A Goal Without a Plan Is Just a Dream

Starting, Running, and Leading a Business

Steve Main

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The stories in this book are the author’s own. Company names, dates, dollar figures and the names of colleagues are reported as the author recorded them at the time. Where two of the author’s own records disagree, both figures are printed and the disagreement is noted in the text.

Nothing in this book is accounting, tax, legal or investment advice. It is one owner’s account of what he did and what it cost him.

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Introduction: A Goal Without a Plan Is Just a Dream

A goal without a plan is just a dream.

I have been saying that sentence for years. I have said it to employees, to partners, to bankers, and to people who came to me wanting to open a business. Everybody nods at it. It sounds like the sort of thing a person is supposed to agree with, so they agree with it, and then they go home and keep dreaming.

They keep dreaming because there is a second half to that sentence, and almost nobody says the second half.

The plan must also have a timeline connected to it. Without the date, it is still a dream.

Put the two together and you have the argument of this book. A goal with no plan is a dream. A plan with no date is still a dream. It is just a dream with a table of contents.

I have watched people write beautiful plans. Market analysis, pricing, staffing, a mission statement somebody paid for. Thirty pages, spiral bound. And not one date anywhere in it that a human being could miss.

You cannot miss a deadline that was never set. That is exactly why people do not set them.

A Month Is Not a Unit of Work

Now here is the part where I am going to lose some of you, and I would rather lose you on page two than page two hundred.

Most people who do put a timeline on a plan measure it in months. Sales up fifteen percent by the end of the quarter. Two hundred new customers in March. Open the second location by August.

A timeline measured in months is a lie.

Not because the number is wrong. Because nobody does anything in a month. A month is not something a person performs. It is a unit of accounting, invented so that a bookkeeper could close a ledger and a landlord could collect rent. No employee of mine has ever done a month of work. They have done Tuesdays.

Ask a man what he did in March. Watch what happens. He will tell you about three or four days that stuck in his memory and he will have nothing at all to say about the other twenty-seven. Those twenty-seven days were not empty. They were the month. He simply has no way to see them, because nobody ever asked him what March required of him at ten o'clock on a Wednesday morning.

That is where businesses are actually lost. Not in bad quarters. In ordinary Wednesdays that nobody was watching, stacked up until the quarter arrives already decided.

So when I say a plan needs a timeline, I do not mean a timeline you could print on a wall chart. I mean one that reaches all the way down to a specific person, at a specific hour, doing a specific countable thing.

Your Decade Is Made Out of Your Tuesdays

The two-hour checklist that runs through the middle of this book is not a management gimmick. It is not a productivity trick. It is the bottom rung of a ladder that reaches a decade.

I am going to prove that with arithmetic in the very first chapter, using my own history and my own numbers, and I am going to work it in both directions so you can check me.

Where the Stories Come From

In October of 1994 I borrowed seventy-nine thousand dollars, spent twenty thousand of it, signed a lease on an unfinished building in Carson City, Nevada, and started selling memberships in it while the contractors were still working. By the day the doors opened in February of 1995 we had two thousand members. Ten years later it was five clubs, more than fifteen thousand members, and over five million dollars a year. Today the same company runs six clubs under the Parkway Athletic Club name, does ten to twelve million dollars a year, and licenses the Fitness For $10 brand to operators in Arizona, Florida, Minnesota, Nevada and Canada that I have never set foot in. In the years most of these stories come from, the clubs were called Nevada Fitness, and that is what I will call them, because that is what they were called.

I have started more than ten businesses over the years. I have done budgets and sales projections for every single one of them, and my projections have never been right. I have been close. I have never once been perfect. That is not modesty and it is not an apology. It is the actual condition of the work, and the sooner you accept it the better your decisions become. Somebody sharp is already asking what the ladder is for, then, if the numbers are always wrong. That is a fair question and it gets a full answer in Chapter 1.

Almost every story in this book is a health club story, because that is where I have spent my life. The method is not a health club method. I have used the same three rungs on a consulting company, on a software product, and on a licensing business that owns nothing but a name. A restaurant owner, a contractor, a dental practice and a landscaping company all have a version of every number in here. Yours will have different words on it. It will divide the same way.

Two Mistakes, Before You Have Paid Me Any Attention

Business books have a problem. They are written by people who won, and the winning gets explained backwards as though it had been a plan the whole time. I have read those books. I have also been in the room where the plan was three men guessing.

So I will tell you now that two of the stories in this book are about money I lost. One is two health clubs I should never have opened, and what it took to close one of them without losing the people in it. The other is the most experienced manager I ever hired, and what four months of him cost. You will learn more from those two than you will from the five million dollars. Both get a full chapter, and I am not going to give you the endings here.

How the Book Is Built

Three parts. Start It, which is whether there is a business here at all. Run It, which is the numbers and the two-hour checklist that carries them. Lead It, which is the people who climb the ladder with you, and where I make the case that employees come first and that they know it, a position I hold more strongly than nearly anything else in this book.

Every chapter opens with one objective, written so that you can tell whether you got it. Not understand your market better. Nobody has ever walked into a building and counted an understanding. Something countable. Every chapter closes with the tasks that obtain it, each one with a column beside it saying how you verify that it actually happened, and one thing to do before lunch. The full set of questions for each chapter is collected in Appendix D, so you can read straight through and work them later. Read the chapter for the argument. Run the table for the result.

Some of this book is long division. I am not going to apologize for it. Almost every business argument I have ever been in was really an argument about a number nobody at the table had computed. You do not need to be good at math. I am not especially good at math. You need to be willing to write the number down and then look at it after you already have an opinion.

I will tell you what I think. It might be wrong, but you will know what I think.

What This Book Is Actually Offering

I cannot give you the instinct. I believe some brilliant business people are born with a sense that others do not have. Some of them have a seventh grade education and some have multiple degrees, and that sense is very hard to teach and very hard to learn.

What I can give you is the teachable part, and the teachable part is the ladder.

Chapter 1 hands it to you whole, rung by rung, with every division written out.

One word holds the whole thing together, and it is not a pleasant word.

Discipline.

Not motivation. Motivation is what a man has on the morning he decides to change his life, and it is gone by the fourteenth of the month. Discipline is doing the two-hour task on the day it bores you, on the day the number already looks fine, and on the day nobody would notice if you did not.

I have reached most of the goals I set, and not because I am clever.

That is not a boast and it is not luck. It is the same short list of tasks, done and then checked, for thirty years.

A goal without a plan is just a dream. A plan without a timeline is the same dream in a nicer folder.

Completed tasks = objectives obtained = GOAL achieved.

That equation is the whole book. The next chapter takes it apart and shows you how to build one, first across a month and then across ten years, and it ends where every ladder ends, which is a task somebody has to do before lunch.

I would read that chapter before the others. Everything after it is the same three rungs applied to a different problem.

Now go set a goal I could count.

Chapter 1: Task, Objective, Goal

The objective of this chapter: Break your longest goal backwards into a task one person can finish before the day ends.

In 2005 I was finishing an MBA at American Intercontinental University. Part of the work was reading other students' business plans and telling them what I thought of them.

One of them handed in a plan with two objectives in it. The first was to increase happiness. The second was to spend five million dollars.

I told her exactly what I thought, which is what I usually do.

Your objectives are still not quantifiable. You cannot measure happiness. It is an emotion. You also state that you want to spend five million dollars. That is a silly objective. Anyone can do that.

The objective must be a challenge, yet obtainable, and you must be able to know if you have obtained it.

It is like counting. You will know when and if you get there.

I have thought about that exchange for twenty years, because the whole method is inside it. Almost every business plan I have ever read fails at exactly that point. Not at the vision. Not at the market. At the moment where the writer had to state something a person could count.

Three Words, In Order

There are three words in this system and people use all three interchangeably. Fix that first.

A goal is where you are going and when you will be there. One statement, with a number in it and a date on it. Nothing sits above it.

An objective is a measurable piece the goal breaks into. Objectives are not smaller goals. They are the arithmetic of the goal, taken apart. If you hit every objective and still miss the goal, your arithmetic was wrong, and finding that out is one of the most useful things that can happen to you.

A task is what a specific person does today. It is on a checklist. It is countable. It gets done whether or not anybody feels inspired.

Now put the three of them together, in the only order that produces anything.

Completed tasks = objectives obtained = GOAL achieved.

That is the equation, and I mean it as arithmetic. The tense is doing work in every term. Not tasks, completed tasks. Not objectives, objectives obtained. Not a goal, a goal achieved. A task half done sits on the left side of that equation contributing nothing.

That is why a goal without a plan is just a dream. The plan is what stands between the two sides of it.

Now the rule most people violate before lunch.

Required tasks are not goals or objectives.

Walking every person who comes in the door through what you sell is not a goal. Publishing a week of social media posts is not a goal. In our clubs we called the first one touring the guest, and nobody arrives at the end of a decade and celebrates having given tours.

The opposite failure is just as common. A man tells me his goal is to post more often. That is a task, and he has built a one-rung ladder that leans against nothing. He will make the posts, he will feel productive, and a year later he will not know why he is in the same place.

Goals must have timelines set for them. Objectives must be countable. Tasks must fit inside a block of time a person can actually finish.

What Makes a Real Goal

Four tests. A goal has to pass all four.

Specific. Not grow the business. Not improve service. A number.

Measurable by somebody other than you. Hand the goal to a stranger. If that stranger cannot walk into your building a year from now and determine, without asking your opinion, whether you reached it, then it is not a goal. It is a mood.

Obtainable, and still a challenge. Those two run against each other and both are required. A goal that is not obtainable is impossible, and an impossible goal does not motivate a staff, it teaches them that your numbers are decoration. An easy goal is worse, because you will hit it and learn nothing.

Dated. Without the date it is not a goal. It is a preference.

And here is why any of this matters, in the plainest terms I have.

If you never set goals then you will never have a basis for evaluation.

Not for your business, not for a manager, not for yourself. Every performance conversation that turns into an argument about attitude is a conversation between two people who never agreed on a number. Progress is tracked through setting and obtaining goals, and followers will lose hope if progress is not tracked.

The Ladder, Short Range

Let me work one all the way down at short range, so you can see the machine before I run it over ten years.

A sales representative in one of my clubs wants to earn three thousand dollars a month.

That is a real goal. It passes all four tests, and others in the same building are already doing it.

Now work backwards.

Rung	The statement	The arithmetic
Goal	Earn $3,000 a month	
Objective 1	Make $1,500 per paycheck, paid twice monthly	$1,500 × 2 = $3,000
Objective 2	Produce $1,100 in commission per check	$1,100 × 2 = $2,200 of the $3,000
Objective 3	Write $3,000 in new dues memberships per pay period	
Objective 4	Write $2,000 in new paid-in-full memberships per pay period	$3,000 + $2,000 = $5,000 written per period
Objective 5	Work six days a week: two new dues	

Rung	The statement	The arithmetic
	memberships daily, one paid-in-full every third day	
Task	Tour every walk-in guest	Every one. No exceptions.

That ladder produced a commission rate and a price per membership without being asked, and I never stated either one. You start with a goal you chose and end up staring at a price you never consciously set.

The last rung is the one nobody argues with and almost nobody does.

Tour every walk-in guest.

Not the promising ones. Every one. A representative who skips the guest in work boots because he does not look like a buyer has just decided, on his own authority, to lower the top of his own ladder.

Your bottom rung will be worded differently. Estimate every job. Quote every caller. The rule is that it says every.

The Same Ladder, Ten Years Long

People will grant you that a month can be worked backwards. What they will not grant is that a decade can.

October of 1994. I have borrowed seventy-nine thousand dollars, spent twenty thousand of it, and I have a lease on an unfinished building in Carson City, Nevada, and a table in it where we are selling memberships. The club opens in February of 1995. That year the company grosses about four hundred thousand dollars.

Goal: annual gross over five million dollars, ten years out.

That passes all four tests, and it is more than twelve times where we are standing.

It took eight divisions to get from that goal down to a Tuesday morning. Here are the ones that matter.

Five million dollars a year is $5,000,000 ÷ 12 = **$416,667 a month**. That is five clubs grossing better than eighty thousand dollars a month each. So objective one is five clubs open and mature by year ten. I have one.

Ten years later the company had over fifteen thousand members across those five clubs.

15,000 ÷ 5 = **3,000 members per club**

Three thousand is not a number you reach and keep. Members leave. Cancellations ran about thirty-five a month per club, so a club at three thousand has to write thirty-five memberships a month before it grows by one person. Run that out against the growth we needed and it came to about fifty-two memberships a month per club.

52 ÷ 26 selling days = **2 memberships a day, per club**

Stop and look at that for a second. The ten-year goal, the five million dollars, the fifteen thousand members, the five buildings, has just turned into two.

