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### Turn your P&L thinking upside down!

Take a look at your current operating statements. Unless you are *really odd* (or have heard my presentation on the topic), your P&L statement begins with Sales Revenue.

Below Sales you show Cost of Goods Sold, then Gross Profit, followed by Fixed Overhead Expenses, and finally Net Profit. This top to bottom series seems to follow Newton's Laws of Gravity, whereby numbers fall as they move down the page. This metaphor may lead to the assumption that if you create sales, you will achieve a profit...based on assistance of fundamental gravity!

Unfortunately, gravity seldom plays much of a part in a company's profitability. Financial experts, CPAs, and the Internal Revenue Service understand the disconnect, but others may not have such a clear understanding about the way a business makes a profit. For instance, when you quiz a cross-section of the general public about corporate profits, most people dramatically *overestimate* the actual profit percentage.

A more realistic way to depict the process of making a profit requires that you turn your P&L thinking upside down.

Let me explain. To begin, let's put Sales Revenue at the bottom of the page. A sale provides income dollars, but those dollars came at a cost. Before a company can claim a profit, the company must exert effort to *squeeze* past the next category placed above Sales (Cost of the Goods Sold), which includes all of the materials, labor, freight, commissions and other variable expenses involved in producing or acquiring the product sold.

If everyone helps, the company makes a Gross Profit on its Sales. But that's only part of the story.

The effort to create the Gross Profit must be followed by even *more effort* to squeeze past all of the Fixed Overhead Expenses, like administrative salaries, sales salaries, insurance, telephones, postage, supplies, rent, property taxes, license fees, and of course, paper for the copy machine. So, overhead expenses get stacked on top of the Gross Profit category...alas, more obstacles to be overcome.

Now, if everyone in the company exerts a lot of *really* effective effort, and serves each customer extraordinarily well, the accumulated effort might squeeze past all of the many fixed costs of running the company on a daily basis.

The sales dollars left, produced by such extraordinary effort might pay bonuses, then finally shows at the top of the page as Net Operating Profit (before income taxes).

Once Uncle Sam gets his cut, what's left over is Net Profit, the reward received by the company's stakeholders.

Nothing in *this* scenario assumes that gravity will help! By turning your P&L thinking upside down, you stand a much better chance of explaining the arduous process of making a business profit to non-financial employees, politicians, and to the general public.