

Chapter Two

Mistake number one: not leveraging your business.

The first powerful tool developed by early societies was the lever.

Societies which understood and developed applications for the lever invariably became more evolved and more powerful than their neighbours.

The concept of the lever is so simple that today we take it for granted. However, in an era when men, either alone or with the help of animals, had to lift every object, the use of the lever was revolutionary

It enabled men to lift objects which could previously never be lifted and thus enabled buildings to be built which previously could never even be dreamed of.

Armies which utilized the lever as the basis for developing new weapons of aggression obtained massive advantages over others.

Lever-driven weapons enabled vast metal balls to be hauled against previously impregnable castles.

Just as use of the lever was integral to the evolutionary path of man from a hunter or farmer into a sophisticated city dweller, so use of the principles of leverage are really what defines a modern, successful business.

Businesses during the middle ages were small hands-on operations.

Every village had its local blacksmith and other small tradesman-enterprises. There were no middlemen or intermediaries.

Farmers brought their produce into the town square on market days and sold directly to consumers.

There was simply no concept of a "businessman," being someone who is involved in making enterprises more efficient, larger and more profitable.

Most businesses in our society are really just only one-step removed from those primitive early business enterprises.

Your local plumber may employ an apprentice and will utilize more sophisticated tools of trade than his predecessor, including a van, mobile

phone and tools which will enable him to carry out his tasks in a far more efficient manner than plumbers of say one hundred years ago.

However, the enterprise of such a plumber is still basically a one man operation, where he handles the initial customer enquiries, provides quotations, carries out the work, usually involving a combination of his own labour and purchased materials and then usually leaves it to his wife or a part-time bookkeeper to handle the office work.

If your desire is to be a one-man-band, then you probably will not be too interested in reading further into this book.

Whilst such enterprises still fall within the definition of “business”, there is a clear delineation between one-man-bands and business enterprises which utilize the principles of leverage.

One-man-bands are low risk enterprises, which require very low levels of capital and are in effect a means of self-employment as much as being a business.

This is not to denigrate self-employment enterprises.

They provide invaluable functions within our society and usually also provide the operator with a higher standard of living than would be the case if he were to take comparable paid employment.

Failure to utilize the principles of leverage will, in most cases, not lead to business failure, in the catastrophic sense of resulting in insolvency.

Usually such enterprises have levels of debt, low wage costs and a capacity by the proprietor to withstand downturns.

A downturn in business usually results in the proprietor simply taking home less money. If the downturn is severe and prolonged, it may result in the enterprise being wound up and the proprietor going off and getting a job. It doesn't usually lead to insolvency

However, **failure to leverage will result in the business enterprise failing to prosper**, grow, evolve and satisfy the aspirations of the business-driver.

Use of leverage provides the means by which businesses develop beyond the one-man-band stage.

What then do I mean by “leverage”?

Anyone who has been reading the newspapers during the unfolding of the world financial crisis will understand the concept of financial leverage.

In fact, financial leverage has become a rather hated and denigrated term.

It symbolizes the greed of hedge funds and the Wall Street banks, which have collapsed so spectacularly.

When I talk about leverage here, I am not talking about financial leverage.

As indicated, this book has nothing to do with get-rich-quick schemes or investment tactics; it has to do with developing real businesses.

Leverage in the sense that I am talking about has to do with leverage of:

- ❖ Ideas
- ❖ Systems
- ❖ People
- ❖ Products

Let us look at some case studies to get an understanding of just how crucial leverage is to business development.

One of the classic tales has to do with the McDonald's story.

The original McDonald's brothers had developed processes in their single hamburger outlet.

Their processes enabled them to produce a small range of fast food products, at low cost, with consistent quality and, most importantly, with very fast turnaround times.

Their real interest was in food production technology and they proved themselves to be masters of the art. They had taken food production techniques to the next level.

This concept involved leverage of a system.

Their single store had taken the production line techniques of Henry Ford and applied it to fast food production.

Putting two hamburger outlets side by side, one using the old traditional method of receiving an order and preparing the product individually, usually with the same staff member handling the whole process, against the McDonald's system, the McDonald's system could produce far greater

output for the same number of staff, with greater consistency and with greater speed.

However, it took someone else to come along and see the potential to then further leverage the *system* in to what has developed as being the most successful food production company of all time.

That person, Ray Kroc, a distributor of milkshake machines, grasped the potential and it was he who led the way in massively leveraging the business.

In hindsight, it all seems so easy. Indeed, as with most brilliant ideas, it was simple.

The difficulty was not in coming up with the idea; it was really in believing in it and in handling the trials and tribulations of execution.

Coming a little closer to home and looking at case studies you can probably more easily relate to, let us look at how two of The Three Clients utilized leverage to build their businesses.

Firstly, think back to the Williams family.