The rest of the divisions run the same way. Two sales a day requires tours, tours require appointments booked, and half of every appointment book is a no-show.

The standard I actually set was two appointments booked every two hours by every sales representative. Two sales a day needs eight appointments booked, because half the book does not show and half of who shows buys. With two or three representatives working a floor, that standard runs well above the requirement, and it is supposed to. Set the standard at the requirement and every bad Tuesday is unrecoverable. Set it above the requirement and the month survives the Tuesdays.

The distance from two appointments before lunch to five million dollars a year is eight divisions.

That is the whole book.

Working Backwards Is the Skill

The ladder does not care what you sell. Mine was buildings and members. Somebody else runs it in trucks, chairs, crews, routes, seats or bids. The vocabulary changes at every rung. The divisions do not.

Almost everybody plans forwards. They start from where they are standing and add fifteen percent, because last year was ten and they are feeling good.

Forward planning always produces a number you can live with. Backward planning produces a number you may not be able to live with, which is exactly what you needed to find out.

Determining the Correct Tasks Is Critical

You can complete every task on the list. On time. Done properly. Confirmed by an honest person. And still miss the goal, because the tasks were the wrong tasks.

Determining the correct tasks is critical.

There are only two ways a task gets onto a list. It is derived or it is invented. Almost every task I have ever read on somebody else's list was invented, and the man who put it there could not tell me where the number came from.

Ask a manager how many social media posts his people should put up this week. Five. Why five? Because five sounds like a serious week. It is a number a reasonable man would defend at a meeting and could not defend on paper.

Now derive one instead. Every business has a funnel whether or not anybody has written it down. Here is mine, from my own buildings, and read it as history.

This many	Produces this many
100 phone calls	12 appointments
12 appointments	6 who show up
6 who show up	3 who join
3 new members	6 buddy referrals

Those were my ratios when the top of the funnel was a telephone. Nobody fills a health club with cold calls now. Marketing is different. It is so many social media posts instead of so many calls.

The top row changed. The shape did not. Posts produce inquiries and direct messages, inquiries produce appointments booked, appointments produce people who actually walk in the door, and the people who walk in produce members. Members still produce referrals, and referrals still come back in at the top without costing you a post.

Say I need three new members this week. Not want. Need, because the objective sitting above it says three.

Three who join requires six people to actually show up. Six who show up requires twelve appointments booked. Twelve appointments requires however many inquiries your own count says it takes. That many inquiries requires however many posts your own count says it takes.

The correct task is a number of posts, and I am not going to hand you the number.

I have not counted your funnel, and neither has the man who told you five posts sounds like a serious week. Count your own for one week and the number falls out the way an answer falls out of a division problem. Nobody had an opinion anywhere in those four lines.

The man working from the invented number does everything he is told all week and lands at half the requirement. He is going to get a conversation about attitude. What he needed was a corrected task.

When My Tasks Were Right and My Objective Was Wrong

Now the expensive version, and it is mine.

I opened two ladies-only health clubs, and the whole story is in Part Three. What belongs here is one fact about it.

The task lists in those buildings were fine. They were the same lists that worked in the co-ed clubs. If you had audited the checklists you would have found a well-run club.

They significantly underperformed our four co-ed clubs anyway, because the rung at the top was a belief. I believed a significant number of women were intimidated by co-ed clubs and would prefer a ladies-only setting. I never wrote down what fraction of the market that was. I never counted.

Belief is not a rung on a ladder.

A number you never write down cannot be wrong, and that is exactly the danger. An assumption that is never stated is never checked, and it holds up everything standing on it right until the structure comes down.

So every rung in those buildings was correct except the one at the top. Correct everywhere else does not help.

Correct execution of an incorrect task is the most expensive thing in business.

It does not look like failure while it is happening. Nobody is loafing. The reports come in complete. It looks like work until the cash flow says otherwise.

The test is not whether your staff is busy. The test is whether anybody in the building can show you the arithmetic that put each task on the list.

The List Is Not a Pile

Correct tasks are not enough. They have to be in order.

If you do not determine the correct priorities for your daily tasks, you will lose. It does not look like laziness. It looks like a hard-working person doing the fourth most important thing at ten in the morning.

Nobody finishes the list. Not once, not ever, in any business I have run or seen. Something breaks, somebody calls in sick, a customer has a problem at the counter. The day eats part of the list every single day.

So the real question is never whether the list gets finished. The real question is which part of it survives.

If the list is a pile, what survives is whatever was easiest, or whatever the last person to walk up to them asked for. If the list is ordered, what survives is the top of it, and the top of it is the part connected to the objective.

That is the whole reason we numbered ours. In our clubs, decisions are made according to the priorities on the checklist. A nineteen-year-old at a front desk with three things happening at once does not have to guess. He reads down the list and starts at the top.

An ordered list is not a list. It is a decision, made in advance, by somebody with more information than the person who will have to act on it.

I order ours with two rules and one test.

What produces revenue outranks what maintains it, and what maintains it outranks what improves it. A booked appointment beats a swept floor, and a swept floor beats a rearranged supply closet.

What is irreversible outranks what can be caught up. A customer who walks out unhappy at nine in the morning is gone. A report that goes in at four instead of two can still go in.

Then the test. For every task on the list, ask which objective it obtains. A task that cannot be traced up the ladder to an objective usually does not belong on the list at all.

Done Is Not Verified

There is one more word in the equation, and the entire system turns on it.

Completed.

A task that is not verified may as well not have been assigned.

Done is a condition a person reports about himself.

Verified is a condition somebody else can confirm, or a physical artifact proves.

Those differ the way an estimate differs from a bank statement.

People report tasks complete that are not complete. It has happened to me for more than thirty years and it will happen to you next week.

Very few of them are liars. A man means to finish his list after lunch, gets pulled away by an angry customer, handles it well, and by four o'clock genuinely remembers the list as done. He has just put a false number on the left side of your equation.

Watch what that costs. The list was reported complete. Appointments come in at seven instead of twelve. The manager reads the funnel and concludes his script is broken, or his market has softened. Then he goes and fixes the wrong thing, competently, for a month.

An unverified report does not merely fail to help you. It sends you to repair a rung that was never broken.

That is why the general manager files a report every two hours, and it is why I read them. That report is not surveillance and it is not paperwork. It is the verification step in the equation, and Chapter 16 is the whole machine.

Without it, completed tasks is a claim. With it, completed tasks is a fact, and only a fact can go into arithmetic.

My Projections Have Never Been Right

My projections have never been right. I said that in the introduction and I will keep saying it, because it is the actual condition of the work.

So what is the ladder for, if the numbers are always wrong?

The ladder is not a prediction.

A plan is a map, and Chapter 8 is about what that means. It is a guideline for decision making and a way to stay focused. It is not a fairy tale book.

What the ladder is for is this. It is a structure for finding out you are wrong early enough to do something about it, and for knowing which rung broke.

Take the ladder away and you miss five million dollars and know one fact. You missed.

Keep the ladder and miss the same five million, and you can walk down it. Were the posts published? Did they produce inquiries at the rate the funnel says? Did the appointments show up? Did they close? Somewhere there is a rung where the actual number stopped matching the required number.

Four different failures and four different fixes. Too few posts is a management problem. Posts and no inquiries is a message problem. Appointments and no shows is a confirmation problem. Shows and no sales is a training problem, or the wrong person in the chair.

A man with a goal and no ladder has a feeling about his business. A man with a ladder has a diagnosis.

A ten-year goal reviewed once a year gives you nine chances to be surprised. The same goal broken to two hours gives you a chance every two hours.

That is the difference between steering and reading a history.

The Bottom Rung Has a Size

The last question is size. How small does the bottom rung have to be before a person can stand on it?

A year is too big. A month is what most owners use, and a month is an autopsy. A day is still large enough that a man can lose the morning, tell himself he will make it up after lunch, and then not.

For me the answer is two hours. Short enough that a bad one is recoverable inside the same day. Long enough to finish something. It is the smallest block of time in which a business either produces or does not.

A man with a ten-year goal does not naturally feel that booking two appointments before eleven o’clock is the ten-year goal.

It is. When I look back at five clubs and fifteen thousand members and five million dollars, I cannot point to the decision that produced it. I can point to tens of thousands of two-hour blocks in which somebody either booked the appointment or did not.

The hourly task is the decade, arriving in the only size a human being can actually handle.

And skipping one does not feel like anything. Skip one block a day for a year and it is about three hundred blocks, and three hundred blocks is more than two months of production for that club, gone.

That is how decades get lost. Not in a catastrophe. In a nothing, repeated.

The tasks are boring. That is not a flaw in the design. That is the design. Booking two appointments before eleven o’clock is not interesting on any single Tuesday, and on all of them together it is five million dollars a year.

Work the equation backwards to build it. Work it forwards to get it. Verify every rung, or you are not doing arithmetic. You are hoping.

Two hours is the answer I landed on, and I have not moved off it in thirty years. What that looks like when it is running in six buildings at once, and how the reports get read before lunch instead of after the month closes, is Chapter 16. You do not need it yet.

What you need first is the rung above the goal, and almost nobody builds it. Before you can set a number for a business, you have to know whether there is anybody left in your town to sell to.

Go count them. That is the next chapter.

The Tasks That Obtain It

Task	How you verify it
Write your longest goal in one sentence, with a number in it and a date on it.	The sentence is on one dated page, and a stranger who read it could tell you a year from now whether you hit it.
Divide that goal down to a yearly, monthly, weekly and daily number, showing every division on the page.	Every division is written out, and a second person can reproduce your arithmetic from the page without asking you a question.
Count your own funnel for one week: contacts made, prospects produced, prospects who sat down with you, prospects who bought.	Four numbers exist for that week, recorded by the person who did the work and initialed by that person’s manager.
Divide your daily requirement by your own funnel ratios to get the number of contacts one person owes per day.	The number is written on the whiteboard where the staff can see it, and it traces back to a division on your page.
Name the objective sitting directly above every task on your daily list, and strike any task that has no objective above it.	The list is shorter than it was, and an objective is written beside every line that survived.

Do This Now

Write your longest goal in one sentence. Does it contain a number and a date? Could a stranger tell you a year from now whether you reached it?

Part One

Start It

Chapter 2: Nobody Is Waiting for Your Business

The objective of this chapter: Know how many people inside your circle fit your category and are not already somebody's customer.

How many people live in your town? How many of them would ever buy what you sell? How many of them already buy it from somebody else?

Only the third question is worth anything, and almost nobody asks it.

I have sat in more than one meeting where somebody put the population of a city on a slide as though that were an argument. Two hundred thousand people live in Reno. Wonderful. Almost none of them are going to buy what you sell, and in my own industry I can tell you within a fraction of a percent how few.

Nobody is waiting for your business. Not one person in your town woke up this morning hoping you would finally open. They already have a place to go, or they do not want what you sell at any price. Those are the only two groups. Your entire business has to come out of the second group, or you have to take it away from somebody in the first.

Thirteen Point Six Percent

Every category has a ceiling.

Some fixed share of any population will ever buy what you sell, at any price, from anybody. That share is not the population. It is usually a small fraction of it, and if you do not know your fraction you do not know your market, no matter how many people live in the county.

Here is the number that governed every location decision I ever made.

Thirteen point six percent of a given population nationwide will join a health club. That is from IHRSA, the International Health, Racquet and Sportsclub Association, which is the trade association for our industry and which counts this for a living.

Sit with that number for a second.

Eighty-six point four percent of the people in a market will not join a health club. Not from me, not from 24 Hour Fitness, not from anybody. They would not come in if we gave it to them free. They did not come in when we built a climbing wall and a virtual golf course and put forty thousand pounds of free weights on the floor, which is exactly what we did. They are not the market. They were never the market.

I am picking on health clubs because that is my industry. Every industry has this number. Yours has one too, and you probably do not know it, and there is probably an association or a trade publication that has already counted it. In my industry it was published. In yours it may take one phone call to a trade association and the price of a membership. Go find it before you sign anything.

Because here is what the number does. It takes the population of your town, which feels enormous, and shrinks it to the actual pool. And then a second thing happens that shrinks it much further.

If Nobody Has Counted Your Industry

Some of you are in a business where no association has published a penetration rate. You can still get one. There are three ways and you should use whichever is available.

The first is the trade association or trade publication, which is what I used. Somebody is already counting your industry and selling the answer for the price of a membership.

The second is the census. The State of Nevada Demographer publishes county and city populations, projections out twenty years, and the methodology behind them, and every state has an equivalent. It is free. I used the Nevada Small Business Development Center’s site to find all of it, and I sent the links to my own owners so they could check my work.

The third way is to build the rate yourself by working backward, and it is the most interesting one.

