



# **“What you can measure, you can manage”**

**A practical guide for small business owners**

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## Introduction

One of my goals as a business therapist is to help small business owners increase their profits. We have a lot of “AH HAH” breakthroughs that result in profit increases when we develop useful **Key Performance Indicators** (KPI's). They are often very simple to implement. The traditional indicator of profitability is your income statement. This is a results-based indicator as well as a trailing indicator. If you only look at your income statement once a year with your accountant, the results you are looking at could be over a year old. Monitoring your business by looking at your income statement and profits is like watching a hockey game by only looking at the scoreboard. The scoreboard is the result of the activities of the hockey teams. If a hockey team wants to score more goals, the coach will need to focus on the activities during the hockey game. To run your business properly, consider a focus on the activities of your business. When you do this well, the resulting profits will improve.

### **The Problem: Trailing Indicators**

I wonder what really goes through business owners' heads when they meet with their accountant to review their financial statements. How long is this going to take? Why don't you just tell me how much tax I owe and what the accounting fee is this year? Is my bank going to like the statements?

Does this have anything to do with how you run your business? No. You probably have your own system for running the business such as looking at the bank balance. The fact that you don't monitor the right activities of your business is totally not your fault. Nobody told you!

It is possible you are already using some good activity-based KPI's. If you are a franchisee, your franchisor may have provided some guidance. Maybe you worked at another business that had a decent KPI program in place, or just maybe your accountant helped you identify some that work for you. It is unfortunate but true that although most accountants are very capable of giving assistance in this area, they don't. Matt Fischer, a consultant, who comes from a family of accountants once told me; there are two types of accountants – ones that help you and ones that “count the beans”.

### **A great example – your “Conversion Ratio”**

Every business has potential customers that come in contact with the business in person, over the internet or by phone. If we just focus on the phone by itself, I think we can agree that although phone calls come into a business for various purposes, some of them are potential new customers and some of them are existing customers who are calling because they are considering a purchase transaction. Let's assume that the number of calls that the business gets from potential and/or existing customers is 100 a day. Out of these 100 possible transactions, not every one

results in a sale. If the business is able to “**convert**” 40 of the calls into actual sale transactions, then the “conversion ratio” is 40 out of 100 or 40%.

Keep in mind the phone call could provide an “appointment” as opposed to a sale directly. The appointment could be for the caller to personally attend at the business or a visit by a salesperson.

Using the conversion ratio example, I will now provide my logic as to why this is a much better “gauge” to monitor your business than your income statement. While activity-based KPI’s are real-time and current and can be very specific, your income statement comes out much later and looks pretty useless in comparison. The ability to get good data on a timely basis is critical to making good business decisions. It is possible to monitor your conversion ratio by the hour if you want. For our example, let’s assume the business calculates it at the end of each business day. What useful information can you get to make better business decisions?

***Useful information example #1*** – the total number of phone calls drops from 100 to 60. By being aware of this right away, you can determine if there is a problem with the phone system or did an employee leave the phone off the hook? Did a new advertisement give the wrong phone number? The suggested action is therefore to determine the problem and correct it immediately.

***Useful information example #2*** – the total number of phone calls goes up to 150 from 100. Why did this happen? Did a new advertising program start working? The suggested action is therefore to start tracking the source of the calls by asking callers how they heard about the business.

***Useful information example #3*** – the conversion ratio on days when the owner is answering the phone a lot is 60% and the conversion ratio on days the owner is away is 30%. This is going to identify the issue that the skills and systems used by employees with potential customers are dramatically different from the owner’s skills. The owner is typically the most educated in product knowledge and also the most confident in the value proposition, which is the value perceived for the price charged. When doing business on the phone, the caller can still sense the confidence of the salesperson. The ability to ask educated questions about the caller’s needs and to give confident explanations to caller questions impacts the ability to close the sale. The suggested action is therefore to have the owner spend time training employees how to ask customers questions consistently and how to answer questions consistently and confidently.

When you complete the suggestions above, you will be able to monitor the conversion ratio to see if it’s working!

It is easier too!