I told you that Robert, the son, came back from the US with the concept of developing convenience stores in Australia.

The concept progressed to the point of their company executing a Master Licence Agreement with the US Company, allowing them the rights to set up the business in Australia.

This whole business was leverage. The system was developed. They now had the job of implementing it and scaling it up.

It had nothing to do with their existing business, other than the fact that there were synergies between the two. As a major food distributor, they could increase the size of their existing business by supplying what they hoped would be many hundreds of convenience stores across Australia. However, this was a side benefit.

The whole concept of a convenience store at that stage was unknown in Australia and obviously, it was not an easy task to set up the new business.

The new stores in reality were not greatly different from many existing milk bars.

Indeed, many of the better-run existing milk bars provided more attractive stores, better located, with a larger and more interesting range of products, provided at lower prices, with friendlier staff.

If that was the case, then how could this new business model hope to make headway?

What the new business model offered was a concept, which evolved from analysing customer needs and providing standard solutions. It was the standardization which allowed for scalability.

The new convenience stores were all located on sites, which offered easy parking.

These stores were usually located on main arterial roads, on the side which led out from the city, thus offering easy access for commuters to call in on the way home from work.

The stores had bright lighting, standard easy-to-find layout and were operated by staff who were trained in the art of customer service.

A special school was set up to train franchisees and staff.

This business is now the largest convenience store operator in Australia.

It has not been an easy ride to get there and, in the way of modern business, there are now several other chains, competing for market share.

The Williams family really impressed me with the vision they employed.

Notwithstanding numerous obstacles they were forced to overcome, they never lost sight of their dream of establishing an Australia-wide chain of convenience stores.

Could you imagine building a chain of hundreds of milk bars? It would be like herding cats.

The essential element was that by adopting standard processes, there was no effective limit to growth in store numbers.

No-one had even considered such an idea.

On a smaller scale, another of The Three Clients employed leverage in the development of a new product, which ultimately became the main-stay of his business.

If you are a keen gardener, you no doubt use this seaweed-based product regularly.

I received instructions from Thomas, at the time when his main business was still relatively small (employing probably no more than twenty-five people). He had come across a struggling business in Tasmania, which was run by an industrial chemist.

The business produced one single product from a small factory in Launceston.

The product had been developed by the proprietor, who had developed it over a long period of time from an initial idea that he had believed in – that certain seaweeds could be processed into a powerful fertilizer.

The trial results were most encouraging and the proprietor was emphatic in his belief in the virtues of the product.

Unfortunately, for him, business was not going well and he was running out of money.

In all likelihood, if Thomas had not come along, this business would have folded and you would not be using the derivative of this product in your garden today.

Thomas was impressed with the concept and bought the business for a relatively small sum and then employed the proprietor to help him develop the business further.

The market at which this product was aimed at was commercial farmers and they proved to be a difficult lot to crack.

Over quite some years, trials were conducted by different farming organizations and by different farmers and the results proved conclusively that application of this product significantly increased yields.

However, selling to tight-fisted farmers proved to not be an easy task.

Most simply did not want to know about the product and those who did know about it, were not prepared to pay a commercial price to buy it.

The seaweed-based division of this company was simply going nowhere and was becoming a drain on profits.

At several meetings over several years, I was asked my advice as to whether or not this division should be closed up.

There really was no evidence to provide even a glimmer of hope that it would become profitable and my general feeling was that Thomas would be better off forgetting about it and concentrating on his major products, which provided hefty margins, good growth and sales.

(Think back to Case Study Eleven in Chapter One.)

Fortunately, for Thomas, he ignored the advice of myself and others.

In a complete turn-about and as a last-ditch effort, the formula was altered to allow for application of the product for domestic garden use.

This company had had no experience whatsoever in distributing products to domestic users so it was really starting from well behind the eight-ball. It was the absolute fundamental belief in this product by Thomas which provided him with the persistence and drive to keep going.

This product is now by far the major product sold by Thomas's company and it has vindicated his long-term vision, which was to build the profits of his company based on his own products rather than distributing products made by others.

Thomas's experience illustrates the benefits of leverage of a *product*.

Despite the fact that he ran an industrial chemicals distribution company, Thomas was never a chemist nor indeed was he even a technical man.

He had transformed himself from being a soccer professional into a marketing whiz.

He always knew that if he could develop or acquire the right product, it would allow his business to grow by leaps and bounds. The cost of manufacture of such a product decreases significantly as the volume increases.

Thus, if a large enough market for a product could be found, there was really no limit as to where it could lead to because he could simply make more of the product and as this happens, the unit cost would decrease and thus the profit would increase.

This is a classic illustration of the beauties of leverage of a product.

There is no limit and the profit percentage rises as sales rise.

Coming closer to home again, the whole Prushka story is really one of leverage of an *idea*.