Count the customers every competitor in your circle already claims, divide by the population, and you have the share of the county that is already buying. I will do that for Washoe County in a minute, once the competitor count is on the page, because the same numbers do both jobs.

The Question Is Not How Big the Town Is

The pool is not yours. Somebody is already sitting on most of it.

In 2004, Washoe County had a population of 373,233 according to the State of Nevada Demographer. Reno is in Washoe County, and Reno and Sparks together were well over two hundred thousand.

Run the first step.

373,233 × 13.6% = about 50,760 people

That is the whole pool. Every human being in the county who will ever, under any circumstances, belong to a health club. Fifty thousand seven hundred and sixty out of three hundred seventy-three thousand.

Now the second step, which is the one that matters. How many of those fifty thousand are already in somebody’s club?

I found out by walking into every health club in the county and asking. That method gets its own chapter, and it is Chapter 4, so I will not spend the whole of this one on it. What I will give you is what came back.

Club	Members
24 Hour North	5,100
24 Hour South	5,400
Double Diamond	2,300
European Fitness Center	3,700
Sports West	3,100
Lakeridge Tennis Club	1,700
Nevada Fitness Sparks	5,100
Nevada Fitness Reno	800
Other clubs	4,200
Total claimed members	**31,400**

Thirty-one thousand four hundred people in Washoe County already had a club, and two of those lines were mine.

50,760 − 31,400 = 19,360

Nineteen thousand three hundred and sixty people in Washoe County fit the profile of a health club member and were not in a health club. That is the market. Not three hundred seventy-three thousand. Not two hundred thousand. Nineteen thousand three hundred and sixty.

That is the number I got to sell to.

Now run it the third way, as a check on the rate itself.

31,400 ÷ 373,233 = 8.4%

Eight point four percent of everyone in the county was already in a health club, against an industry ceiling of 13.6 percent.

31,400 ÷ 50,760 = 62%

The Reno market was already sixty-two percent full.

That is a very different sentence from “Reno has two hundred thousand people.” Sixty-two percent full says the easy part is over. It says the remaining thirty-eight percent are the people the industry has failed to reach for twenty years, and that they will be harder and more expensive to sign than anybody currently on a membership list. It also says the market is not closed, because thirty-eight percent of fifty thousand is still nineteen thousand people.

Do that division for your market. Customers already served, divided by the total pool. It is one line of arithmetic and it will tell you what kind of fight you are walking into.

I Ran It Three Ways and Got Three Answers

Now the honest part, and it is a good one, because I still have all three spreadsheets.

I did not run the Reno market once. I ran it three separate ways, on three separate worksheets, and I got three different answers for the unserved market.

Nineteen thousand three hundred and sixty. County population times 13.6 percent, minus every member claimed by every club in the county, mine included. That is the arithmetic above and it is the one I trusted most.

Four thousand three hundred. Same club list, same 31,400 members claimed, but a total pool of only 35,700 instead of 50,760. Subtract and you get 4,300. That sheet also carried three lines I still think are the most useful three lines in the whole file. Annual increase in population: 5,221. New potential members annually: 731. New Nevada Fitness members annually: 209. In other words, the market itself was handing the entire industry about seven hundred new prospects a year, and my share of that flow was a little over two hundred. One note on that sheet, because I said I would print these when I found them.

Seven hundred and thirty-one against five thousand two hundred and twenty-one is fourteen percent even, not the thirteen point six the rest of my work ran on. At 13.6 the answer is seven hundred and ten. I do not remember which rate I typed that night. The difference is twenty-one people and it changes nothing about the shape of the flow, so I have left the sheet the way I wrote it.

Twenty-five thousand five hundred. A third sheet, headed “Total Health Club Members in Reno, NV,” listing the same competitors with 24 Hour North at 5,200 instead of 5,100 and Other at 4,100, and reporting 25,500 as “Available Members.”

I will tell you what I now think that third number was, because it is the most instructive thing in this chapter.

Add up that third sheet. 5,200 plus 5,400 plus 2,300 plus 3,700 plus 3,100 plus 1,700 plus 4,100 is 25,500 exactly. And my own two clubs are not on that sheet.

Twenty-five thousand five hundred was not the available market. It was the total membership of my competitors. Somewhere between building the sheet and labeling the answer, the meaning of the cell changed, and nobody caught it. I did not catch it. I am catching it now, twenty years later, writing a book.

That is not a small thing. That is a number that would have gone into a presentation.

As for the 35,700, I cannot now reconstruct what population base produced it. It is smaller than the county pool, which suggests I was drawing the boundary around Reno proper instead of all of Washoe County. That is a defensible boundary. It is just a different question, and it gives a very different answer.

What the Three Answers Actually Told Me

Here is why I am not embarrassed by any of this.

Three methods. Three boundaries. Three answers: 19,360, 4,300 and 25,500. Throw out the third one, because I have just shown you it was mislabeled. That leaves a range from 4,300 to 19,360.

The new club needed one thousand members.

Four thousand three hundred, at the same ten percent capture I used on the larger figure, is 430 members. That is well under the thousand the club needed. My most pessimistic pass failed my own test. To pull a thousand members out of a pool of 4,300, I would have had to take twenty-three percent of the unserved market. That is more than twice the rate I used anywhere else in this book.

That is what running it three ways is for. Not to find the right answer. To find out whether the decision changes when the answer changes.

Here it changed. At 19,360 the new club was an easy yes. At 4,300 it was a no, and the whole case rested on where I had drawn the circle. What I should have written down, in the plan, is which of the three numbers I was betting a lease on.

If your business only works under your most optimistic estimate, you have not built a case, you have built a wish. Run it under the estimate you hate. If it still works, go.

At ten percent of the larger figure, the arithmetic ran like this:

19,360 × 10% = 1,936 members

1,936 × $39 monthly dues = $75,504 a month in dues

And the lowest month any Nevada Fitness club ever had in new memberships, personal training and pro shop sales, in the entire history of the company, was well over ten thousand dollars. Add it and you are at eighty-five thousand five hundred and four dollars of monthly gross against a club I expected to cost something in the neighborhood of fifty thousand dollars a month to operate.

I wrote both of those down as claims that could be proven wrong rather than as forecasts I liked. Chapter 8 is about why writing them that way matters.

The Five Mile Line

One more thing decides all of this before you compute anything, and it is where you draw the circle.

Every business has a radius, and the radius is measured in minutes rather than miles. A person will drive so far for what you sell and not one minute farther. A dry cleaner has a short radius. A furniture store has a longer one. A specialist people fly in to see has almost none at all. You have to know yours before you can count anything, because the radius decides which population you are even allowed to multiply.

Here is mine. The average health club member drives ten to twelve minutes to get to their club. That translates to about five miles from the site. That is a rule of thumb in my industry rather than a published number, and it matched everything I ever saw in Nevada.

Five miles. That was the business. A person eleven miles away was not my customer no matter how good the club was, and no amount of advertising is going to fix a map.

This is why my three answers differed. The population base changes depending on where you put the circle, and every number downstream moves with it. Draw the circle first. Write down why you drew it there. Then count.

The Snowball, and the Trap Inside It

There is a bias in this chapter that nearly got me, and I want to name it because it is the most expensive thinking error in market analysis.

Since Nevada Fitness entered Northern Nevada, more than ten competing health clubs closed their doors. One of them was 24 Hour Fitness's Carson City location. Every competitor from Carson City down to Minden was eliminated except one. Five health clubs closed in seven years. Our market share in Carson City behaved like a snowball rolling downhill.

So when I looked at Reno, what do you suppose my gut said?

It said Reno will do the same thing.

Max Bazerman, who studies how managers actually make decisions, documents that we judge how likely something is by how easily we can call an example of it to mind. Psychologists call it the availability heuristic. My examples were all Carson City, and Carson City was a rout.

Reno was not Carson City. Reno had 24 Hour Fitness with two locations and better than ten thousand members between them. It had Double Diamond, European Fitness Center, Sports West and Lakeridge. My own Reno club had eight hundred members while my Sparks club had five thousand one hundred. That eight hundred was on the same sheet as everything else, and I looked at it every time.

Write down the counter-evidence on the same page as the evidence. Then it cannot be conveniently unavailable.

The Ceiling Moved

Now I have to tell you something that undercuts half of what you just read, and I am telling you because it is the most valuable thing in this chapter.

The 13.6 percent number is not true anymore.

When I wrote *Total Health Club Management*, 13.6 percent was the industry figure and I treated it as a law of nature. I built market analyses on it. I told other operators to build theirs on it. I have used it in this chapter to walk you through 2004 because that is honestly what I used at the time and the arithmetic has to match the decision I actually made.

For 2025 the Health and Fitness Association, which is what IHRSA renamed itself in 2024, reported that 81 million Americans belonged to a gym, a studio, or some other fitness facility. That is 26.1 percent of the population aged six and older. An all-time high, and up 5.2 percent over the year before.

The ceiling did not move a little. It nearly doubled.

Run Washoe County again with the number that is true today rather than the one that was true in 2004.

373,233 × 26.1% = about 97,414 people

That is generous, because the 26.1 percent is measured on the population aged six and older rather than on everybody. It is still not close.

Against the 50,760 I was working with. The same county, the same people, and a pool almost twice the size. Every conclusion I drew in 2004 about how full that market was, how hard the remaining customers would be, and how much room was left for another club, was drawn against a boundary that has since moved forty-six thousand people.

I want to be careful here. That does not mean I was wrong in 2004. I used the best number available and I checked it three ways. It means something more uncomfortable than being wrong.

The single most important input in your market analysis is not a constant.

Think about what that number actually is. It is not a physical limit like the seating in a room. It is a description of how many people in a country currently want the thing you sell. That is a behavior, and behaviors change. Between then and now the country got heavier and more worried about it, doctors started writing exercise into treatment plans, and a whole tier of clubs made membership cost less than a couple of coffees a week.

I was part of that last one. Fitness For $10 exists because we bet that price was holding people out.

So here is a thing I got wrong twice over. I wrote that price decides which slice of the ceiling walks into your door and does not raise the ceiling itself. Then I spent twenty years helping raise the ceiling with price. I did not connect those two facts at the time. The industry did not lift 13.6 to 26 by building nicer clubs. It lifted it by making the decision small enough that people who had never considered a gym would try one.

The practical instruction is short.

Pull the number yourself, this year, before you use it. The trade association for your industry publishes it and updating it costs you one afternoon. If your business plan contains a market figure you learned once and never checked, you are not sizing your market. You are sizing a market that existed when you learned it.

Second, watch the direction. A ceiling that is moving up means the growth is not only in taking somebody else's customers. It means there are people arriving in your category every year who have never belonged to anybody. Those are the cheapest customers you will ever sign, and the operator who notices the ceiling moved gets them before the operator who is still quoting a twenty-year-old statistic.

Third, and this is the one that costs money, a moving ceiling cuts both ways. It went up for health clubs. It has gone down for plenty of other categories, and the operators in those categories were all still using the number from the year they started.

Count it again. Every year.

I Did Not Count the One That Mattered

I did all of this work for Reno. I did not do it for the ladies-only clubs.

I never found a trade number for what percentage of the female population wanted a single-sex facility. I never shopped a ladies-only competitor and asked two managers how many members they had. I believed it, and belief felt like enough because I had been right about Carson City several times running.

Both ladies-only clubs significantly underperformed the four co-ed clubs, and it caused a cash flow problem in those two units. In 2004 I closed the Carson City one and converted the Reno ladies club to co-ed. That decision cost me the price of two build-outs, several years of two leases, and a stack of equipment that I ended up moving down the road in a truck.

The thirteen point six percent number would not have saved me by itself. But the discipline behind it would have. The discipline is that you do not get to assume a segment exists. You count it or you do not open.

Count the market before you sign the lease, because nobody in that market is waiting for you.

The Tasks That Obtain It

Task	How you verify it
Draw your circle on a paper map and write the drive time and the date beside it.	The map exists with a circle, a mileage figure and a date on it.
Pull this year’s penetration rate for your industry and write the source beside the number.	Anyone can go to the source you named and get the same figure.
Multiply the population inside the circle by that rate and write the arithmetic out on one line.	Somebody else can redo the multiplication and land on your number.
Write down every competitor inside the circle and how many customers each one claims.	Every line names a competitor and the date somebody gave you the number.
Subtract the competitor total from the pool, then run it again with a tighter circle.	Both answers sit on the page and the one you are betting on is circled.

Do This Now

List every competitor inside that circle and write down how many customers each one has. If you cannot fill in a single number, what does that say about how ready you are to open?

Chapter 3: The Seventy-Nine Thousand Dollars

The objective of this chapter: Know your reserve in dollars and the loss at which you will stop.

