Profit First, Profit Always with Mike Michalowicz

Episode #32

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Lisa Larter (00:01):
Welcome to She Talks Business. If you're an entrepreneur, business owner or aspiring mogul, chances are you want to learn more about marketing and mastering and monetizing your business. She Talks Business is where you'll learn all of that and more. My name is Lisa Larter and I'm an entrepreneur, high school dropout, wiener dog enthusiast and your host. Let's get started.

Lisa Larter (00:24):
Well, hello and welcome to this edition of She Talks Business. We have a really, really, really exciting episode ahead for you. I am having a conversation with Mike Michalowicz, the author of *Profit First* and a series of other books that you've probably heard of like *Clockwork*, *Fix This Next*, *Get Different*. But I asked Mike to come to the show because I believe that talking about profit is such an important thing, and his book has impacted the lives of so many people in terms of separating the profit from their sales at the very beginning, so that their businesses can be profitable.

Lisa Larter (01:06):
We've talked about some really, really, really interesting things on this today. We talked about debt, which is really important. He has a chapter in his book called "Destroy Your Debt", but we're talking about debt from the perspective of coming out of the pandemic and the difference between leveraging, bridging, and anchors. Really important, if you have debt, to listen to this.

Lisa Larter (01:28):
We're also talking about some things that are important moving into next year around the habit of saving, having strong customer relationships, and

really considering how you can retain your customers. And then, we also talk a bit about what Mike calls the 150 Rule, which is a great guideline to help you know when you need to invest in the next member of your team. I think you're going to really enjoy this episode with Mike. Make sure you listen to the end because he gives us one stellar piece of advice that is really a mindset and an identity shift that is critical for business owners as we move into the upcoming year if you want to, a) protect your business and, b) put your business into a situation where it can be more profitable than ever. And most importantly, so that you don't have to be the person doing everything all the time.

Lisa Larter (02:32):
This is a fantastic episode. Mike has an open invitation to come back anytime. I really hope you enjoy this. You know where to find me. Send me a message and tell me what was the one thing you the most about this episode with Mike? Thanks for listening and enjoy.

Lisa Larter (02:48):
I am so happy to have you here, Mike, to have a conversation with you about your book *Profit First*, but I want to talk to you about more than just your book. I think your book is going to make a huge comeback in 2022.

Mike Michalowicz (03:06):
Ooh! Tell me why.

Lisa Larter (03:08):
Because I think that we have a world of entrepreneurs right now that are walking around with blindfolds on. I don't think they realize what inflation and shrinkflation is going to do to their business. And, I think we're going to see a lot of people who have their profits degraded because they're not paying attention. And so, that's one of the reasons that I really wanted to talk to you and have you on the show because I'm really curious as to your perspective on what's going on in the world right now. I just recorded an episode on pricing for profit during inflation and I'd love to get your take on what you think entrepreneurs should be doing right now.

Mike Michalowicz (03:57):
I think your point is great that there's going to be this reverberation through the economy. It was interesting when COVID “hit” back in March of 2020 was when the shutdown started happening. For a three, maybe four period *Profit First*, the book, had a massive dip in sales. It dropped by 50% of its sales and then it normalized; it climb back up relatively quickly and then it's been at a normal sales rate.

Mike Michalowicz (04:27):
And my perception's, "Wow! This book, when we have a need to really focus on profit, we didn't do it, like what happened during that month?” And I think there's a very short time focus. It's very human of us to go into a panic stricken state or respond to the immediate pain, but not consider the ultimate disease. I think that's what's happening and it's going to happen, going forward is, right now for some businesses it's catch the ten, but for other businesses it's this great divide. So typically, we see when there's economic decline, the entire economy slows down. Typically, it starts with larger businesses and then it plays out with smaller businesses, but this one, it's weird.

Mike Michalowicz (05:13):
There was... Well, historically, until maybe recently, but there's been growth in Wall Street, collapse in Main Street, online businesses burgeoning, traditional brick and mortar collapsing. I think 2022, we're going to... This hyper response is going to settle in. I agree. I'm really concerned about the economy. You just can't keep printing money without that causing hyperinflation. I've been studying Ray Dalio's work, studying recessions and so forth, and all indicators are we're heading in that direction very soon to the point where we may actually, in the US, have insolvable debt: we have so much debt that we can't even pay our interest.

Mike Michalowicz (06:00):
And then this can result in what's called the Great Jubilee, which is not a very exciting big party. It's like a big collapse where basically all debts have to be forgiven because there's no alternative except a mass war. And what does that get? So, it's coming, I think. I think there's two ways to navigate. A) you can do preparation. Financial preparations: you can start resolve reserving more profitability now, but if $1 gets one item and then a year from now $10

gets that one same item, you might not be able to save enough, but don't avoid that. Minimally, we need to be in the habit of saving because this will fall out in a new place, but we have to have the habit of saving.

