agentprofitplanner

Precision agency planning

PROFIT POINTS

Understanding Profit

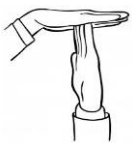
UNDERSTANDING PROFIT

This publication discusses the key financial aspects of a real estate agency business – concepts that are essential considerations for effective short and long term business planning.

Real estate agencies require the input of large amounts of energy and resources, particularly for the typical agency principal or manager, who must often juggle multiple roles while accommodating the increasing demands of satisfying statutory requirements and other risks involved in business ownership.

Accordingly, the agency owner should be adequately rewarded for the roles, risk and investment made in the business.

The reality is that many aren't. They become caught in the 'no-man's land' situation of being the primary sales producer, leaving little time to monitor and manage the key financial drivers of the business, relying on broad assumptions and using the bank balance as a measure of profitability. Just focusing on the short-term ability to survive.



The agentprofitplanner approach is to encourage business owners and managers to regularly step aside from the day to day distraction of working 'in' the business, taking the time to work 'on' the business.

What is the 'real' Break Even Point of the business?
What steps can I take to improve profitability and grow the value of the business over time?
How many staff do I require to achieve those objectives?
How can I reduce the risk of negative impacts on the business by better managing risks?

PROFIT: A DEFINITION

A financial gain, especially the <u>difference between the amount earned and the</u> <u>amount spent</u> in buying, operating, or producing something. **THE OXFORD DICTIONARY**

This definition refers to 'amount spent'. One expenditure that is not often accounted for is the 'opportunity cost' of the owner's time. If a 'real' Break Even Point is to be established, this cost should be factored in to the calculation.

BREAK EVEN POINT

Calculation of the Break Even Point (BEP) is critical to business planning.
In simple terms, the Break Even Point (BEP) is calculated as: -

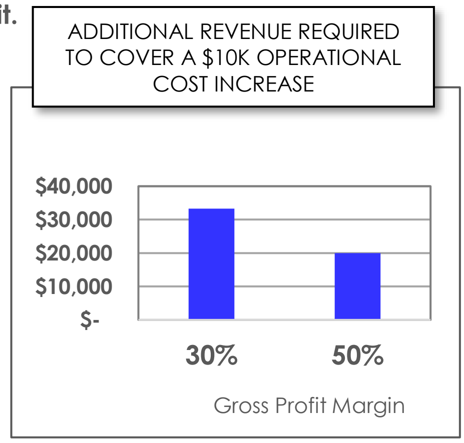
Revenue – (Variable costs + Fixed Costs) = 0

The agentprofitplanner philosophy suggests that the calculation of the BEP must include 'adequate compensation' for the agency owner. The agency owner may wear one or more of the following 'hats' and should therefore be compensated for these roles within a break-even scenario. This is an allowance for the 'opportunity cost' of time spent in each of the roles.

Role	**Compensation**
Business Owner:	Margin of Net Profit as reward for taking on business risk.
Business Manager:	A management fee for the time spent in this area.
Salesperson:	50% (?) of personally generated sales commissions.

MARGIN OF GROSS PROFIT: CRITICAL IMPLICATIONS

Managers must carefully monitor the margin of gross profit.



If gross margins are only 30 percent, for every $10,000 increase in operating costs, sales commission revenue needs to increase by $33,300 just to stay even. In some areas, this is equivalent to 4 or 5 sales. However, if gross margins are 50%, a $10,000 increase in fixed costs requires an increase in sales commissions of just $20,000.

Gross Profit is calculated by deducting the 'Cost of Sales' from the gross revenue. The main components of 'cost of sales' is: -

1. Payments to salespeople (salary and commissions)
2. Advertising over-runs are the key 'cost of sales.

Therefore, it is critical that agency managers ensure they maintain appropriate salespersons remuneration structures and carefully manage advertising costs.

SALESPERSONS BREAK-EVEN POINT

The Salespersons Break-Even Point is the point at which gross commission revenue generated by the salespersons covers the 'Desk Cost' calculated as: -

Desk Cost ÷ (1 - S/P *Cost)

*As a % of gross revenue generated by the S/P

DESK COST

Desk Cost is the cost of accommodating and servicing one salesperson calculated as: -

Operational Costs ÷ No. of *Salespeople

*including 'selling' principals/owners

Example

Total Operational Costs	$200,000
No. of Salespeople	5
Desk Cost	($200,000 / 5) = **$40,000**
Salespersons Gross Sale Commissions	$150,000
S/P Total Cost (wages/comm, super etc.)	$80,000 (**56%** of gross commission)
S/P Break-Even Point	($40,000 / (1 - 0.56) = **$90,909**

BUDGETING & FORECASTING

Budgets are an essential financial planning tool, a method of control over the day to day operation of the agency, and an opportunity to involve all staff in the budget planning and implementation process.

