



The 1/3 Rule

Here's a question—really a way of thinking—that few people ask themselves when they start a small business. And even if they do ask it of themselves, they often don't have the slightest plan to make it happen.

The question is simple—how much do I want to make in my business? Simple question, right? As is so often the case, the question is easy, but the solution is difficult.

Here's a good starting point: I call it the 1/3 Rule. Using total annual sales as your starting point, divide that number into 3 equal pieces.

One third should go to the operation of the business. A second third should go to the people employed in your business.

And the final third goes to the owner(s). That's your jumping off point. Now compare those numbers to your business's actual numbers.

Classically, the owner's third is consumed by one or both of the other two pieces.

So now you do some reality testing. Try to get a sense of what fractions should be right for your business. Ask other business owners what their ratios are, and even ask others who do the same thing you do.

Maybe you don't ask your competitor down the street, but you likely are friends with others who do what you do. They'd probably welcome the opportunity to compare notes.

Your accountant, banker, or business advisor are other good sources of insight. They have access to tables of industry-specific ratios arranged by assets, annual revenues, and other common indexes.

For instance, it's not difficult to determine the average annual revenues of a sample of 50 two-physician chiropractic offices, as well as how much the typical two-physician office spends on clinical supplies, telephones, malpractice insurance, and so on.

A different part of the same table will tell you the ratios for a 5-physician office.

Trade journals are another good source of information. They often have practice management articles addressing these issues.

The starting point for your research is, of course, your basic financial reports. These reports help you answer two main questions:

**How much did I make?
If I made this much, where
did it all go?**

Now that you've got a handle on those two questions, you're ready to really take control of your business's life by asking two more questions:

How much should I have made?

And if I didn't make it, what do I have to do to get there?

These questions bring us back to the 1/3 Rule.

Using the three equal pieces, adjust your numbers up or down until they begin to resemble your sense of what your business's financials "ought" to look like.

What you're looking for, of course, is a formula that makes sense for you: how much must I spend on everything else to get me where I want to be?

If you're spending too much on the first two pieces, the amount left over for the owner's share must inevitably be reduced.

You've got two choices: reduce spending in the first two areas, or keep the ratios the same and increase sales.

Before you go making decisions to reduce expenses or to increase revenues, there's one more easy step to take that will provide additional insights.

And you've already got the information—you just didn't realize it. Do the same analysis on your business, but for prior years!

You'll be able to see whether you are gaining ground or losing ground.

You're really asking yourself, "Over time, am I getting more or less from this business each year?"

If your answer is, "Yes", then you've produced a record of which you can justifiably be proud. That information is also good ammunition if you need to justify a bank loan or maybe even to explain to your spouse where the family fortunes are headed!

A "No" answer at least comes with some insights about what your next actions must be.

Here are two thoughts to mull over as you think about your business:

Do I control my business, or does it control me?

Why do I seem to be able to pay everyone but me?

The 1/3 Rule can be a powerful and simple tool to get answers, as well as develop solutions.

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