Mike Michalowicz (06:44):
Secondly, it's being in a position where you have strong relationships with your customers, where you have strong momentum, and where your business can retain customers because [inaudible 00:06:56] when there's mass panic, everyone panics, including customers. But the one big difference I've noticed between big business and small business, if a big business loses 10% of its customers it's talking about thousands of customers, the small mom and pop shop, you lose 10% of customers. You're talking maybe 20 people, 30 people. We serve such a smaller base and if we do the right moves in the right way, may be able to get those 30 back or 30 different folks. So, those relationships, those even tactile relationships where we've connections with people, I think are so important for small business right now to facilitate that.

Lisa Larter (07:34):
I agree. I think some businesses are operating with rose-colored glasses on right now. I think a lot of it is because in Canada and the US, these businesses have been given these loans to help them through the pandemic. And so people are feeling flush and they're not necessarily understanding the difference between cashflow and profit, which I see all the time-

Mike Michalowicz (08:03):
That's [crosstalk 00:08:03].

Lisa Larter (08:02):
And they're not thinking about how they are going to service the debt down the road. I love... You have a chapter in your book called “Destroy Your Debt”. I live debt-free. I've built a business debt-free from the very beginning, like since 2006. I don't know that people recognize that what happens when we start to see inflation go up, we may see interest rates go up on debt in order to bring inflation down, and that's going to create a whole other set of problems for business owners.

Lisa Larter (08:41):
So, that's why I say I think your book is going to make a comeback because I think that people are going to have to open their eyes and pay attention to what's going on. If you're a business owner that actually looks at your P&L or your income statement on a monthly basis, it is almost impossible that you are not going to see some changes happen. I'm seeing changes happen already. And if you're not paying attention to that, it's going to be a huge shocker and could potentially destroy your business depending on how skinny your profit margins are.

Mike Michalowicz (09:13):
I like that you made the differentiation between cashflow and profit. I think cashflow does trump profit in the short term. If you're flushed with cash, things feel good and it serves your business. Profit is the habit of continually creating positive cashflow by having the margins that serve in your favor. I think people conflate the two and say, "Well, if I have cash, I am profitable." Right?

Lisa Larter (09:42):
Right.

Mike Michalowicz (09:42):
Or, "If I'm profitable, that means I will have cash," and they don't necessarily work directly with each other. So, when I wrote *Profit First*, it's actually a cash management tool that brings about profitability, but that's just too long of a title. So, it got consolidated under *Profit First*.

Mike Michalowicz (10:01):
The first part is cashflow. The profit part of that title is sustainability. And so what we do in the system is we have to ensure that every transaction facilitates the margins that's bringing in profit, meaning we're spending less to deliver X than we are in making a return. We're making more than we spent. In cashflow, those ensuring that we have the cash in the bank because you can be profitable without having any cash and then you're in real trouble.

Mike Michalowicz (10:34):
These loans, it's been interesting. I'm not a fan ever of taking loans, but this PPP loan, what was so interesting about it, was so many businesses were

funded. If you didn't take a PPP loan... I don't find enough Ps in there... you actually put yourself a step behind. So all my competition takes a loan and now they're flush with cash. If don't take a loan, even though I'm profitable and even though I'm cash flowing positively, strategically it's smart to take the loan. Now, I understand there's ethical considerations too: if I take it could someone else not take it? So there's lots of considerations. But you do not grow your business off of loans.

Mike Michalowicz (11:16):
I believe there's actually three forms of debt and, sadly, I think it's the third form that we take on, and these are my own terms. One is what I call debt leveraging. And honestly, everyone says that, but no-one does it. Debt leveraging is where I know that if I spend a dollar today, a month from now, I'm getting $2 in return. I have a guarantee or an extraordinarily high probability that's going to happen. Now I take money, I borrow money from you, that dollar, so that month from now I get the $2 back, so I return your dollar plus the interest I owe you and still have a profitable venture. That is debt leveraging, where you use one to make more.

Mike Michalowicz (11:54):
Debt bridging is more common though. We don't use that term. Debt bridge is basically there's a slow down in cashflow, but there's an assurity I'll recover. So, I have expenses that I don't have enough cash to cover today, maybe a payroll or something, but I know within one month that cash should be coming in from my existing work for my client. I need to bridge that and I can take on debt to do that. Often people use their revolving line of credit for that. But in both those scenarios, rarely do people go in with the predictability of the return and that puts us in the third scenario, which I call debt anchors.

