EXPENSE ANALYSIS OVERVIEW

What: The goal of the expense analysis is to differentiate between costs and investments in daily/regular spending. This is typically the first step when implementing Profit First, as most businesses can cut between 10%-25% of expenses without jeopardizing the quality of service or product. This allows the business to ensure they are using their current revenue to its highest potential.

Who: Most business owners think they are running lean and there is no waste. An expense analysis is beneficial even to these businesses, as it either confirms this to be true or sheds light in areas where this is not the case. **EVERY BUSINESS** MUST RUN AN EXPENSE ANALYSIS QUARTERLY.

Why: It is imperative for each business to do its due diligence to ensure the health of the business. An expense analysis allows the business owner to understand where they are spending, and it drives them to ask better questions surrounding their daily investments to ensure they continuously generate a return.

How:
Because an expense analysis is just as emotional as anything else in a business' finances, we take a different approach to avoid an extreme case of loss aversion, which often leads to unwarranted justification. We accomplish this by reverse engineering into the expense goal for the quarter.

Step 1: Run a Profit & Loss Statement (P&L) to include % of revenue for each expense.

Step 2: Based on the business' Real Revenue, determine the Target Allocation Percentage for Operating Expenses.

	A	B	C	D	E	F
Real Revenue Range	$0 – $250K	$250K – $500K	$500K – $1M	$1M – $5M	$5M – $10M	$10M – $50M
Real Revenue	100%	100%	100%	100%	100%	100%
Profit	5%	10%	15%	10%	15%	20%
Owner's Pay	50%	35%	20%	10%	5%	0%
Tax	15%	15%	15%	15%	15%	15%
Operating Expenses	30%	40%	50%	65%	65%	65%

Step 3: Once you have identified the Target Allocation Percentage (TAP), use the P&L to identify which expenses are ABSOLUTELY NECESSARY to maintain the standard of service or quality of product up to this percentage point.
For many businesses this includes, but is not limited to, payroll, software, internet/phone, etc.

Step 4: Once you have reached the TAP (let's say 30%), "ring the towel." Start to explore and CONFIRM the business is getting the most from these necessary expenses.

There are a few ways to do this:

1. **Call vendors and negotiate -** "I have been a loyal customer, paying on time for years. WHAT CAN YOU DO FOR ME?" In many cases, this can result in a discount. If it does not, it often leads to an increase in value for the same investment you are making now.

2. **Explore other options -** Technology is constantly changing, and so are the accessible resources. There may be a resource available for ½ the cost with greater capability to meet your needs. Ask for references and do your due diligence in research.

3. **Eliminate overlap -** Many times businesses have multiple resources with the same capabilities. Is there an option to consolidate?

4. **Create systems to track and verify expense success -** For many expenses, there is no actual direct return on investment. For example, many employees do not generate revenue; instead they retain revenue and support those who do generate the revenue. They are just as crucial to the success of the business as the revenue generating employees.

   Is there a definition of success for each employee or position and each daily investment? For expenses that cannot be cut, put tracking in place to verify the business is getting the most from the resource.

Repeat this process for EVERY single line item within the 30% of expenses under evaluation. You may end at 29.2%. That is a huge success! You were able to trim fat on essentials in the business.

Can the business succeed with only the 30% of expenses under evaluation right now? If the answer is yes, start cutting the expenses that are not imperative to the quality of work or efficiency level.

If the answer is no, move on to Step 5.

Step 5: Increase your expenses TAP to 40%. This adds an additional 10% to the 30% we have already evaluated. Identify which expenses are IMPERATIVE to the quality and efficiency of work.

Step 6: Repeat Step 4. Ring the towel for the additional 10%.

Repeat Steps 4, 5, and 6 until you reach the Quarterly Target Percentage in the Profit First Implementation.

Step 7: Cut outliers. Once necessary expenses have been confirmed, it is a lot easier to say goodbye unused subscriptions, software purchased for one client, and any other excess spending.