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## PowerGrowth Tip: Beware of Hidden Costs

### Sales are Up, But Profits are Down. How Come?

**Michael Bitter**

One of the biggest obstacles to profitable growth we uncover when helping our clients create a more profitable, faster growing business is cash flow problems caused by unprofitable sales.

And, in nearly every case, the reason for unprofitable sales is the same—failure to identify all of the costs associated with a specific service, job, or project, and failure to charge a high enough price to offset all costs—and still produce a profit on every sale.

If you find that you are successful selling your products or services, but still suffer from lack of profits or continuing cash flow problems that keep you from growing, the problem may be a failure to recognize, account for, and manage something called “hidden” costs.

A hidden cost is cost that is incurred to purchase, sell, stock, deliver, bill, and/or collect for a product or service you provide, that is not readily apparent, and thus, is not properly accounted for when you price your product or service.

#### Why it Matters

Hidden costs may be accounted for as part of your operating costs. However, because those costs are not specifically identified, you may not be selling your product or service at a price high enough to produce a profit---given what it really costs you. In some cases, you may be selling your product or service for less than it actually costs you to provide it. In other cases, you may be selling your product or service at a price that is too high to allow you to be competitive.

#### Hidden Cost Example

ACME Lawn Care provides lawn and landscaping services. One of ACME’s services is simple grass cutting and weed “whacking”. ACME’s owner charges customers a simple flat price based on the size of the lawn. His formula is pretty simple, and until recently has worked well to produce a profit. However, as his business has grown, he has noticed that, even though he has more customers than ever, profits have slowed, and he is now beginning to experience cash flow problems.

A simple analysis revealed that his current pricing model failed to account for all of the costs associated with providing his service. When he was small, these hidden costs were not a problem, since there were not enough of them to create noticeable profit erosion. But, as he has grown, the compounding nature of hidden costs has reached a point where his profit erosion is not only noticeable, it is now problematic.

#### The Keys to Understanding Hidden Costs---Activities and Expense Allocation

There are two keys to understanding how to identify and account for hidden costs. The first is to understand that all activities associated with selling, delivering, tracking, billing, etc. have costs.

The second thing you must understand is that all activities use resources of the business—which also have costs. To understand this concept, let’s look at a simple example.

ACME Lawn Care provides a simple grass cutting service. ACME's owner uses a simple formula to determine how much to charge a customer to cut a lawn:

- Labor rate (\$7.00 per hour) x average time to cut a lawn + profit percentage

On the surface this appears to be fairly simple and workable. However, there are a myriad of other "hidden" costs:

- Time to load and unload equipment
- Time to fill gas tanks and check oil
- Time to drive from the garage to the customer's home
- Time and costs to bill and collect for the service
- Time and costs to maintain the equipment
- Truck and equipment depreciation costs
- Customer service costs

There are probably other costs, but this list is a good idea of some of the hidden costs associated with a simple lawn cutting job. If ACME's owner wants to really understand what his true costs are, he must track and allocate all activity and resource costs at a JOB level. Once he knows what it really costs him to cut ONE lawn, he is well on his way to ensuring that every job is profitable.

Understanding all of your costs associated with selling and providing your products and services also has another benefit. It will help you identify inefficiencies in your processes and identify areas where you can reduce costs—providing you with more profitability and potentially providing you with a competitive advantage resulting from lower prices.

### Learn More

Want to learn more about this topic? Interested in other ideas to get your business growing?

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- Attend a **PowerGrowth Boot Camp**: [www.bizresults.net/bootcamp.htm](http://www.bizresults.net/bootcamp.htm)
- **Call us** to discuss your specific business growth challenge: **636.207.1227**

### About the Author

Michael Bitter is a well known educator, mentor, and professional speaker with over 30 years of business development experience. He is the owner of Business Results Unlimited ([www.bizresults.net](http://www.bizresults.net)), a firm that provides business growth and development focused education, coaching, and mentoring services to small businesses and professional service firms. He can be reached via email at [mcbitter@bizresults.net](mailto:mcbitter@bizresults.net) or by telephone at 636.207.1227.

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