Budgeting and budgetary control can be regarded as a combination of forecasting, planning, and monitoring financial results against plans.

Typically, the budget will estimate expenses over the year ahead and then calculate the revenue required to cover those expenses after the 'cost of each sale' and allowing for a margin of profit. Once the budget has been established for the year, it is presented as a budgeted monthly cash flow statement used to monitor 'budget v actual'.

In many cases of business failure, the major contributing factor was the inability of the agency to either (a) failing to monitor progress of a predetermined budget, or (b) a failure to prepare a budget at all and operating on

The purpose of a budget: -

- Assisting the agency to control financial and overall business results.
- Assist in decision making (e.g. recruitment, marketing expenditure).
- Aid in coordinating the agency's operational activities.
- To assign responsibility to managers and staff for achieving levels of performance.
- Motivate managers and staff to commit to achieving budgeted goals
- Increase the credibility of the agency with financial institutions.

Key Financial Reports

Profit & Loss Statement

A detailed statement of the revenue generated over a period and the expenses incurred in generating that revenue. Revenue less expenses will result in either a profit or a loss.
The Profit & Loss Statement for the previous period is used to generate a 'Budgeted Profit & Loss Statement' which is then expressed as a series of monthly inflows and outflows for a twelve-month period ahead to enable the monitoring of 'budget v actual'.

Balance Sheet

A statement of the Owners' Equity (the 'value') of the business at a point in time. In simple terms, it is expressed as: -

Owners' Equity = Assets - Liabilities

Cash Flow Statement

A statement of the actual (previous period) or anticipated (budgeted) monthly inflows and outflows of cash. The budgeted cash flow statement is used to monitor 'actual v budgeted' and to formulate contingency plans. For example, arranging additional finance during periods where expenses are anticipated to exceed revenue.

Cash v Accrual Accounting

Accrual accounting: -

- Revenue / income being recorded when it is earned, not when it is received. In the real estate agency context, sales commission is recorded as earned in the month when the contract becomes unconditional (e.g. at the 'fall of the hammer' at auction), even though the agency will not actually receive the commission until the settlement date which may be in another period.

- Expenses are recorded in the month when they are incurred, not necessarily when they are due for payment which may be in another period. An example would be a property advertising account. The expense is incurred when the advertisement was lodged, however the bill may not be paid for 30 days.

Cash accounting: -

- Revenue is recorded in the month that it is received by the agency.
- Expenses are only recorded when they are paid.

Cash accounting is usually used in small business where expenses are generally paid at the time the service is provided or product purchased. However, Cash Accounting is not a good way to measure business performance. Even though a cash surplus during a month may seem to indicate a successful month, revenue contributing to the surplus may have been the result of listing and sales activity in previous months. During the current month, listing and sales activity may be well below budget.

Managers are encouraged to generate 'accrual' reports so that profitability for a given month can be measured. This is possible in most accounting software packages however, requires the entry of tax invoices for payables as they are received and invoices for receivables as the right to income becomes unconditional (e.g. upon the fall of the hammer at auction);

The Australian Tax Office allows small to medium size business to use either method.

MONITORING SUCCESS: THEY KEY INDICATORS

What cannot be measured, cannot be managed.

For the business and individuals, targets should be set around the key performance indicators:-

- No. Sales / Sales Commission Revenue
- No. of Exclusive Listings generated
- Average Commission per transaction (% & $)
- List to Sell Ratio (%)
- Appraise to List Ratio (%)
- No. personal contacts with past and potential clients required to generate a listing opportunity
- Advertising expended v advertising (vendor) reimbursed

Annual targets for the business and individuals should be broken down to monthly targets and carefully monitored. Failure to achieve monthly targets will have a compounding impact the budgeted level of profitability as the year progresses.

If targets are not being met, corrective action should be undertaken as soon as possible: -

- Release underperforming sales staff
- Increase personal prospecting
- Training (commission rates, listing presentations)
- Reduce fixed costs
- Price reduction campaign for properties outside anticipated market price

RISK & CONTINGENCY PLANNING

Agencies should take reasonable steps to avoid the negative financial impact arising from the occurrence of certain events. List below are common threats to agencies and how principals may guard against their impact.

Event	Management & Contingency
Damages claim for mis-leading or deceptive conduct	• Professional Indemnity Insurance • Internal controls, training
Damages arising from fraud	• Professional Indemnity Insurance • Internal controls, training
Damages arising from personal injury	• Public Liability Insurance
Inability to meet short term obligations	• Diligent & regular financial analysis • Pre-arranged line of credit
Suspension of Trust Account by statutory Authorities due to irregularities	• Internal controls & risk prevention procedures
Duress resulting from the departure of a major contributor to sales revenue	• Ensure more even contribution From each salesperson through continual recruitment, training and performance management