I formed Prushka because I could see that debt collection could only be handled efficiently if it were to be done in volume.

For this to occur, it became necessary to set up a business structure.

Large volumes of debt collection were simply not going to end up in the lap of a law firm.

It was necessary to set up a business which could be promoted to potential customers and which provided the structure for bringing in new business, whilst retaining existing business and servicing the clients' needs.

There is no practicable limit to the size Prushka can grow to. If it was to be based just on clients who dealt personally with me, the limit would have been reached very quickly.

Leverage and the Prushka Story

I learnt about business leverage at a young age.

When I'm talking about young, I am talking about really young.

I was twelve or thirteen at the time when the penny dropped.

This is how it happened.

Part of my weekly chores was to wash my parents' cars.

My father always drove luxury English cars, from the age when I can first remember.

He initially drove Daimlers and then switched over to a Rolls Royce and continued driving Rolls Royces until the day he died.

I used to love cleaning and polishing those beautiful cars and took great pride in seeing them sparkle and shine.

I am not sure where the idea came from but, I made the decision to approach several of our neighbours and see if they would allow me to wash their cars as well.

Within a short space of time, I was washing several other cars each week and getting paid the grand sum of ten bob per car (equating to one dollar in today's money and being equivalent to probably twenty five dollars in terms of current spend power – not a bad price).

Demand for my services grew to the point where I invited some of my local friends to assist me.

I got the jobs, showed them how to wash the cars and ensured that the work was carried out to my satisfaction. I then collected the money from the customers and paid my friends a set fee per car.

It did not take me long for me to realise that I was quite adept at knocking on doors, winning neighbours over, ensuring that high standards of car cleaning were maintained and then in attracting more friends and acquaintances to help carry out the work.

In a small way, I had made the switch from being a car washer into being a tiny-scale car wash businessman.

It became clear to me that there was no real limit to the number of cars we could wash. All I had to do was win over new customers and then get more of the local kids involved in helping me carry out the work.

I really was an early convert to the idea of business leverage.

At the time I started Prushka, I had absolutely no wish to handle any debt collection work in any manner whatsoever.

I had no experience in the legal side of debt collection and enforcement and, odd as it may seem, I knew that I would not make a good debt collector. It was simply not part of my make-up.

Accordingly, the decision for me to build up a debt collection business did not involve a switch from doing the work to running a business.

It started with running a business.

There is an oft-quoted business maxim:

“You must work **on** your business-not **in** your business.”

I never worked in my business. Accordingly, if it was to be successful, I had to be successful in building and developing the business itself.

I instinctively knew that Prushka would provide me with the nucleus of a business which had the potential to grow exponentially.

Like the tiny car wash business, there was really no limit on how large it could grow.

Obtaining more customers, hiring more staff and developing better systems could be carried out without effective limit.

This is easy to say but much more difficult to successfully execute.

However, most business operators do not fully grasp this point.

If they do, they are too nervous or too self-restrained to really go for it.

The rider to this is that if a business is to obtain the benefit of leverage, there must be a viable business model in existence in the first place.

A tree will find it hard to grow and reach its full potential in stony, dry ground.

Likewise, a business must be based on providing services or products for which there is either a current genuine need or a need which can be developed after the market is made aware of the benefits of what is on offer.

When I started Prushka, the market was not looking for **No Recovery – No Charge** debt collection services.

In many cases, the market was really not looking for any debt collection services at all.

A large percentage of the business market simply did nothing about their unpaid debts except write them off.

However, I logically knew that a business would prefer to not write off bad debts if it were to be offered a solution which would not cost it additional money. Thus, I understood that, long though the road ahead may be, there would be an underlying demand for the services Prushka offered.

It is beyond the scope of this book to examine what is required in order to ensure that there is a viable market for the products or services you offer.

Obviously, there are the extreme cases where there would obviously not be sufficient market.

For example, I could not conceive of a business which manufactures or sells chastity belts in a modern, western democratic society, having much chance of success.

In a similar vein, a business selling out-dated technology such as record players would really have a struggle to get off the ground.

Unviable businesses do not even qualify for consideration in terms of **The Ten Mistakes** because, even if the operator were to make none of the **Mistakes**, they would still fail.

The Prushka story involved leverage of:

- ❖ Ideas
- ❖ Systems
- ❖ People

Many of these different components are examined in more detail elsewhere in this book.

In this chapter, we are reviewing the underlying principles of leverage and the crucial role played by leverage in developing a successful business.

I came from a profession in which leverage played a very small part, namely the legal profession

It was and is still very difficult to obtain leverage in the practice of law.

As a result of this, most law firms, even the First Tier law firms, are essentially a collection of individual practices operated under one name and sharing facilities and resources.

Clients come to law firms largely because they know of or know a particular partner or practitioner.

The partner will have reached partnership level because he has a proven capacity to generate work.

