

Strategies for Success—Billings Business News

Before you buy, ask, “What is my return on investment?”

Joe Michels, Ph.D, P.E., C.P.L.
Solomon Bruce Consulting LLC
Billings, Montana 59106
406-672-6387
jbm@solomonbruce.com
www.solomonbruce.com

One of the biggest decisions that a business owner has to make when buying a new piece of equipment or making a capital expenditure is the proverbial question, “What will my return on investment be with this piece of equipment?” This may seem like a dumb question, however, it is a question that is very germane in these turbulent economic times where cash flows are very sparse.

I was with a business owner last week that was having a furniture reduction sale. I was looking for a few pieces for my office, so I stopped to see what might be available. Interestingly, the business owner had at least 2 dozen brand new desks and chairs available for sale, at some great “fire sale” prices! The best part of this was the fact that all of the furniture was brand new, never having been used. The furniture was purchased in support of a business plan that failed to materialize, thus leaving the business owner with excess property that he had no use for.

The desks were beautiful pieces of furniture, well built, ideal for a tough office environment where many people are coming and going all the time. However, I do not need new desks, so elected to pass on any of the purchases. However, as I was driving to my next appointment, I begin to wonder if the business owner did at least a rough “return on investment” analysis before he spent several thousand dollars on all of these furniture pieces. Sadly, I concluded that he must not have, or he would not be in the bind that he was the day I visited with him.

For any business owner, the return on investment question is one that you need to ask every time that you are thinking about buying a new piece of equipment or making any capital expenditure. If I buy this piece of equipment, what will be my return on investment? This is a simple business question; however, the answer is usually much more complex. In a pure business economic sense, the question becomes “What does this asset do for my bottom line?” If the answer is nothing, or very, very low, then one must really question if the expenditure is worth making. However, there may be times that although the economic part of the question is very poor to non-existent; you may elect to buy the equipment anyway.

Let me give an example. I visited with a client several years ago that had spent several thousand dollars for a whole office suite. His office was very nice with all of his new furniture; however, he worked in a spare building at his ranch. He never had customer’s coming to his office, for

the bulk of his clients were obtained from the internet and long distance telephone service. When we discussed his reasoning for spending all of his dollars on a real professional office, he told me that he had to have all new furniture because he was the Chief Executive Officer of his company! He never even gave the ROI question any analysis, he was the CEO of his company and that alone required that he have a very nice suite of office furniture. Sadly, he did not understand that the fancy office furniture did not help him in increasing his bottom line—the main reason most business owners are in business!

Now, do not get me wrong! I like brand new, nice equipment like anyone else. However, as a business owner, the return on investment question must be front and center whenever you are thinking of buying new equipment. Image, visual appeal is important for professional recognition. If you are seeing clients in your office each day, you must have a nice office suite. Conversely, if the business is ran over the internet or through long distance phone, or you have no client interface, then furniture that is pre-owned and shows wear and tear may be perfectly acceptable and very serviceable.

I know another firm that is in the start up phase and is renting some pre-owned equipment from an individual that no longer had any need for the equipment. This equipment is used, is not of the most modern model, but is very functional and serviceable and works without question. Here, this owner recognized very clearly from the beginning that buying new equipment was not an option, especially since his firm was in start up phase. The equipment that he has works well, and best of all, the complete rent bill is only \$100/month. The equipment they use is worth over \$40,000! Now, this is a business owner who knows how to hang on to a dollar and be able to show good return on investment.

As a business owner, before you elect to make a significant capital expenditure, be very honest with your self and ask the return on investment question. Although the new equipment may be new, shiny and fancy, if you cannot justify the expense or financial return, then look at using some other means to fulfill the operational need. This may be leasing some equipment, buying used equipment, entering into a co-operative agreement with a local firm or governmental entity instead of spending precious working capital that is difficult to obtain, but more difficult to retain!

Many times a salesperson will come and present a new piece of equipment with such enthusiasm and excitement, that you cannot wait to get your checkbook and buy several of whatever is being sold. Be very careful here—really think, “Do I really need this?” “Will we really use this like we think we can?” “How have we been doing the task without this new piece of equipment?” “Will this equipment increase our bottom line significantly?” If you either cannot answer these questions, or do not know the answer, I would suggest that you wait until you have more data before making any expenditure. What this really does is allow you to keep your money longer. If you can “run the numbers” and see how the new piece of equipment can increase productivity, increase sales, improve quality or any host of other types of questions, then go for it. If the justification appears somewhat less than definitive, wait. It may be that the new equipment was a passing fancy that could not be justified, either economically or emotionally!

The converse of the question is also important. If you can show that a new piece of equipment will provide a great rate of return, saves time, money, frustration, and projects a wonderful image for your firm, then do not wait, get out and buy it today!

Joe Michels, Ph.D, P.E., C.P.L.
Solomon Bruce Consulting LLC
P.O. Box 866
Billings, Montana 59103
www.solomonbruce.com
May 2010
Page 3 of 3

Pull Quote:

“Will this purchase lower costs, increase sales or increase productivity?” If no or not sure, don't buy it!

27-year independent investment advisor, Billings, Montana