Business Performance Management

Part 1a

The Basic Equation
Cost per Order

For more visit http://bpmsg.com

The Basic Equation

Operational Result
= Sales - Cost of Sales - Expenses

OR* = (*S* - *COS*) - *EXP

Expenses: labor costs (salary), **rental**, **stationary**, **traveling cost**, **depreciation**, **etc.**

Cost of Sales,
Cost of Goods Sold (*COGS*)

Sales, **Revenue or Turnover**

Operational Result, Operational Income
Profit, Earnings before Interest and Tax (*EBIT*)

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The Basic Equation

Operational Result =
Sales - Cost of Sales - Expenses

$$OR = \underbrace{(S - COS)}_{\text{Gross Profit (GP), Gross Margin (GM)}} - EXP$$

Gross Profit (*GP*), Gross Margin (G*M*)

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The Basic Equation

Operational Result =
Sales - Cost of Sales - Expenses

OR* = (*S* - *COS*) - *EXP

Example:

Sales per month *S*	**$20,000**
Cost of Sales *COS*:	**- $12,000**
Gross Profit *GP*:	**$ 8,000**
Expenses per month *EXP*:	**- $ 5,000**
Operational result *OR*:	**$ 3,000**

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The Basic Equation

Operational Result =
Sales - Cost of Sales - Expenses

OR* = (*S* - *COS*) - *EXP

Sales *S* is the result of booked orders.
There is a time delay *t* between *OI* and *S*
Because of manufacturing time, delivery time …
We will neglect it in our model at the moment.

!

For simplification we replace **sales *S*** by **order income *OI*** in our model

The Basic Equation

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Key Ratios and Key Performance Indicators

1. **Cost per Order** ***CPO***
2. **Profit per Cost** ***PPC***

For key performance indicators, we use preferable *ratios* instead of absolute figure

Ratios make it easier to compare organizations of different size

Key Ratios

Operational Result =
Sales - Cost of Sales - Expenses

$$\frac{OR}{OI} = \frac{(OI - COS)}{OI} - \frac{EXP}{OI}$$

As we want to come to ratios,
we divide the equation on both sides by *OI*

Key Ratios

Operational Result = Sales - Cost of Sales - Expenses

$$\frac{OR}{OI} = \frac{GP}{OI} - \frac{EXP}{OI}$$

PR	GMP	CPO
Profitability	Gross Margin Percentage	Cost per Order

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Key Ratios

Operational Result = Sales - Cost of Sales - Expenses

$$\frac{OR}{OI} = \frac{GP}{OI} - \frac{EXP}{OI}$$

$$PR = GMP - CPO$$

Profitability = Margin - Cost per Order

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Key ratio:
Cost per Order

$$CPO = \frac{EXP}{OI}$$

Order income per month: $20,000
Expenses per month: $ 5,000

Cost per Order ***CPO*** = $5,000 / $20,000 = **25%**

PR = GMP - CPO

Profitability = Margin - Cost per Order

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Key ratio:
Cost per Order

$$CPO = \frac{EXP}{OI}$$

Order income per month: $20,000
Cost of Sales: $12,000

Margin $GMP = \frac{\$20{,}000 - \$12{,}000}{\$20{,}000} = 40\%$

$PR = GMP - CPO$

Profitability = Margin - Cost per Order

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Key ratio:
Cost per Order

CPO = $\frac{EXP}{OI}$

Profitability *PR* = *GMP* - *CPO*

= 40% - 25%

Profitability *PR* = 15%

PR* = *GMP* - *CPO

Profitability = Margin - Cost per Order

Key ratio:
Cost per Order ***CPO***

A **lower *CPO*** is better than a high ***CPO***

CPO should be **lower than** your gross margin percentage ***GMP***, otherwise the company will make losses

CPO is always positive (as you have always certain costs and expenses)

Increasing your order income *OI* (with given operating expenses) **will lower your *CPO*** and increase your operating result

Doing “cross country business” with order income in foreign currency, ***CPO* will reflect changing FX rates**