Mike Michalowicz (12:30):
Debt anchors are where we take money from someone with an intention, or hope I should say, of making a return of some capacity or bridging us through a period of time where we know we'll be in solvent ground again, but we don't run the calculations; we just hope. It's a pot shot. I think that's what most people do is like, "Oh, I take money and I need it and I feel good because I now have it," but there's no consideration on how we're going to pay that loan back, and then we're in trouble.

Mike Michalowicz (12:58):
One thing with the PPPs' that may be unique is it may not actually be a loan, it may be a grant. Or basically, your rich uncle gifted you the money until your rich uncle, Uncle Sam, is broke himself. He's writing out blank checks basically, but, a grant is great, but it doesn't make it healthy business. So, there's all considerations. I'm afraid of the... debt anchors coming.

Lisa Larter (13:18):
Oh, I agree and I'm afraid of the false sense of security that business owners have because they have that money and they think they're okay. In Canada, they offered a small business loan of... I think it was $40,000 and you didn't have to pay it back until I believe it's 2023, and if you pay back three quarters of it, the 25% or 10,000 was basically forgiven. So talk about leverage, you, if you can pay the money back, then you get a $10,000 reward.

Lisa Larter (13:59):
I took that loan at the very beginning because I didn't know what I didn't know in terms of what was going to happen to my business. And I have the money to pay that loan back because I manage cash flow like a crazy person, but I am more concerned with the people that spent it and don't have the money to pay it back, and they're not planning for that, and they're not looking into the future and seeing the things that are happening.

Lisa Larter (14:28):
I love talking about shrinkflation because I feel like manufacturers are doing things and people aren't even noticing. I was at Publix and my husband loves to drink flavored soda water like La Croix or Bubly, and I'm looking at the Bubly box and I'm looking at the La Croix box and they're the same price, except Bubly now only has eight cans in a box instead of twelve. And I'm laughing to myself because I'm wondering how many people don't notice that. The same thing is happening all around us and people are not paying attention, so the same thing happens in your business when you're buying supplies. God help you if you are a retailer and you are not noticing that the cost of goods is rising and adjusting your pricing in accordance with that. You're going to end up in, I think, a really bad situation.

Mike Michalowicz (15:28):
Yeah. Shrinkflation's interesting. I think it actually serves us in one capacity. I noticed the exact same thing. I was returning from a business trip yesterday and I was at the airport. I didn't have time to eat a meal, so I stopped by one of the concession stands. They had Cliff bars there and I made the purchase; price was in “the same” whatever: $3/$4 for a bar. As I picked it up, I was like, "Oh, my gosh, this bar is now half the size of the original size." And so the consumer's getting not tricked here, but they are where it's like, "Oh-"

Lisa Larter (16:01):
They are.

Mike Michalowicz (16:01):
"... a bar is $40", but you're actually not getting the same thing; you're getting less. I think it actually serves as when it comes to food and stuff and consumption, and especially in the US, the waistlines and the consumption. Maybe it'll serve us.

Mike Michalowicz (16:15):
I noticed these soda cans that used to be 16 ounces now are 24 ounces. They're these massive cans and they're selling everywhere, so maybe actually it serves us, the shrink there. But when it comes to items where we're using for production or business, like you order a ream of paper... if you still use paper a lot... and used to get 200 sheets for $5. Now, you're getting 100 sheets for $5. You have to realize your costs have doubled.

Lisa Larter (16:45):
Exactly.

Mike Michalowicz (16:45):
So you have to respond in your business by streamlining things down. One common way is to continue that shrink, so shrink has this cascade effect. You shrink on me; I got to shrink on the next person, and the next person. At a certain point, that's not sustainable, but it's a little bit of an insidious way of navigating inflation.

Lisa Larter (17:03):
Absolutely. It is and I think a lot of people are not seeing it right now. The other thing that's happening is with all the supply chain issues, it's driving the costs of things up. I used to buy Hint Water at the Publix grocery store: 10 bottles for $10. It's now $1.60 a bottle and I know that's not because water's more expensive; it's because plastic is.

Lisa Larter (17:27):
And so, I just notice these little things and I notice the price of these things and it makes me think about... I am a numbers person and in the work that I do with small business owners, it's more so with women than men. Women are like, "Oh, I'm just not good at math," and they use that sometimes as an excuse to not look at the numbers. I love numbers. I love math. I love data. I love looking at all of that stuff to really understand how to run a business effectively, and it just concerns me because I think there's so much oblivion to when it comes to numbers and business that if people don't start paying attention, they're potentially going to put their business at risk. It's interesting. Elon Musk tweeted the other day... People are on the rich, right? The rich need to pay for world hunger.