In 1994 I borrowed seventy-nine thousand dollars to start a health club in Carson City, Nevada.

I spent twenty thousand of it.

The other fifty-nine thousand sat in the bank and did nothing for a year. It bought no equipment. It signed no lease. It hired nobody. It appeared on no list of accomplishments, and if you had audited me at the end of the first quarter you would have said I was carrying dead money at interest.

The entire loan was repaid with interest before the end of 1995.

Almost everybody who hears that story hears the twenty thousand. Twenty thousand dollars to start a business that would be grossing over five million dollars a year within a decade, and ten to twelve million a year today. That is the part that sounds good, and it is the wrong part.

The fifty-nine thousand is the lesson.

What the Other Fifty-Nine Thousand Was For

It was for being wrong.

Not for a disaster. Not for a fire or a lawsuit or a flood. For the ordinary condition of being a business owner, which is that the thing you carefully projected does not happen on the schedule you projected it on.

My projections have never once been right. Close is the best I have ever done.

Read that again, because I want you to notice what it does and does not say. It does not say my projections were bad. It says they were never right. Close is the good outcome. Close still costs money, because close means the revenue arrived in month seven instead of month four, and the rent showed up in months four, five and six anyway.

Money that covers the gap between your projection and reality is not idle money. It is the only thing standing between a business that is merely wrong and a business that is closed.

Run the Arithmetic on My Own Pro Forma

I want to show you how thin the estimates are, using my own numbers on my own company, because it is the fastest way to make this point.

Years later, when we were analyzing whether to open another club in Reno, this is what I wrote down as the unit model. A ten thousand square foot satellite club. One thousand members needed to maintain a significant monthly profit. Total monthly expenditures of fifty thousand dollars. Dues of thirty-nine dollars a month.

Fine. Now run it.

1,000 members × $39 = $39,000 a month in dues

Add the other income. The lowest month any Nevada Fitness club ever had in new memberships, personal training and pro shop sales combined, in the history of the company, was well over ten thousand dollars. Use ten thousand, which is the floor.

$39,000 + $10,000 = $49,000

Against fifty thousand dollars of monthly expenditure.

$49,000 − $50,000 = ($1,000)

That is not a significant monthly profit. That is a thousand dollars short, using my own two numbers from my own document. One thousand members at thirty-nine dollars does not carry a fifty thousand dollar month. It nearly does. It does not.

I wrote both of those numbers. I believed both of them. They do not agree with each other, and the disagreement is only one thousand dollars wide, which is exactly why nobody catches this kind of thing.

Now imagine you are opening with no reserve and your business is a thousand dollars a month short of what you told yourself. How many months do you get?

Nobody Fails Because of the Big Number

Businesses do not usually die of catastrophe. They die of a small monthly gap that ran longer than the bank account.

That is as true of a restaurant, a print shop or a two-truck plumbing company as it was of my clubs. The gap is different sizes. It kills the same way.

I know this one from the inside. The two ladies-only clubs did not blow up. There was no dramatic month. They significantly underperformed the four co-ed clubs, quietly, for a long time, and what that produced was a cash flow problem in those two units.

Notice the language. Not a profit problem. A cash flow problem. Those are different things and Chapter 14 is entirely about the difference. For now, the short version. Unprofitable is a condition you can survive for a while if you have money. Out of cash is a condition you cannot survive at all, regardless of how good next year looks.

The reserve is what buys you the “for a while.”

Undercapitalization Kills Businesses That Were Otherwise Right

I want to say that plainly, because it is the reason this chapter exists.

The two ladies-only clubs were a bad idea. I have said so and I will say so again. But I have also watched good ideas die, and they die the same way, and it is worth separating the two failures so you do not confuse them.

A bad idea fails because nobody wants it. There is no amount of money that fixes that. You can pour a reserve into a business the market has rejected and all you will have purchased is a longer, more expensive version of the same answer.

A good idea fails because the money ran out before the market showed up. That one is entirely preventable, and it is preventable in advance, and it is not preventable at all once it is happening. By the time you are short, your options are gone. You cannot raise money from a position of need on terms you would accept. Nobody lends to a business that is out of cash, and anybody who does will charge you accordingly.

That is what the fifty-nine thousand dollars was. It was not confidence. It was the purchase of my own future options.

Now here is the part I did not understand in 1994, and it cost me later.

Getting out costs money too.

When we closed the Carson City ladies club in 2004, the club stopped operating. The obligations did not. The building lease and the equipment leases both ran another seven months, and Chapter 13 opens on exactly what that felt like.

Every promise you sign at the opening outlives the decision to stop. The lease does not care that you changed your mind. The equipment company does not care that the club is dark. A reserve is not only for the ramp at the front. It is also for the tail at the back, and almost nobody plans for the tail, because at the moment you are opening you cannot imagine closing.

What a Lender Is Actually Underwriting

People think a lender is evaluating their idea. A lender is not evaluating your idea. A lender does not want a percentage of your idea and will not get one.

A lender is underwriting one thing. Getting paid back.

Everything in the packet is a proxy for that question. Not “is this a good business?” but “where does my money come from if this is not a good business?” If you understand that, you stop pitching and start answering.

So answer these three, out loud, before you walk in.

One. What is the money for, specifically? Not “working capital.” Twenty thousand dollars for equipment, leasehold improvements and the first two months of rent, and fifty-nine thousand held in reserve against a slower ramp than I have projected. That second half is not a weakness in your request. It is the strongest sentence in it, because it tells the lender you already know your projection will miss.

Two. What pays it back if you are wrong? Have an actual answer. Mine was that most of the loan was going to be sitting in the account untouched.

Three. What do you lose personally? In a small business the honest answer is usually everything, and pretending otherwise fools nobody who has done this before.

I am not going to tell you my loan was hard to get or easy to get, because your situation in your town with your credit is not mine in 1994. What transfers is the structure of the request. Ask for the amount that lets you be wrong on schedule.

How to Size a Reserve

Here is the actual method. Five steps, and you can do it in an afternoon.

Step one. Compute what it costs to open the doors. Everything you spend before the first customer pays you. Equipment, build-out, deposits, first and last month, signage, licenses, the sign guy who charges more than he quoted. Call this number O, for opening.

Step two. Compute your monthly cost of existing. Everything that goes out in a month whether or not anybody walks in. Rent, payroll, utilities, insurance, lease payments, loan payments. Call it M.

I can give you a real one. In the early years, one club grossed about fifty thousand dollars a month and made about four thousand dollars a month in profit. So the club spent roughly forty-six thousand dollars a month to exist. That is M for a single mature Nevada Fitness location.

Step three. Write down how many months until you cover M from revenue. Use your own projection. Be as optimistic as you honestly are. Call it T, for time.

Step four. Double T. Not because your projection is stupid. Because it has never once been right, and because the errors run in the direction of slow rather than fast. I have never in over ten businesses had revenue arrive earlier than I said it would.

Step five. Your reserve is roughly M × the extra months, plus a cushion.

Now check it against what I actually did. I spent twenty thousand dollars to open. I held fifty-nine thousand in reserve. That reserve is just about three times what it took to open the doors.

Three to one. That is not a formula I derived. It is what the number turned out to be, and I have never regretted the shape of it.

If you cannot borrow three times your opening cost, you have two choices, and only two. Lower the opening cost, or do not open yet. Opening with the exact amount it costs to open is the single most common way that a business which was fundamentally right dies anyway.

Paying It Back

Here is the part that surprises people.

I repaid seventy-nine thousand dollars plus interest inside a year, and I did not do it out of profit. The club was making something like four thousand dollars a month at that stage. Four thousand a month for twelve months is forty-eight thousand dollars, and that assumes I took every dollar of it and paid nothing else with it.

I repaid it because fifty-nine thousand of it had never moved.

That is the whole trick, and it is not a trick. Most of what I paid back was money I had borrowed and never touched. What I actually had to generate was the twenty thousand I spent, plus the interest on the whole balance. At roughly four thousand a month, twenty thousand dollars is about five months of profit.

A reserve is not consumed by default. It is consumed only if you need it. If you do not need it, you give it back, and the only cost was the interest.

There is a discipline in that, and it is harder than it sounds. Fifty-nine thousand dollars sitting in an account while you are running a young business is loud. There is always something to buy. Better equipment. A second sign. A second truck. A television. The reserve is not a fund for opportunities. It is a fund for being wrong. If you spend it on an opportunity, you no longer have a reserve, you have a bigger business with no margin for error, and those two things feel identical right up until the month they do not.

What the Interest Cost Me

I paid interest for about a year on fifty-nine thousand dollars that never left the account.

That was a real cost and it came out of real profit. I do not know what I would have bought with it. I know what it bought instead, which is that I never once, in the first year, had to make a decision because I was out of money. Every decision I made in 1995 I made on the merits.

Nobody puts that on a balance sheet. It is the best money I ever spent.

Now the part I would do differently.

In 1994 I wrote down what I was going to spend and what I expected to make. I did not write down the number at which I would stop. I never once, in any of the ten-plus businesses I started, wrote down in advance the level of loss and the date at which I would shut it down.

That omission is what the two ladies-only clubs cost me. There was never a moment when a pre-written rule said this is enough. There was only a running judgment, made by the same person who had decided to open them, month after month, with the whole weight of the original decision leaning on his shoulder. I eventually said it out loud in 2004. We have given these two clubs plenty of time to grow.

Plenty of time. That is a phrase you say when you never defined the time.

Write the kill number down the same day you write the loan request. Put it in the same file. It is worth more than the projection is. Chapter 23 is about why the person who made the decision is the worst possible person to review it, and Chapter 25 is about how to actually shut something down when the day comes.

Borrow for the version of your plan that misses.

The Tasks That Obtain It

Task	How you verify it
Add up every dollar you spend before the first customer pays you and write the total on one page.	The page carries a date and every line traces to a quote or an invoice.
Add up what one month costs you with zero customers.	Your bookkeeper can match the figure to the lease, the payroll and the utility bills.
Write how many months until revenue covers that monthly number, double it, and multiply it back out.	The three numbers and the multiplication are on the page for somebody else to check.
Divide the reserve you are asking for by your opening cost and write the ratio beside both numbers.	The ratio sits on the page and a lender can read it in one line.
Write the loss and the date at which	That person can read your number

Task	How you verify it
you would close, and hand a copy to somebody who is not you.	and your date back to you.

Do This Now

Write down, today, the loss and the date at which you would stop. Who else has a copy?

Chapter 4: Shop Them Yourself

The objective of this chapter: Know each competitor’s customer count and price sheet, gathered in person from two people at each.

The best market research you will ever get is not for sale.

You cannot buy it, because the people who have it do not know they have it, and they will hand it to you across a counter for free if you walk in and ask. I have built entire expansion cases on data I collected by driving around a county for two days and opening doors.

Competitor analysis is accomplished very easily by posing as a potential customer.

That is my method, stated as plainly as I know how to state it. It is not clever. It is not proprietary. It costs the price of gas and an afternoon, and in more than thirty years I have watched almost nobody do it.

Shopping Washoe County

In 2004 we needed to know whether an additional Nevada Fitness location in Reno would work. The entire question came down to how many people in Washoe County were already in somebody else’s club. Chapter 2 is what I did with the answer. This chapter is how I got it.

I shopped each health club in Washoe County and asked at least two managers or owners the number of members their club has.

That is it. That is the whole methodology, and I wrote it down in exactly those words in the research file.

I want to be clear about what kind of data that is, because it is better than it sounds. I used no formulas and no estimates. The number for each club came directly out of that club’s own membership database, read off a screen or quoted from memory by the person who runs the place. There is no survey error in it. There is no sampling. It is the actual count, or the count that the manager believes.

And it is not hard to get. A manager showing a prospective member around a health club wants to tell you how many members he has. It is a selling point. It says the place is busy, it says other people have made this decision, it says you are not about to join something that is going out of business. He volunteers it about half the time before you ask.

Nothing about that is peculiar to health clubs. A contractor will tell a homeowner how many roofs he did last year. A dentist's office will tell a new patient how many families they take care of. Size is proof, so people give it away.

That is the thing nobody believes until they try it. The information is not guarded. It is advertised.

Why Two People

I did not ask one manager. I asked at least two managers or owners at every club.

Here is why. The first number you get from anybody is a sales number. It has been rounded in a direction. In a health club it may be the number of records in the database rather than the number of people paying, and those two numbers are never the same, because a database holds everybody who ever joined and never got purged. Your competitor has his own version of that gap, whether he counts it in accounts, patients, contracts or names on a route sheet.

Ask a second person on a different day and one of three things happens.

The two numbers match, and you have a good figure.

The two numbers are close, and you take the lower one and move on.

