



# Business Learning by Dan

## Understanding our Members' Businesses: The Income Statement

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One of my program participants told me recently, "Learning business is like learning another language." Well, I'd have to agree. If we learn the basics, the advanced things are easier to do. So, today, we look in-depth at the basic financial statement language for any business: The Income Statement.

The Income Statement shows a business how much it had in revenue, costs, and profits during a given period. It's important to know how it works in order to better understand what it's telling us.

The Income Statement shows a business how much it had in revenue, costs, and profits during a given period.

Revenues reflect what was billed to customers during the period. Please see my earlier column on Price and Volume to explore how companies generate revenue and how training and development makes the difference for most companies.

Next up, costs. The costs of doing business during a period are sometimes the most obvious and understandable. Cost of raw materials, labor, technology, marketing, sales, research and development. These costs come in two types: Fixed and Variable. Fixed costs do not vary with the volume of sales. Variable costs do. It's important that you know the difference and how your company treats fixed and variable costs. So, ask around.

Revenue minus cost equals profits. There are three types of profits: gross profit, operating profit, and net profit. Let me explain:

**Gross profit** tells us what we sold minus the cost to produce it. Some say that this is an indicator of whether or not the business is being paid enough.

**Operating profit** tells if our costs are in line with our expectations. This is sometimes called EBIT (Earnings before Interest and Taxes). This is a good way to compare companies.

Finally, **Net Profit** tells us if our company made any profit after all the costs for the period.

<b>Income Statement</b>		
(In Millions)	2011	2010
<b>*Revenue</b>	<b>80</b>	<b>80</b>
*Direct Costs	40	36
<b>Gross Profit</b>	<b>40</b>	<b>44</b>
*Sales and Administration	18	16
*Depreciation	5	6
<b>Total Overhead</b>	<b>23</b>	<b>22</b>
<b>Operating Profit</b>	<b>17</b>	<b>22</b>
*Interest Expenses	9	5
*Financial Income	1	1
<b>Profit Before Taxes</b>	<b>9</b>	<b>18</b>
*Taxes	3	6
<b>Net Profit/Loss</b>	<b>6</b>	<b>12</b>

Every company has an income statement, although it may be slightly different than my example. All of these statements are easy to figure out, once you realize that they all follow the same sequence, top to bottom. Revenue minus direct costs minus overhead minus interest and taxes . . . They always follow this sequence.

Income statements may use unique terms, to better and more accurately reflect their businesses. Here are a couple examples to help you:

Universal Term	Insurance companies call it . . .	Banks call it . . .	Manufacturers call it . . .
<b>Income Statement</b>	Statement of Operations	Summary of Operations, Income Statement	Profit & Loss Statement
<b>Revenue</b>	Premiums, fee income, investment income	Interest income, non-interest income	Sales, Revenue
Direct Costs	Benefits, payouts, claims	Provision for loan losses, Interest expense	Cost of sales, Direct costs, Production costs
<b>Gross Profit</b>	(Not applicable in many cases)	Gross profit	Gross margin, Contribution
Overhead	General expenses, Operating expenses	Non-interest expense	Sales, General, and Administrative
<b>Operating Profit</b>	Operating profit, Operating earnings, Income from continuing operations	Income before interest and taxes, EBIT	EBIT, EBITDA, Operating Earnings
Interest and Taxes	Interest expense, taxes	Interest expense, taxes	Interest expense, taxes
<b>Net Profit</b>	Net gain from operations, Net income available to shareholders	Net Income	Net Profit, Net Earnings

Most of us can easily find where the training and development budgets are recorded: Overhead. Yet, we have a direct effect upon ALL three levels of profitability. Consider these questions:

1. What impact does your front-line technical training have on direct costs? *Learning and performance in continuous improvement, safe work process, efficient procedures all contribute.*
2. How do your customer service programs drive revenue and repeat business? *Learning and performance in service excellence, living the brand, following service business rules all contribute.*
3. What impact do sales training programs have on revenue, but also overhead expenses? *Learning and performance in sales skills, pricing, sales systems, sales support processes all contribute.*
4. How do your key individual contributor programs drive performance for revenue, direct costs, and overhead? (Consider actuarial development, underwriter training, engineer development, physician retention, etc.) *Learning and performance in rotational assignments, professional designations, and technical certifications all contribute.*

In a later column, I'll explore how we can create narratives around each of these impacts for our programs. It's in these narratives, called "business cases," that spur investment in training and development over the long term.

The income statement is a basic score sheet for your business. By understanding how it works, it's similarity from company to company, and how it's unique to your business or industry is vital to your success. Congratulations. Before you know it, you'll be fluent in this language too!

Where to learn more:

Berman, Karen and Joe Knight. *Financial Intelligence: A Manager's Guide to Knowing What the Numbers Really Mean*. Harvard Business School Press. 2006.

Celemi Apples & Oranges. Business simulation available from MDI, Inc.

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