Mike Michalowicz (18:27):
Yeah. Yeah.

Lisa Larter (18:27):
And so, he tweeted, "If WFP can describe on this Twitter thread exactly how $6 billion will solve world hunger, I will sell Tesla stock right now and do it." And then he said, "But it must be open source accounting, so the public sees precisely how the money is spent." I thought that was really an interesting way for the wealthiest person in the world to hold organizations accountable to how they spend the money that they want the uber wealthy to give. Did you see that?

Mike Michalowicz (19:04):
Yeah, no, I did not see that. That's really interesting. So, accounting can be manipulated by any entity, so governments are highly guilty, but so are public companies, private companies too. Private companies do these things called recasting. "I want to sell my business. Let's make the numbers look as

appealing as possible." And so it becomes funny money. We're playing around things.

Mike Michalowicz (19:30):
When I sold my company, we, as every company that sells, went through a recasting experience to put us in the most favorable light and you see... Yeah, public companies do this. Enron: they were able to change the numbers around long enough that their valuation exploded until we saw it was a house of cards. Governments live by this. You play with the numbers and make them say what you want to say. It is impossible to dispute cash in the bank dollar for dollar. If it's in the bank, it's in the bank. If it's not, it's not. That's why I do like that concept of open books. It is either you have it, or you don't. There's absolute clarity.

Mike Michalowicz (20:09):
When people say they're not good at math... I'm not particularly good at math... This isn't like... You're not running the square root of something and multiplying by pi. It's plus and minus, is pretty much the essence of it. Sometimes you do a multiple. It's not sophisticated math.

Lisa Larter (20:26):
It's not calculus.

Mike Michalowicz (20:27):
No, it's not. It's just basic arithmetic, and simple. And if even that gives you the icky feeling, get on the phone with your bookkeeper and just ask lots of business questions. Have them prove it to you by showing you the hard numbers. It really is that simple.

Lisa Larter (20:43):
I agree with you. It's a cop out because every woman knows-

Mike Michalowicz (20:47):
Its a cop out.

Lisa Larter (20:47):
... how much money she has in her bank account, and she can eyeball a grocery cart and tell you what it's going to cost when you get to the checkout.

Mike Michalowicz (20:52):
Exactly. That's all you need.

Lisa Larter (20:53):
And she's probably going to be within $20 of accuracy, so it's a cop out for not looking at what's really going on in your business and I think we can do better. I think there's some shame when it comes to asking questions of your accountant. People don't want to look dumb. They don't know what questions to ask. We put accountants on pedestals and think that they know better than we do and, in some cases, the person doing the bookkeeping in your accountant's office is making mistakes and you don't even realize it.

Lisa Larter (21:23):
So, as business owners, you can't be afraid to ask questions. You can't be afraid to look at a line item on your income statement and say, "Show me the details that are in there because that number seems odd to me." You've got to learn how to do that. I have another question for you.

Mike Michalowicz (21:41):
Yeah?

Lisa Larter (21:41):
So there is this thing called the Rule of 3 and 10. I heard about it from a colleague of mine, and I believe that that's the guy that founded Evernote was interviewed on a Tim Ferriss podcast and they talked about this. But essentially, the Rule of 3 and 10 means that every time you triple the size of your business, something breaks.

Lisa Larter (22:00):
So, if you go from one employee to three, you need to do things differently. You go from 3 to 10, you've got to do things differently. From 10 to 30... The same principle is true if you go from, say, 150,000 in sales to 500, to 1.5, to 5 million. And so, I have experienced this in my business too, that every

time either my sales go up by a multiplier of three or the size of my team goes up by a multiplier of three that everything breaks, and I have to dip into my profitability to invest in the architecture of the business in order to make things work again. So I am curious, when was the last time something like this happened to you? When did your business break and what did you have to do to fix it? Can you relate to that?

Mike Michalowicz (22:51):
I can relate to it. I've never heard of the 3 and 10 Rule, or theory, but I definitely noticed distinct stages associated with two outside measurements, which you already said were number of employees or revenue. It's interesting.

Mike Michalowicz (23:08):
I've noticed some businesses today, with the online economy, that it's one owner and they're the only employee and yet they do a million dollars in revenue. Rewind 20-30 years ago, when I started my first business, that just didn't correlate. We used a rule; we call it the 150 rule for service organizations and it's 150,000 that every full-time employee should bring in minimally $150,000 of revenue to put you in a profit full state. So if you have 300,000, you need two full-time equivalents or two full-time. If you have 500,000, now you need four because you have to get over that three threshold that puts you at 450, and I've experienced it. What I've found is a business owner can be actively involved at a micromanagement level up to about a million dollars in revenue where the business owner basically you know everything that's going on.