The two numbers are far apart, and now you have learned something more valuable than the count. You have learned that the business does not know its own customer base, which tells you about their data, their billing, their collections and their management. A competitor who cannot tell you within a few hundred how many customers he has is a competitor with a back office problem, and a back office problem is one you can beat.

Two sources. Always. It is the cheapest verification in business.

What to Write Down

Do not go in with a notepad. Go in with your eyes and get in the car afterward and write for ten minutes before you drive away. You will lose half of it if you wait until you get home.

Here is my list.

1. **The customer count**, from two people.
2. **The price sheet.** Every rate they offer, not just the one on the banner. In my industry that meant the down payment, the monthly dues, the initiation, the family rate, the corporate rate and the paid-in-full price. In yours it is every number they will quote that is not painted on the window.
3. **The contract terms.** How long is the agreement? What does it cost to get out of it? What happens at renewal? This tells you more about how they make money than the price does.
4. **The head count at their busiest hour.** Go when they should be full. For a health club that is five thirty on a Tuesday. Count bodies, then compare that to the customer number they gave you. A club claiming five thousand members with thirty people on the floor at five thirty has a usage problem, a data problem, or both. A restaurant with four cars in the lot at seven on a Friday is telling you the same thing.
5. **The staff count**, and what each of them is doing when you walk in. Are they on the phone? Are they with a customer? Is anybody greeting people?
6. **The condition of the place.** Cleanliness, equipment age, what is out of order and how long the sign has been on it.
7. **The sales presentation itself.** Whatever they do to walk a stranger through the thing they sell. In a health club it is the tour. In a car lot it is the test drive, and in a kitchen remodel it is the in-home estimate. How long did it take, what did they show you first, what did they ask you, when did they bring up price, and what did they say when you said you wanted to think about it? That is their entire sales system and they will perform it for you at no charge.
8. **What they said about me.** Ask what makes them different from the competitor down the road. Their answer tells you what they think their weakness is.

Then get in the car and write it down. Then repeat it once a year, because all of this decays.

What a Price Tells You About a Cost Structure

A competitor’s price is not a number. It is a confession.

I got a very clean example of this outside the club business. When we were building the WebFit system, I shopped the health club billing companies the same way I shopped health clubs. ABC Financial Services. ASF International. eFit Financial. Websites, phone calls, and posing as a club owner shopping for service.

Here is what came back.

Service	Fee
Electronic fund transfers, drafts, billing, use of club software	1% of amount billed monthly
Add full database management, data entry, cancellations, collections	up to 5% of amount billed monthly
Collections on delinquent accounts	as high as 40%

Now read it.

The gap between one percent and five percent is data entry, cancellations and collections. That is a four hundred percent price increase for one bundle of services, which tells you that bundle is where all the labor is. They are not charging five times as much because it is worth five times as much to you. They are charging it because it costs them people.

And then look at forty percent on collections. A company does not charge forty percent of a receivable unless it expects most attempts to fail. That number is not a price. It is a probability estimate, published by people who do this all day, and it told me exactly how much of a health club's billed revenue is actually at risk of never arriving.

I did not have to ask anyone for that. It was on a rate sheet.

Read every competitor's price list this way. Where is the price disproportionate to the effort? That is where their margin is, and that is where you attack. Where is the price low relative to the work? That is a loss leader, and something else in their business is paying for it.

One more piece of intelligence I got just by asking. Large health club chains do not hire outside services for billing and data. They do it in house. A manager at 24 Hour told me that directly, back in January of 2001. One sentence, from a competitor, that cut a whole segment out of a target market years later. I was not doing research that day. I was talking to somebody in my industry, and I wrote it down.

A Customer Is Not a Customer

Now the caution, and this is the part that will save you from a bad decision.

The numbers you collect are true and they do not mean what you think they mean. A competitor's customer count is a headcount. It is not a revenue figure, and the two get confused constantly.

Take my own company as the example. In 2004 Nevada Fitness had over fifteen thousand members and charged thirty-nine dollars a month in dues.

15,000 × $39 = $585,000 a month

Our actual monthly gross was over four hundred thousand dollars. Not five hundred eighty-five thousand. Over four hundred thousand, and that figure includes personal training, pro shop sales and new membership down payments, which are not dues at all.

So where is the difference?

It is in the word "member." Some members paid in full up front and pay no monthly dues at all. Some are on a family plan where a second person costs a fraction of the first. Some are on old rates from years ago that we never raised. Some are in the database and have stopped paying and have not been purged yet.

Every one of those is a legitimate member. Not one of them pays thirty-nine dollars a month.

Now apply that to your competitor. When 24 Hour South tells you five thousand four hundred members, that is five thousand four hundred records, and I have no idea what the average one is worth. Your competitor has the same rot in his number. Somebody is on an old price, somebody bought once and has not been back, somebody is a name in a file that stopped paying two years ago. Do not multiply a competitor's customer count by their advertised price and think you have their revenue. You do not. You have a ceiling, and the real number is well under it.

What the customer count is genuinely good for is the thing I used it for in Chapter 2. Counting how many people in the market are already spoken for. For that purpose a record is exactly as good as a payer, because a person in somebody else's file is a person who is not walking into your front door.

Use the number for the question it can answer. Do not stretch it.

The Line I Draw

I should say something about the ethics of this, because “pose as a potential customer” makes some people uncomfortable and it should be discussed rather than skipped.

Here is my position, and I will flag it as a position rather than a fact.

When I walked into 24 Hour North, I was a potential customer. I could have joined. I have money and I use health clubs. Nothing I said was false. I asked the questions any shopper asks, on the tour they give to anyone who walks in, and everything I was told was volunteered to a member of the public in a sales conversation. There is nothing hidden about that transaction. They were selling. I was shopping. Both of those were true.

My rules, and you may draw yours somewhere else.

I do not lie about my name. If somebody asks me directly who I am, I tell them. That has happened, and the conversation usually gets better, not worse, because two operators in the same industry generally find they have more to talk about than either expected.

I do not take anything. No paperwork off a desk, no lists, nothing that was not handed to me.

I do not record anybody.

I do not send an employee in to do something I would not do standing there myself.

I do not ask an employee of theirs to violate a confidence or hurt their own employer.

Everything on that list is available to any member of the public who walks in the door. If you would be embarrassed to have the manager read your notes, you went too far.

The Shopping Was Clean. The Arithmetic Was Not.

Two things.

First, the data collection was the easy part and I still got the analysis wrong.

Everything in Chapter 2 came out of this one shopping trip, and Chapter 2 also shows what I did with it: three different answers for the size of the unserved market, one of them mislabeled.

The shopping was clean. The arithmetic on top of it was not. Nobody ever fails at competitive research because they could not get the numbers. They fail at what they do with them afterward.

Second, there is a whole category of things this method cannot tell you, and I did not appreciate that at the time.

I walked into every club in Washoe County and I came out knowing their prices, their member counts, their floors and their sales scripts. I did not know a single one of their rents. I did not know their payroll, their lease terms, their debt, their equipment payments, or which of them had a partner who wanted out. I did not know which of them was three months from closing.

And that mattered, because more than ten health club competitors closed their doors during our run in Northern Nevada. Some of those clubs were dying while I was standing in their lobbies taking notes on their equipment, and I could not tell.

The floor tells you about their operations. It tells you nothing about their balance sheet.

So use this method for what it is. It is the best free information available to you and it is better than anything you could buy. It is not omniscience. Get the numbers yourself, verify them twice, write down which question each number can actually answer, and then go do the arithmetic slowly, because the arithmetic is where you will go wrong.

Walk in the door yourself. Nobody is going to hand you your own market.

The Tasks That Obtain It

Task	How you verify it
Write your own rules for shopping a competitor on one page before you go.	The page exists and anybody who goes with you has a copy of it.
List every competitor inside your	A stranger could drive to every

Task	How you verify it
circle with the address of each one.	address on the list.
Walk into each one as a shopper and ask two different people, on two different days, how many customers they have.	Two numbers and two dates sit under every competitor’s name in your notes.
Collect the full price sheet and whatever terms each one will state, and file them together.	The folder holds one price sheet per competitor.
Divide your own monthly gross by your own customer count and write that figure beside your advertised price.	Both figures are on one page and your bookkeeper can confirm the gross.

Do This Now

When did you last physically walk into a competitor’s place of business? Not their website. Their building.

Chapter 5: Price Is a Decision, Not a Discovery

The objective of this chapter: Name the pricing objective you are using and the number of customers your price requires.

What are you trying to be in this town? What is the customer comparing you to? What does it actually cost you to deliver?

Three questions, and the answer to the third one is not a price.

There is no correct price sitting out in the market waiting for you to find it.

People talk about pricing like it is a rock under a log. Lift enough logs, run enough spreadsheets, and there it is. That is not how it works. Price setting is more of an art than a science. You gather what you can, you look at what the competition charges, you count your costs, and then you make a decision. A person makes it. You.

I have set the price on more than ten businesses. I have never once found a price. I have decided one every single time.

Thirty Variables and Four That Matter

When I sat down in the fall of 1994 to price a health club membership in Carson City, I could name about thirty things that moved the number. Rent per square foot. Equipment lease payments. Payroll. Utilities in a building with forty thousand pounds of iron and a hundred people sweating in it. What the club down the street charged. What the club down the street charged people who threatened to leave. How much cash I had and how much I needed in ninety days. How long a member stays. How many cancel every month. How many refer a friend. Whether I wanted the low-income part of town or the high-income part. Whether I wanted to be full at nine in the morning or full at six at night.

I am not going to pretend I can rank all thirty in order of importance. Nobody can.

Four of them do most of the work.

1. Your marketing strategy. What are you trying to be in this town?

2. The value the customer thinks he is getting, relative to what else he could buy.
3. The competition.
4. What it actually costs you to produce and deliver the thing.

Notice that only one of those four is your cost. Most new owners spend ninety percent of their pricing time on the one variable the customer will never see.

The Customer Does Not Care About Your Profitability

Here is a sentence I have said to a lot of people and I have never had to take it back.

The customer does not care about the company's profitability. Customers only care about the value they receive when spending dollars on a product or service. I would challenge anyone to come up with a scenario where this is not the case.

Your landlord does not care either. Your rent is what it is. Your customer standing in front of you at five thirty in the afternoon is not thinking about your equipment lease, your insurance, or the fact that you personally guaranteed the note. He is thinking about whether your price is a good trade for what he is holding.

Cost tells you what price you cannot go below and survive. It tells you nothing about what price you should charge. Those are two different questions and business owners run them together constantly.

Low-Price Theory

Low-price theory says you go in under the market, take volume, and make your money on the number of units.

Low price does specific things for you, and I will use my own industry to show what they are.

It widens your pool. Chapter 2 shows the industry ceiling nearly doubling over twenty years, and most of that was price. Price makes the decision small. A person deciding on twenty-two dollars a month is making a smaller decision than a person deciding on thirty-five, and small decisions get made faster. Faster decisions mean shorter sales presentations, which means more presentations per day per salesperson. Run that across a whole industry for twenty years and you do not just win a bigger share of the people who were already shopping. You pull in people who were never shopping at all, because the reason they were not shopping was the price.

Low price also does something people forget. It is a weapon. When you are the cheapest thing in a town, every competitor above you has to explain themselves to their own customers. More than ten competitors closed their doors after we entered Northern Nevada, and that did not happen because we had nicer carpet.

Now the disadvantages, and they are real.

A low price makes volume mandatory. It is not a preference. If your model needs a thousand customers and you get seven hundred, a higher price would have let you survive the miss. A low price will not. A low price also cuts your margin for error on everything else. Every dollar of waste is a bigger share of what you kept. And a low price is hard to walk back. Raising a price on people who came to you because you were cheap is the most expensive conversation in any business.

Low-price theory	
Advantage	Bigger share of the available pool
Advantage	Smaller decision, faster close, more presentations per day
Advantage	Pressure on every competitor above you
Advantage	Word of mouth is cheap advertising and price travels by word of mouth
Disadvantage	Volume is required, not optional
Disadvantage	Thin margin, so operating mistakes hurt more
Disadvantage	Hard to raise later without losing the people it attracted
Disadvantage	Attracts a customer who is shopping price and will leave over price

High-Price Theory

High-price theory says you charge more, serve fewer, and make your money on the margin per unit.

It has genuine advantages. Perceived value follows price. When a price is high the customer expects quality, and a portion of the time he will find it because he expects to find it. High price funds service. If you want a towel handed to a member at the door, or a hostess who remembers a name, somebody is standing there for eight hours and that person is paid out of the price. High price also lets you survive a bad month. If you need three hundred customers instead of a thousand, missing by fifty is an inconvenience instead of a funeral.

