Deviations from the plan can place additional risk on these decisions, which could make such decisions appear to have been ill advised. Negative deviations by a division such as OurCompany are expected to be recognized and quantified so that contingency plans can be considered. Contingencies can be as simple as

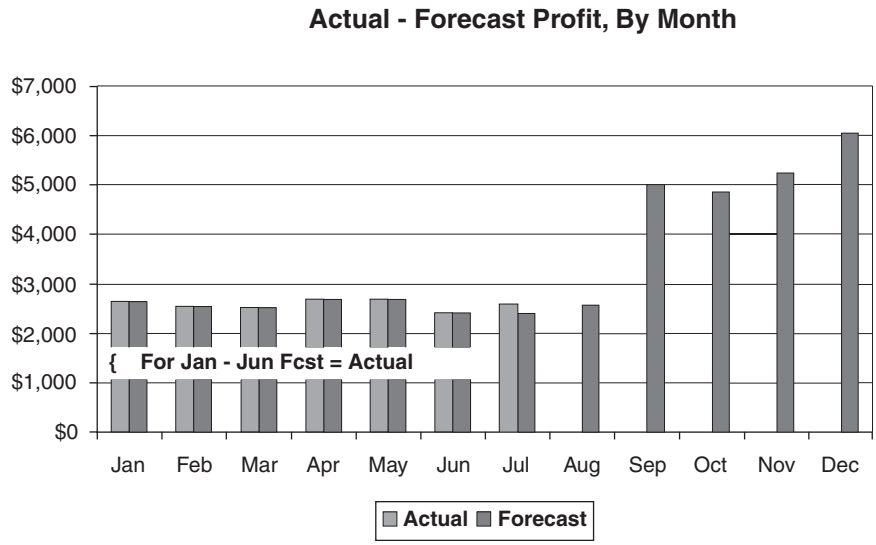

EXHIBIT 1.5 **Monthly Profit/Loss Bar Graph**

balancing a negative with a positive from another division that is experiencing better-than-plan performance. The Forecast formalizes commitment measures such as profit for such ongoing planning.

Returning to the Full Year picture, note that the July Year-to-Date Plan variance of −12.3% is greater than the variance for the Full Year Forecast comparison, which is −11.7%. This is because the positive variance of $176,000 in July is carried forward to the forecast for the *full year.* A full year forecast figure incorporates actuals to date, for purposes of comparison to Plan. Management has convinced their managers—a division President, a Board of Directors—that the forecast is *achievable.* Correspondingly, OurCompany management will be expected to *manage* to achieve it.