Mike Michalowicz (24:03):
Now, my experience is mostly service-based businesses. I did own a manufacturer so the numbers play out a little bit different, and my manufacturing business was bigger numbers where we had more sales per employee. But a service-based business, basically, is around a million dollars. I found that that's when the owner can no longer be involved in every element of the business. And between 1 upwards of about 3 million, it's actually the discipline of the owner removing themselves from doing work to being strategic in designing.

Mike Michalowicz (24:35):
My biggest business I ever grew to 7 million, so my practical experience expires there, but from 3 to we'll say 10, but I can say 7, it becomes about automation, technology systems investment. You got to be cash rich once you're at 3 to support going to the next 10 from my experience. So that was the three distinct stages I went through.

Lisa Larter (24:56):
Yeah. That makes a lot of sense. I'm in the between 1.5 and 2 million stage right now and my business grew at a rate of 50% for three years in a row. And so I've stabilized around the same for the last two years as I try to rework the structure, but I'm in the midst of doing that. I've just given approval to hire additional people and I know that is going to impact profitability short term, but it's what needs to be invested to get to the next level.

Mike Michalowicz (25:27):
Yeah, what I found is I needed... That's the classic integrator versus innovator. I had to stop trying to be the integrator and bring someone in to execute. It's actually slower... not slower, but more thorough, specific decisions like, "What's the quarterly shift we can make for our business that's going to have a great impact?" Where sub-million's all about, "What can we do today?" Sub-million to one million, you're in firefighting mode. Now, you're the fire chief and, "How we doing the dispatch in the best way and do we have the right equipment?" and so forth. I don't know if it's a great analogy.

Lisa Larter (26:05):
Super. Yeah. It's a great one. I love it. All right, I want to be respectful of your time. I know you have something right after this.

Mike Michalowicz (26:11):
Yeah.

Lisa Larter (26:11):
So, let's wrap up. I could talk to you all day, but let's wrap up with one piece of advice you would like listeners to carry forward into next year, so that they can have a profitable year.

Mike Michalowicz (26:21):
A little bit out of the box here, but I want to change the title to what we call ourselves. I'd say don't call yourself an entrepreneur or a business owner, call yourself a shareholder and here's why I like that term. I'm a shareholder in Ford. I own 100 shares. But what that means is my job is to give strategic direction through votes and to share and profit. If we treat ourselves as the shareholder of the business, it's less about, "How do I do everything?" and now it's about, "What strategically can I do to direct my business and channel my business forward, and profits a reward for being an investment in that business in the first place?" Change the title and you start shifting your identity and how you treat your business.

Lisa Larter (27:03):
I love that. I love that. That's really, really, really smart. It removes some of the mindset nonsense that we may buy into in terms of why we can or can't do certain things. I think that's really smart.

Mike Michalowicz (27:17):
That's right.

Lisa Larter (27:18):
Thank you very, very much, Mike. Anytime you want to come back and be on the show again, you have an open invitation.

Mike Michalowicz (27:25):
Oh, you're the best.

Lisa Larter (27:27):
I love, love, love having this conversation with you.

Mike Michalowicz (27:29):
This has been a real joy, Lisa. Thank you for having me.

Lisa Larter (27:32):
Thank you, Mike.

Lisa Larter (27:33):
Thank you for joining me for this episode of She Talks Business. If you enjoyed the show, you know the drill, leave us a review, tell someone about it and join the conversation on social media. Thanks for listening and until next time remember, done is always better than perfect.

Lisa Larter is a Business Strategist, Digital Marketing Expert, Author and Speaker.

The Lisa Larter Group helps their clients to formulate marketing strategies that support their business goals and objectives. Lisa provides consulting & advisory services, and implementation services including: social media & content management, book marketing, and website design.

Mike Michalowicz is an Author, Speaker and Entrepreneurial Innovator.

He created “Profit First”, which is used by hundreds of thousands of companies across the globe to drive profit. He is the creator of “Clockwork”, a powerful method to make any business run on automatic. In his 2020 release *Fix This Next*, he details the strategy businesses can use to determine what to do, in what order, to ensure healthy, fast, permanent growth. Today, Mike leads two new multi-million-dollar ventures, as he tests his latest business research for his books. He is a former small business columnist for The Wall Street Journal and business makeover specialist on MSNBC. Mike is a popular main stage keynote speaker on innovative entrepreneurial topics; and is the author of several books including his latest, *Get Different*.