The disadvantages are just as real. Your pool is smaller, so a competitor who takes two hundred of your customers has taken a much bigger share of your business. You are more exposed to a recession, because a high price is the first thing a household cuts. And you are permanently vulnerable to somebody doing to you exactly what we did in Carson City.

High-price theory

Advantage	Price itself signals quality
Advantage	Margin funds real service, and service defends the price
Advantage	Fewer customers needed, so a small miss is survivable
Disadvantage	Smaller pool, so every lost customer matters more
Disadvantage	First thing cut in a bad economy
Disadvantage	Open invitation to a low-price competitor

Neither theory is right. They are two different businesses that happen to sell the same thing.

Seventy-Nine Dollars Down and Twenty-Two Dollars a Month

We went low, and we went low on purpose.

The competition in our market was in the mid-thirties per month. We set a seventy-nine dollar processing fee to join and twenty-two dollars a month in dues.

Do the arithmetic the way a member does it. A competitor at thirty-five dollars a month costs $35 × 12 = $420 for a year. We cost $22 × 12 = $264 for a year. That is $156 less. Add our seventy-nine dollar processing fee and the first year with us is $343 against their $420, and every year after that the gap is the full $156.

Now do it the way an owner does it. The seventy-nine dollars is not profit. It is the cash that pays for the sale. It covers the advertising that brought the person in, the commission of the person who sold them, and the paperwork of putting them into the billing system. If you set your up-front charge below what it costs you to acquire a customer, you are paying people to buy from you. Plenty of businesses do this and do not know they are doing it.

The twenty-two dollars is the actual business.

Recurring revenue is what you build on. In our clubs we called it the dues base, and the dues base is what a health club actually is. A lawn service has it in monthly accounts. A dentist has it in the patients who come back twice a year. An accountant has it in the clients who file every April. Everything else is noise.

Money That Repeats Versus Money That Does Not

Every sale in any business is one of two things. Either it repeats on its own or it happens once. You need both, and the ratio between them is a decision, not an accident.

In our clubs it looked like this. Every membership sale was one of two things. Either the member went on monthly dues, or the member paid in full up front for a term at a discount.

We ran about seven to three. Out of every ten memberships sold, seven went on dues and three paid in full.

That ratio was not an accident and it is worth understanding why.

Take one hundred sales in a month at the early price. Seventy go on dues at twenty-two dollars. That adds 70 × $22 = $1,540 to the dues base. Not once. Every month, from now until those people cancel. The thirty who pay in full hand you cash today and add nothing to the base.

Now run that forward. Every month you lay another layer of dues on top of the layer you laid last month, before cancellations. That is the snowball. It rolls downhill and gets bigger and you did not have to push it again.

The paid-in-full members are the shovel, not the snowball. They are how you make payroll in February. A club with no paid-in-full sales has a beautiful dues base and no cash, and it dies with a great-looking balance sheet.

So why not go ten out of ten on dues? Because you would starve before the base got big enough. Why not ten out of ten paid in full? Because in year three you would own nothing. You would wake up every January with the same empty building and have to sell it all again.

Seven to three is the trade. Seven builds the thing you are actually building. Three pays for the building of it.

Your ratio will not be seven to three, and your two kinds of money will not be called dues and paid in full. A shop has walk-in sales and house accounts. A software company has subscriptions and setup fees. A builder has one enormous job and a service contract afterward. Name your two, count last month's sales into the two columns, and find out what ratio you have been running without choosing it.

Now the honest part on that ratio. Cancellations run against you the whole time. In 2004 our clubs averaged about thirty-five cancellations a month each. The national average I was working from at the time was about seventy, so we were doing twice as well as the industry, and it still hurts. At the 2004 dues price of thirty-nine dollars, thirty-five cancellations is 35 × \$39 = \$1,365 a month walking out the door. Every month. Your salespeople have to sell that much just to stand still.

Nobody puts that number on the wall of the sales office. You should.

The Five Pricing Objectives

Before you set a number, decide what the number is for. There are five common pricing objectives. I have used three of them and I have refused two of them, and I can tell you why in each case.

Pricing objective	What it means	Verdict
Penetration	Price low to take market share, keep less of the	Adopted

Pricing objective	What it means	Verdict
	value for yourself	
Investment, or return on sales	Price to hit a required return, regardless of the market	Adopted
Competitive	Price close to the competition and win on what you give for it	Adopted
Skimming, or prestige	Price high, keep the value gap for yourself, harvest the top of the market	Rejected
Pricing for stability	Hold the price flat so customers can forecast their own costs	Rejected

Penetration, adopted. Penetration pricing delivers most of the value to the customer and keeps less for you. It is an entry strategy and it is the right one when you are new and unknown. We used it in Carson City in 1995 and we have used it since. When I later priced our consulting service at three percent of a club’s monthly gross against a guaranteed twenty percent increase in that club’s gross, that was the same move. The customer gets the lion’s share of the gap. That is the point of it.

There is a wrinkle worth knowing. Penetration pricing usually fights against perceived quality, because cheap reads as cheap. You can beat that if you attach a guarantee to the low price. Then the perceived value goes up while the price stays down, and the low price stops eroding your advantage and starts increasing it.

Investment, or return on sales, adopted. This one says management has decided what it expects to earn, and the price is set to produce it. It ignores customer value and it ignores competition, which sounds like bad practice and sometimes is. It is legitimate when the economics are unusual. In our consulting venture the tools had already been built and paid for by two operating companies. There was basically no overhead. If it obtained one customer it would be profitable. It could be argued that with one customer the return on investment is infinity. In a case like that it is not a matter of whether you will make money but how much, and you are free to price to a target.

Be careful with this one. Most businesses are not in that position and they think they are.

Competitive, adopted. Competitive pricing means you price near the competition and win on what the customer gets for it. It works on a customer who has not yet been persuaded that there is any real difference between you and the next guy. That customer is more common than owners want to admit. If he cannot tell you apart, he will decide on price and location. So you get close on price, beat them on what is included, and let him find the difference himself.

Skimming or prestige, rejected. Skimming keeps most of the cost-value gap for the seller and passes less to the customer. I did not want it. If I am guaranteeing a customer a twenty percent increase in his gross and charging him three percent of it, I have already decided the customer gets the lion's share. You cannot skim and promise a big return at the same time. Those two things point in opposite directions.

Skimming can still be the right answer for somebody else's business. A man I know was pricing a new line of watches, and I told him to raise his price above what he had written down, because a higher price would increase the perceived value of the watch. Skimming was correct for him and wrong for me. A price objective is not a moral position. It is a fit.

Pricing for stability, rejected. Pricing for stability matters when your customer has to build his own budget around what you charge him. Industrial buyers care about this a great deal. It was irrelevant to us. Our fee was a constant percentage of the customer's own gross, there was no cost of goods sold to swing, and the cost did not get passed down to the customer's customers. Nothing about our price made his profit margin fluctuate. So the objective had nothing to do.

Rejecting an objective for a plain reason is not laziness. It is the work. Two of the five did not apply and I said so instead of writing a paragraph about each one to look thorough.

Our Price Did Not Stay at Twenty-Two Dollars

Our price did not stay at twenty-two dollars.

By 2004 our monthly dues were thirty-nine dollars. That is a seventy-seven percent increase over about nine years. I am not going to dress that up. The low price got us in, and then the business needed more, and we raised it.

Anyone who tells you they set a price in year one and rode it for a decade is running a business that is not growing or is not telling you everything.

Second honest thing. Low price gets you volume and volume gets you saturation, and saturation is a real ceiling. Our company's profit peaked and then came down because of competition and market saturation, and Chapter 26 has the numbers. Saturation limits new sales. A low-price strategy accelerates you toward that ceiling faster than a high-price strategy does. That is the bill for the volume.

Third. When you price low you attract some people who are shopping price and nothing else, and those people leave over price and nothing else. Thirty-five cancellations a month per club is partly the cost of the strategy that filled the club in the first place. You do not get one without the other.

I would still do it the same way. But I would tell a new owner to write down, before opening day, the exact number of customers at which the low price stops working. Then check it every month. Most owners never write that number down, and then they cannot tell the difference between a bad month and a broken model.

One more thing, and I will say it once. A price is a promise about what a person gets for their money. The old version of breaking that promise was a merchant with his thumb on the scale. The modern version is a price that hides a fee, an automatic renewal nobody explained, or a cancellation policy written so that only a lawyer can find the door. I have competed against clubs that did all three. They are gone. Charge what you decide to charge, say it out loud, and let people decide.

Price is not a discovery. It is a decision, and you are the one who has to make it and live in the building afterward.

The Tasks That Obtain It

Task	How you verify it
Write which of the five pricing objectives your price serves, in one sentence, and date it.	The page names one of the five and carries a date.
Add up what it costs you to acquire	The acquisition figure traces to last

Task	How you verify it
one customer and write your up-front charge beside it.	quarter's advertising and commission spend.
Count the customers you lost last month, multiply by what one of them paid you in a month, and post the result where your sales staff works.	The figure is on the board where the sales staff can read it.
Pull last month's sales and write how many were recurring and how many were one time.	The two counts match a report anybody can pull from your sales records.
Write the number of customers at which your current price stops working and the date you must reach it.	The number and the date are on one page and your manager has a copy.

Do This Now

What is your price actually for? Write down which of the five objectives you are using, and if you cannot name one, you have not made a decision yet.

Chapter 6: Two Thousand Members Before the Doors Opened

The objective of this chapter: Know how many people will pay you for the thing before you build it.

In the fall of 1994 I had a lease on a building in Carson City, Nevada, with nothing in it.

No equipment. No front desk. No carpet worth mentioning. The loan from Chapter 3 was in the bank, and fifty-nine thousand of it was staying there. The club would open in February of 1995.

By the day we opened the doors we had two thousand members.

That is the whole chapter in one number, but the number is not the lesson. The lesson is what a presale actually is. Most people think a presale is a way to raise money before opening. It is that. But its real job is to answer the only question that matters, and to answer it while you can still change your mind.

Will anyone buy this?

Strip the barbells out and a presale is a plain thing. It is taking money for something that does not exist yet. A caterer takes a deposit on a wedding two years out. A machine shop takes half down before it cuts any metal. A magazine gets paid today for twelve issues it has not printed. None of that is unusual and none of it is new. What we did in Carson City in the winter of 1994 was that same move with a health club on the other end of it.

So this chapter is not really about health clubs. If you can describe what you are going to sell, and put a date and a price on it, you can presell it. And if nobody will pay you for it in advance, you have learned something enormous for the price of a folding table.

The Cheapest Test You Will Ever Run

You can research a market for six months. I did. I have counted populations, pulled penetration rates, walked into competitors and asked two different managers how many members they had, and drawn pie charts of who is being served and who is not.

All of that is estimating. A presale is measuring.

Here is the difference, in the plainest terms I know. Research tells you how many people in your town are likely to want what you sell. A presale tells you how many people in your town will hand you money for it before it exists. Those are not close to the same thing, and the second one is worth more than the first.

The market study for our Reno expansion, the one in Chapter 2, produced three different answers for the size of the unserved market, and the two that survived sat fifteen thousand people apart. That is what estimating looks like when you are being truthful about it.

A presale does not have a range. It has a count. Either two thousand people signed or they did not.

If you are going to be wrong about your market, be wrong before you buy the equipment.

What a Presale Is Worth in Dollars

Take our own numbers. Two thousand members at a seventy-nine dollar processing fee is 2,000 × $79 = $158,000. Two thousand members on dues at twenty-two dollars a month is 2,000 × $22 = $44,000 a month of residual income, beginning the month you open.

Look at what those two numbers do to a startup.

The first number is cash before opening. It is the money that buys the equipment you have not bought yet, pays the first months of rent, and covers the payroll of the people selling. Understand what that means. A presale run properly can fund a large part of the buildout of the very thing being presold.

The second number is more important and almost nobody talks about it. Forty-four thousand dollars a month on day one means the club is not starting at zero. Most new businesses open at zero and climb. A presold club opens at forty-four thousand and climbs from there. In a business with high fixed costs, the difference between opening at zero and opening at forty-four thousand is the difference between a company that survives its first winter and one that does not.

Against that, remember what I actually borrowed. Seventy-nine thousand dollars, of which I spent twenty. The presale did more for the opening of that club than the loan did. The loan was insurance. The presale was the business.

What You Can Promise and What You Cannot

Now the part that most books skip, and the part that matters more than the money.

You are selling something that does not exist. That is not automatically wrong. Every builder who takes a deposit, every farmer with a subscription, and every author with a preorder is doing it. It becomes wrong at a specific line, and the line is this.

You may sell what you have already committed to deliver. You may not sell what you are hoping to be able to deliver.

That distinction sounds small. It is not. It is the difference between a business and a story.

Some rules I follow, and I have followed them since 1994.