The clients refer their work to a particular partner and normally expect him to either personally handle it or to take an active involvement in it.

This really limits the capacity of any individual partner to develop his client base and is a reason why partners in law firms invariably work excessively long hours.

The partner may be able to build up a small team of lawyers around him and be able to delegate some of the work to the team. However, he will not be able to get around the fact that his clients will want to have direct access to him and will expect him to know what is going on in their files.

Multiply this by say forty partners and you end up with a large law practice.

However, it is really a collection of forty individual firms.

If a partner leaves, he will usually be able to take his client-base with him because the loyalty of his clients is to that partner, not to the firm.

In circumstances like this, it is very difficult to obtain leverage.

For this reason, the good-will value of law firms tends to be low.

The same problem applies amongst all professional practices to some degree.

If the practice takes on a young practitioner, such as a dental practice taking on a young dental assistant, he will soon develop a relationship with the patients he deals with.

If he is good, he will develop good relationships and get repeat work from his patients as well as referrals of new patients to him.

However, the goodwill in those patients really belongs to him and not the practice by virtue of the fact that if he were to leave, he would be able to take most of those patients with him.

In reality, it is very difficult to develop leverage and thus, develop the business, in such circumstances.

Professionals know that if they are to be successful, they need to be personally successful within their chosen profession, work hard, service their patients or clients and make as much money as they can during their working life.

They know that at the end, when they retire, there will be little of value, which can be sold to someone else.

It is the knowledge of this, which attracted me away from law and into business in the first place.

I saw that spending a life-time as a pure professional may provide interesting challenges and a degree of satisfaction but it was not something which could be easily built upon.

It was not like getting more car wash clients and building the car wash business or getting more debt collection clients and building a debt collection business.

One has natural limits and the other does not.

For Prushka to develop sufficient scale in order to become a viable business, it had to build up a quality client base, which would refer regular ongoing debt collection work to it.

Getting the initial momentum going is a difficult task and this is the point at which most businesses flounder.

They simply do not gather enough momentum to become viable.

They are like an aeroplane rolling down the runway but being unable to develop sufficient speed to reach take-off.

Maintaining the Edge

It was crucial that Prushka develop techniques to enable it to handle the incoming work efficiently and productively and this really involved gaining leverage arising from development of the system.

This process has never stopped.

Leveraging an idea or system is not a one-off action. It is an ongoing process.

A significant part of my role is to poke around, prod, ask questions and look at ways and means of improving our processes.

We have now reached the stage where our culture is based around development, refinement and improvement and this means that there are

many other senior and experienced colleagues within the business doing the same thing.

Notwithstanding this, I never cease to be amazed at the results of my constant prodding and probing.

I learn at least one new significant piece of information every day, either about Prushka itself, our processes or about the legal work carried out by our in-house law firm.

I often come across little areas or pockets where I find out that we have been making fundamental mistakes which either result in our costs in a particular area being higher than they should be or resulting in us missing out on revenue which is there for the taking.

Our system is an evolving work of science and art and just simply continues to get better.

When we have lost staff members who have gone to work for competitors, I have never been concerned about them passing on knowledge about our operational systems to their new employers.

The reason is that I know that by the time they try to copy us, we will have already moved on.

What is essential is to enshrine a culture of development and evolution.

This is not something, which can be pilfered from a competitor or learnt out of a book.

It something which must be believed in and which must be built into the very gene-pool of the business.

It is this enshrined culture of innovation and development which provides enormous leverage to a business.

Leveraging Your Business

How do you know what to lever in your own business?

Unfortunately, there is no easy answer to this.

In many cases, you will intuitively know the answer to this, although you may need to sit down with a bottle of good Merlot and your closest business associates in order to ask the right questions.

The real questions are:

- ❖ What are the major underlying strengths of your business?

- ❖ What do you need to change your business model into in order to allow it to grow without natural limit?

- ❖ What are the elements, which attract current customers or clients to your business? Is it reputation, of low prices, provision of quality products, capacity to solve their problems?

- ❖ What really differentiates your business from its competitors?

- ❖ What changes to your business model would need to be made in order to completely remove you from the business operation?

For most small businesses, the seeds to the answer lie in the last question.

If you can change your business model so that you truly work on your business rather than in your business, you will be forced to make changes to implement leverage.

If you are carrying out or closely supervising the actual work, then you simply must empower others to do so.

If the revenue generated by you directly were to be removed from the business, then other areas of revenue-generation must be developed, which do not rely personally on you.

By doing these things, you will be forced to make decisions which you may find personally very difficult to make.

The more entrenched you are within the business, the more difficult that task is going to be.

However, if you do not develop a business model, which involves significant leveraging of your business, then your business will simply not grow and develop beyond a certain point.

It will be like the tree, which grows on dry, rocky soil.