Business owners can relate to and understand activity-based KPI's far better than financial statements. It's a no-brainer! Do you want to go back to school and learn to be an accountant so you can understand trailing indicators, results-based financial statements or do you want a performance indicator that is easy for you to understand almost instantly and which you can start to use to make more money tomorrow morning?

Just starting to monitor an activity will increase it.

This is an old story but a good one. It is so old, the business in the example manufactured aluminum windows. Anyway, the business owner had a concern that there was too much aluminum being wasted. So the activity he implemented was to collect and weigh the amount of scrap aluminum created at the end of each day. This new program reduced his costs by 2%, even though the scale he used to weigh the scrap didn't work at all! It was the "**awareness**" that waste was now being monitored that actually reduced the amount of waste.

Monitoring activities forces business owners to reconcile what they think to what is actually reality.

Before you read the next paragraph, write down on a piece of paper what you think the conversion ratio is for your business. If you know the answer because you monitor it, kudos to you – you are truly in the minority. Now, the rest of you probably didn't write anything down yet. That might be because you didn't feel like it or you didn't have any paper, but more likely it is because you just don't know. That's okay! I'll give you another chance and make it easier for you. Let's just assume that you do know what your conversion ratio is and all you have to do now is pick a range from the choices listed below. Do it in your head if you don't want to write it down.

- 100%
- 80% to 99%
- 65% to 79%
- 50% to 64%
- 35% to 49%
- 20% to 34%
- Less than 20%

Although I have no formal research to confirm this, my experience is that most business owners will guess between 50% and 64%. That would be great if it was reality. When they actually calculate it, it usually ends up in the 25-45% range. Right now you are probably challenging my suggestion that you guessed too high. That's okay too. I hope it gets you so fired up that you actually go out and start to monitor it!

Paco Underhill is a retail guru who wrote the best selling book "Why We Buy". He certainly understands KPI's and he calculates conversion ratios for his clients as part

of his analysis of many retail store activities. In his book, he tells the story of when he asked the CEO of a large, national retail chain what his conversion ratio was. The CEO very confidently said, “100%, we are a destination store, customers come here to buy and they all do.” When Paco told him it was 48% the CEO wouldn’t believe him. He went out and checked for himself. Paco was right!

You may be thinking that guessing high and then finding out you have a lower conversion ratio is a bad thing – it’s not – it’s actually a very good thing if you act on it. The statistics vary by industry, but it costs roughly 6 to 7 times more to get a new customer than to convince an existing customer to do business with you again. When you think about where this cost of acquisition is, it is spent in getting the potential customer to contact your business – either by phone, in person or on your website. In the conversion ratio example, it is in getting the 100 calls per day. I stated the business in the example converted 100 calls to 40 sales. Let’s say we wanted to increase the sales by 50%. Do you want to invest 6 to 7 times your cost to try and get the total number of calls up to 150 calls per day? You could then convert 40% of them to sales and have 60 sales per day. Can you see how putting your effort into increasing the conversion ratio from 40% to 60% might be a far less expensive option? The potential customers are right there on the phone, in your store or browsing your website – all you have to do now is convert them!

The purpose of this guidebook is to explore activity based key performance indicators, not to advise you specifically on how to improve your conversion ratio. I hope the rather detailed and thorough discussion of the conversion ratio example helps you see a critical point:

### **What you can measure, you can manage!**

It is a waste of time exploring profit improvement strategies to improve your conversion ratio if you don’t have a system in place to measure it first. In any effort to improve a business activity, you also need to measure the effects of the changes you make. It is never perfect and you often have to use trial and error experiments and test the results. But compared to flying blind with no gauges at all and waiting to see what your income statement tells you, you should now be starting to see the real value in having activity-based KPI’s on your business dashboard.

If you are interested in learning more about developing good gauges for your business activities, consider our Small Business Conversion Ratio Tool Kit available on this website for \$224.95.

It contains:

- Actual forms to print and start using immediately; we have tested and improved these to make sure they are easy to use;
- Explanations on how to test various business activities;
- Ideas to improve conversion ratios over the phone and in person;

- Best practices and hugely valuable tips to make the positive changes stick and the implementation successful;
- A money back guarantee;
- An offer of additional telephone and email support to assist in implementation;
- Other business activities you should be monitoring.