1. **Do not sell a feature you have not ordered.** If the equipment is on order and the purchase order has a number on it, sell it. If you are planning to buy it if presales go well, do not put it on the flyer. The customer cannot tell the difference between those two situations and you can.
2. **Publish the opening date and pad it.** Then publish what happens if you miss it. We told people when we would open. If a presale member's dues were scheduled to start and the doors were not open, the dues did not start. That is not generosity. That is the only honest way to hold money for a thing that does not exist yet.
3. **Publish both prices.** The presale price and the after-opening price go on the same piece of paper. The customer should be able to see exactly what he is being paid to take a risk on you. A presale price that is a secret is a trick.
4. **Do not spend the deposits on anything but the build and the cost of the presale itself.** Presale money is not revenue. It is an obligation you have been paid to fulfill. If the money goes into a truck or a salary or an expansion, and then the build runs over, you have a problem that no amount of selling fixes.
5. **Give the money back if they ask before you open.** Every time. Without a conversation. A person who cancels a presale and gets a fast refund tells six people you are straight. A person who has to fight you tells sixty.

I will put it in one line. If you would be embarrassed to have the customer read your own project schedule, you are not presale-ready, you are fundraising.

The Mechanics

Here is how to actually run one.

Step one. Lock down the thing you cannot change later. For most businesses that is the address. You cannot presell a location you might get. The address is half of what the customer is buying. The average health club member will drive ten to twelve minutes, which is about five miles, so if I had moved a site six miles after the presale I would not have moved the club, I would have refunded it. If your business is not tied to an address, then the thing you cannot change is the delivery date, or the specification, or the person who will actually do the work. Whichever it is, lock that one before you take a dollar.

Step two. Set the target before you start. Ours was two thousand. That was not a hope. It came from the market work. In a town of about forty-five thousand people, with ten percent of them ever likely to join a club, the pool was about four thousand five hundred. That ten percent is not the 13.6 percent the rest of this book runs on. Ten is the number I used in Carson City in 1994. Thirteen point six is the number I had later, and it is the better one. Both are in this book because both are what actually happened. Three competitors already held fifteen hundred of those. That left three thousand unclaimed, and two thousand of the three thousand was the number we set out to get. That is the number that has to be on the wall.

Step three. Sell from a temporary space. A folding table in the empty building. A card table in a strip mall suite. It does not need to be nice. It needs to be at the address, because the address is what you are selling.

Step four. Set the presale price and know it is the lowest price you will ever charge. That is the trade. The customer is taking a risk on an empty building, and the discount is what you are paying him for that risk. Do not resent it later. He bought the club before there was a club.

Step five. Track it daily, not weekly. A presale that is going to fail shows you in the first ten days. Weekly reporting hides the slope. Count every day, post the number where the sales staff can see it, and compare it to the straight line you need to hit the target by opening.

Step six. Write the kill criteria down before you start. This is the step everyone skips and it is the most valuable one in the list. Decide, in writing, what number by what date means you do not open. Then hand that piece of paper to somebody who is not you. Chapter 23 is about why, but here is the short version. The person who decided to do the presale is the worst possible person to decide whether the presale is failing.

Step seven. Have a plan for the deposits if you do not open. If you write step six honestly, you have to answer step seven. If the answer is “we would have to hope,” go back to rule four and do not take the first dollar.

Who Actually Sells It

One more mechanical point, because presales fail here more often than they fail on price.

A presale does not sell itself and it does not sell off a screen. Social media can put a person in front of you. It cannot sign anybody. There is no building to walk through, nothing to touch, and no other customers to point at. Everything the customer is buying is in the head of the person across the table. That means the presale is the most demanding selling environment your business will ever have, and it happens before you have hired anyone good.

I sold in that Carson City presale myself. Every day. So did the small handful of people I had.

Two rules came out of that and I have used them ever since.

The first is that the owner sells during a presale. Not supervises. Sells. You are the only person on earth who can describe the thing that does not exist yet without lying, because you are the one who decided what it will be. You also need to hear the objections firsthand. When forty people in a row ask about childcare, that is your buildout plan changing, and it will not reach you the same way secondhand.

The second is that the compensation has to come out of the up-front money and nowhere else. We charged a seventy-nine dollar processing fee, and that fee is what pays for the advertising that produced the appointment and the commission of the person who closed it. If you pay presale commissions out of revenue you have not collected yet, you are borrowing against a customer who has not walked in the door.

What It Tells You and What It Does Not

A presale tells you three things and you can trust all three.

It tells you people will buy. It tells you they will buy at your price. It tells you your location is acceptable to enough of them.

It does not tell you they will stay.

That is the honest part, and I know it firsthand. Winning a customer and keeping a customer are two different businesses run by two different sets of skills. A presale is entirely the first one. Retention does not show up for a year, and by then you have signed a five-year lease.

I can show you what that looks like inside my own company. In 2004 our Sparks club had five thousand one hundred members. Our Reno club had eight hundred. Same company, same system, same brand, same sales training, same market. One of them is six times the other. Both of them opened.

And there is a harder one. A presale proves demand for a price. It does not prove the concept is right.

I opened a ladies-only club in Carson City on a belief about the market that I had never counted. Chapters 24 and 25 are the whole story.

So run the presale. Believe the number it gives you. And know exactly which question it answered.

The Honest Part About the Two Thousand

I want to be careful about the two thousand members, because a number like that turns into a legend if you let it.

It was February of 1995 in Carson City, a town where a health club was still a slightly unusual thing to belong to. We were priced well under the competition and we were selling the lowest price we would ever offer. We worked it every day for months with a small staff and no marketing budget to speak of. Two thousand was a good result and it was also a result produced by a specific town, a specific year, and a specific price.

If you presell in a saturated market at a market price, you will not get two thousand. You should not expect to. What you should expect is a number, honestly counted, delivered to you while the building is still empty and while every one of your options is still open.

That is what a presale is. It is not a marketing tactic. It is the last cheap chance you get to find out you were wrong.

Sell it before you build it, and let the count tell you the truth.

The Tasks That Obtain It

Task	How you verify it
Set the presale target from your market arithmetic and write the number on the wall.	The number is on the wall and the arithmetic that produced it is on the same page.
Write what number by what date means you do not open, and hand it to somebody who is not you.	That person can read the number and the date back to you.
Sell the presale yourself, in person, on every day it runs.	Your name is on signed agreements and the dates on them are yours.
Count the signed agreements every day and post the count against the line you need to hit.	The board carries a dated count for every day of the presale.
Multiply your count by your up-front charge, then by your recurring monthly price, to get your opening cash and your opening recurring revenue.	Both figures are on one page and your banker can show the deposits sitting in the account.

Do This Now

Before you spend money on the thing you are building, what is the smallest test that would prove a stranger will pay for it?

Chapter 7: Who Owns What

The objective of this chapter: Know in writing who decides, and what happens to the partner who loses when you decide correctly.

Who owns your business? Not who runs it. Who owns it?

And here is the question underneath that one. When the hard decision comes, and it will, who gets hurt by the right answer?

Most people set up the ownership of a business the way they pick a phone plan. They ask what is cheapest and easiest today. Then five years later they are sitting in a room with a partner, holding a decision that is obviously correct for the company and obviously bad for one of the people at the table, and there is no mechanism in place to handle it. So the decision does not get made. The company carries a losing operation for two more years because the paperwork from year one made the truth too expensive to say.

Set it up so the hard decision is still possible later. That is the whole chapter.

The Boxes You Can Put a Business In

I am not a lawyer and this is not legal advice. Get one in your own state. But you should walk into that lawyer's office knowing what the boxes are, because otherwise you will get sold the one he is fastest at.

Sole proprietorship. You and the business are the same thing. Simple, cheap, and everything you own is on the table. Fine for a man who mows lawns alone. Not fine for anything the public walks into, whether that is a building full of barbells or a dining room full of strangers.

General partnership. Two or more people, same exposure, and every partner can bind the others. This is the arrangement that ends more friendships than money itself does.

Limited partnership. One or more general partners who run the thing and carry the risk, and limited partners who put money in and stay out of operations. Nevada Fitness was structured with a general partner and limited partners, and I was the general partner. It works well when the people with the money do not want to be the one unlocking the door at six in the morning, and that describes most people with money.

Corporation. A separate legal person. It can own things, owe things, and outlive you. Main Corp Enterprises, Inc. is a Nevada corporation. I founded it in October of 1994 and I am the Chairman of the Board. A corporation costs more to maintain and it gives you something the others do not, which is a clean place to hold a brand, a license, or a subsidiary.

Limited liability company. The newer middle ground. Liability protection with less ceremony.

Here is the practical rule I would give a person starting today. You do not choose an entity for the business you have. You choose it for the business you intend to have in five years, and for the argument you intend to be able to survive.

The Owner Who Would Lose

Let me give you the real one.

In the summer of 2004 we had four co-ed health clubs and two ladies-only clubs. The two ladies-only clubs had significantly underperformed compared to the four co-ed clubs, and it had caused a cash flow problem in those two units. The right answer was not complicated. Close the Carson City ladies-only club, convert the Reno ladies club to co-ed, move the equipment from Carson into Reno, and let every member of the closed club use all five Nevada Fitness clubs at no additional charge.

Here is the complication that made it hard.

The two ladies-only clubs had one owner who was not an owner of the co-ed clubs.

Read that again, because it is the exact situation nobody warns you about. Every other owner at that table won if we combined the clubs. One owner had his entire position inside the two units we were about to fold into a business he did not own a piece of. He was not being difficult. He was not wrong. His interests simply did not line up with the company's interests, and that was not his fault. It was a structural fact created years earlier by how we papered the deal.

I wrote it down at the time in one sentence. The variables of this decision must be structured to benefit all owners.

That sentence is easy to write and expensive to honor.

How I Weighted It

I ran that decision on five weighted criteria, and Chapter 24 walks through the whole matrix, because the method is worth a chapter of its own. What matters here is one number in it. Ethics carried a nine on a scale of ten. Higher than lower overhead. Higher than maintaining current market share. Only the two growth criteria outranked it, and only by one point.

I put it there on purpose and I will defend it. When you have an owner who cannot win under the correct decision, ethics is not a footnote to the analysis. It is one of the largest numbers in it. If ethics had carried a three, the ranking would not have moved. I have run it. What the nine actually bought was not the answer. It was the obligation to build the transition around the man who was going to lose.

What I want you to see here is what we actually did for the owner who was going to lose.

We did not buy him out at a discount because he had no way to stop us. We did not simply outvote him. We structured the transition so the thing he owned turned into a share of something that would produce more. The Carson dues base, meaning the residual monthly income from the dues-paying members, moved to the new co-ed club in Reno instead of evaporating. His equipment moved with it instead of being sold at auction for thirty cents. And the argument I made to him was a business argument, not a favor. A co-ed club in Reno wins corporate accounts, because most companies have employees living in adjacent towns. More corporate accounts means more sales in every club. Adding a fifth co-ed location that all members can use raises the value of every membership we sell. Increased value should equate to more sales for all clubs.

The employees mattered too. The Carson ladies club had few employees and they were placed in positions at other clubs. The response from all of them was positive. I checked that before I moved, not after.

How the closing itself went is Chapter 25.

The Rule I Took From It

Structure the ownership so that the person who would lose still has a road.

That is not softness. It is the only way a company keeps the ability to make correct decisions over a long period of time. If a partner's only outcome under the right decision is a total loss, then either the right decision does not get made, or it gets made and you have created an enemy who knows everything about your business.

Practical version, four items.

1. **Do not let a partner own a piece of one location when everyone else owns a piece of all of them.** Put owners at the same level. If somebody wants exposure to one unit only, that is a loan or a revenue share, not equity.
2. **Write the exit before you need it.** Buy-sell terms, valuation method, and who can force a sale. Write it in year one when everyone likes each other, because in year six you will be writing it in a lawyer's office at four hundred dollars an hour with somebody you no longer speak to.
3. **Write down who decides.** Not who is consulted. Who decides. I consulted Bruce Gimple and John Gutierrez on the ladies club transition and they both changed my timing. That is consultation working exactly as it should. It is not the same as authority.
4. **Say the hard thing to the losing partner first, and in person.** Before the memo. Before the staff knows. Proverbs puts it in one line. Do not withhold good from those to whom it is due, when it is in your power to do it. In business that mostly means one thing. When you have the power and the other person does not, that is precisely when what you do says who you are.

Two Businesses, One Parent

Now the structural piece that I use today, and the one I get asked about most.

Main Corp Enterprises, Inc. does two entirely different things.

Main Corp **owns Parkway Athletic Club**. Six clubs. South Reno, Downtown Reno at Saint Mary's, Sparks, Carson City, Fernley, and Fallon. That means we sign the lease, hire the staff, buy the equipment, run the payroll, and answer for the condition of the locker room at nine o'clock at night.

Main Corp also **owns the Fitness For $10 brand and licenses it to independent operators for a fee.** That is why there are Fitness For $10 clubs in Arizona, Florida, Minnesota, Nevada and Canada that I do not operate. Somebody else signed that lease. Somebody else hired that staff. They pay us for the brand and the system.

Two brands. One parent. Two completely different business models.

Almost every business that works eventually faces this fork. You can own the operation, with the lease and the payroll and the customers, or you can own the name and the system and let somebody else carry the lease. A restaurant becomes a second restaurant or it becomes a franchise. A contractor hires another crew or he licenses his method to a man in the next county. The two roads look similar from a distance. They are not the same business at all, and the arithmetic will show you why.

I want to be precise about this because people get it backwards. Fitness For $10 was not renamed Parkway Athletic Club. They are not the same company wearing two hats at different times. They are two separate lines of business running at the same time under one corporate roof, and they have opposite risk profiles.

Look at the arithmetic side by side.

Operating a club. Take our own unit model from Chapter 3. A ten thousand square foot satellite club at one thousand members grosses about $49,000 a month against forty-five to fifty thousand dollars of expenditure. So at exactly one thousand members you are somewhere between a small profit and a small loss, and every dollar of upside comes from member one thousand and one and up.

That is operating. Enormous fixed costs, real control, and real upside once you clear the hurdle.

Licensing the brand. Take the fee structure I designed for our consulting venture, which was three percent of a client club's monthly gross. A club grossing fifty thousand dollars a month pays 0.03 × $50,000 = $1,500 a month. Twenty of those clubs is 20 × $1,500 = $30,000 a month. And the licensor has no lease in any of those twenty buildings, no payroll in them, and no equipment leases in them.

Thirty thousand a month with almost no fixed cost is a very different animal from forty-nine thousand a month against forty-five to fifty thousand of expenses.

So licensing is better? No. Read the risk instead of the margin.

An operator controls the customer experience and eats the fixed cost. A licensor controls almost nothing about the customer experience and carries a different risk entirely, which is that somebody in another state runs a dirty club with your name over the door. You cannot fire his front desk person. You can only enforce a contract, and enforcing a contract is slow, expensive, and never gets the towel picked up off the floor today.

Operating risk is financial and it shows up on the fifteenth of the month. Licensing risk is reputational and it shows up in a review two years from now that you never see.

Keep them in separate boxes for exactly that reason. Separate books, separate reporting, separate people accountable. A parent company can hold both. A single set of books cannot tell you which one is working.

The Third Layer Nobody Sees

There is one more piece, and I put it here because it is the part that confuses people who look at my companies from the outside.

Two of those six Parkway clubs do not sit directly under Main Corp. The Carson City club and the Sparks club run through a separate entity, Carson City Fitness. I am the general partner of Carson City Fitness through another company I own, CCF, LLC. Carson City Fitness also owns the building in Sparks.

So a member walking into the Sparks club sees one thing. A Parkway Athletic Club. What is actually there is a brand owned by one company, an operation run through a second company, a general partner interest held through a third, and a building owned by the second.

That is not complexity for the sake of complexity. Every layer is doing a job.

The brand sits in the parent because a brand is the thing you license, and you cannot cleanly license something that is tangled up with a lease and a payroll. The real estate sits with the operating entity that uses it, because a building is a different kind of asset with a different kind of risk, and the day you want to sell a location is not the day you want to be forced to sell the ground underneath it. And the general partner interest is held through an LLC rather than by me personally, because a general partner carries the risk, and I would rather that risk stop at a company than at my house.

Here is the test I would give you. For every entity you own, you should be able to say in one sentence what job it is doing. If you cannot, you either do not need it or you do not understand it, and both of those are expensive.

I will also say the obvious. Every one of those boxes costs money to keep. Filings, separate books, separate tax returns, and a lawyer who has to be told the whole picture every time anything changes. Do not build this structure on day one. Build it the day the job appears.

I Built the Misaligned Owner Myself

Two things I would tell you straight.

First, I set up ownership of the ladies-only clubs in a way that created that misaligned owner. Nobody did that to me. I did it, and it was fine for as long as the units were profitable, which is exactly how these things hide. A bad ownership structure is invisible while the money is good. It only becomes visible on the day you need to do something painful, and that is the worst possible day to discover it.

Second, on aligning interests, the best structure I ever designed was in the consulting venture, and it was almost too clever. Employees of both parent companies held ownership in the new company. To keep that from simply adding cost, we built in a payroll offset. If an employee who was an owner of the new company received five thousand dollars from it, his paycheck from the parent was reduced by twenty-five hundred for that month. That significantly increases profit for all owners of the parent by reducing payroll, and it significantly benefits the employee, who nets more.

On paper it aligns everyone perfectly. In practice, the moment you tie two paychecks together you had better be able to explain it in one sentence to the person receiving it. If your ownership structure needs a diagram, your people will not trust it, and a structure your people do not trust does not align anything.

Ownership is not paperwork. It is who gets hurt, who decides, and whether you can still do the right thing in year six.

The Tasks That Obtain It

Task	How you verify it
Write one sentence for each entity you own stating the job that entity does.	Your lawyer or your accountant can match every sentence to a filing.
List every owner and exactly what each one owns, the whole company or one unit.	The list matches the operating agreement and a second reader gets the same answer.
Write down who decides each kind of decision, not who is consulted.	Ask two people on your leadership team separately and both name the same person.
Have your bookkeeper produce last month’s profit for each line of business, with the fixed cost of each beside it.	Two reports exist, each with its own bottom line and a date.
Read your operating agreement and mark the buy-sell terms, the valuation method, and who can force a sale.	The sections are marked, or a lawyer’s appointment is on the calendar with a date.

Do This Now

When was the last time you read your own operating agreement, and would it survive the worst month you can imagine?

Chapter 8: The Plan Is a Map, Not a Fairy Tale

The objective of this chapter: Write the plan down and state its main claim as a number that could prove you wrong.

Your projections are going to be wrong.

I have said it already and I will say it again here, because it is the whole reason this chapter exists. My projections have never been right. I have been close, but never perfect.

Not once. Not in more than thirty years.

Now, if you have decided from that sentence that planning is a waste of time, you have drawn exactly the wrong conclusion, and I want to fix it right here at the top of the chapter.

Business plans and marketing plans are guidelines for decision making. You could call them maps. They are a way to stay focused on goals and objectives. They can also help you measure success. They are not fairy tale books.

A football team has a playbook. Every single play in that book is drawn up to score a touchdown. That is not how it happens. Nobody throws the playbook away because the plays do not all end in the end zone. The playbook is what lets eleven men move at the same time in the same direction, and it is what lets the coach know, at the end of the drive, which play failed and why.

A map does not promise you will arrive. It tells you where you are and which way is north.

Why It Has To Be Written

The most important thing about a plan is that it exists on paper.

It should not just exist in the mind of the owner. A written plan sets guidelines and timetables. It communicates efficiently and consistently, which means it says the same thing on Tuesday that it said on Monday, and it says the same thing to the general manager in Fallon that it says to the one in Sparks. It forces you to look at the outside world and at your own internal condition, which is something no one does voluntarily.

And it lets you find out that you did not explain yourself.

I learned that one the hard way. I had a plan I thought was airtight. I gave it to a handful of sharp people who did not work for me and asked them to tear it up. One of them, a woman named Yahna, came back with four objections. Three of them were things I had genuinely failed to communicate. I made three adjustments to the plan because of her.

It is easy to communicate written plans to yourself. It is much more difficult to communicate them to others.

That is the sentence I would tattoo on the inside of a new owner's eyelids. In your head the plan is perfect, because in your head you have already filled in every gap without noticing you filled it in. Hand it to somebody who owes you nothing and watch what happens.

Who The Plan Is For

The plan is not a sales document. Marketing plans are not shown to customers. The plan is a guideline for the company.

It is for the staff members who are implementing the strategies. That is who reads it and that is who it is written for. If your plan is written to impress a banker or a partner, it will be full of adjectives and short on numbers, and your general manager will not be able to do anything with it on a Tuesday morning.

Write it for the person who has to execute it. Everything else follows.

The Three Parts and the Six Components

A plan has three major parts.

1. **The homework.** A background assessment. You collect your own historical and current data and you analyze it. This is the boring part and it is the part that makes the rest of it true.
2. **The strategy.** What you are actually going to do.
3. **The financial implications.** The numbers that let you monitor whether the objectives are being hit, plus your contingencies.

The strategy in the middle breaks into six components, and I have never found one you can skip.

Component	The question it answers
Objectives	What exactly are we trying to hit, and by when?
Customer targets	Which specific groups of people are we selling to?
Competitor targets	Whose customers are we taking, and from whom?
Product and service features	What are we actually offering?
Core strategy	Why would somebody buy from us instead of them?
Marketing mix	Price, communications and promotion, product policy, channels of distribution, and customer relationship management

Core strategy is where most plans get soft. It is three things. Your value proposition, meaning the plain statement of why a customer buys from you. Your differentiation, meaning the actual or perceived advantage you have. And your positioning, meaning how that advantage gets communicated. Owners write two sentences of feeling here and move on. Then they wonder why the sales staff cannot explain the company to a stranger in an elevator.

Turning a Plan into a Testable Claim

Here is the move that separates a plan from a wish.

Take the main claim of your plan and write it as a hypothesis you could be proven wrong about.

In 2004 our sales and profits had leveled off. We were not growing the way we wanted to. The question on the table was whether to open another location in Reno. I could have written a nice paragraph about the exciting opportunity in the Reno market. Instead I wrote two lines.

Hypothesis 1. An additional Nevada Fitness in Reno will obtain more than one thousand members. H1 is $M > 1{,}000$, where M is members.

Hypothesis 2. An additional Nevada Fitness location in Reno will be profitable. H2 is $G - E > 0$, where G is monthly gross income and E is monthly expenditures.

Look at what those two lines do. They are falsifiable. There is a number that would kill each one. That is the entire point.

Now the arithmetic that tested them, and it is the arithmetic from Chapter 2, so I will only give you the shape. The shopping trip put the unserved pool at 19,360 people. Ten percent of that is 1,936 members. H1: 1,936 > 1,000. True. Those members at thirty-nine dollars, plus the ten thousand dollar floor every club in our history has cleared, is $85,504 of monthly gross against forty-five thousand of expenditure. H2: $85,504 − $45,000 > 0. True.

Both hypotheses held, and they held with a lot of room. That is the answer you want. If H1 had come out at 1,050 against a threshold of 1,000, I would not have called it proven. I would have called it a coin flip with a lease attached.

Your two lines will not say members. They will say covers per night, or billable hours, or trucks on the road, or units out the door. It does not matter. The form is always the same. Write the claim, put a symbol on the quantity, put a threshold number beside it, and then go find out. A plan that cannot be proven wrong cannot be proven right either.

The Honest Part About My Own Numbers

I am going to do something here that most business books will not do, which is show you where my own analysis disagrees with itself.

First. That pool of 19,360 was one of three answers I got, and Chapter 2 shows all three. What matters for a plan is what the spread does to the hypothesis.

H1 survives comfortably under the number I actually used, and under the larger one as well. Ten percent of 4,300 is 430 members, which is well under the thousand I needed. Under my most conservative pass, my own project fails my own test.

I do not think that means the decision was wrong. I do think it means I should have written down, in the plan, which of the three numbers I was betting a lease on, and why. Working a number three ways is good practice. Not declaring which one you are standing on is not.

Second. In the same document I stated that total monthly expenditures for the new club would be fifty thousand dollars, and then I tested the hypothesis using forty-five thousand. Both numbers are mine. Same page, same club, five thousand dollars apart.

At $85,504 of gross it does not change the answer. At a thousand members it flips the club from a profit to a loss, and Chapter 13 takes that crack apart properly.

A pro forma is only as good as the assumption you are least sure of. If you take one thing from this chapter, take that.

What Makes an Objective Real

Now the blunt part. I have read a lot of business plans and most of the objectives in them are not objectives.

The classmate in Chapter 1 is the clearest example I know. Her objectives were not quantifiable, and she had no way of measuring whether she had increased anybody's happiness.

"Increase customer happiness" is not an objective. Neither is "become the premier provider" or "build a world-class culture." Those are moods. You cannot count them, so you can never know whether you got there, so nobody can ever be held to them, so nothing happens.

Then there is the other failure, which is the objective that is measurable and worthless.

The same plan said the company wanted to spend five million dollars. That is a silly objective. Anyone can do that.

Here is what I told her to write instead. The objective of the company is to reach five million dollars in gross sales the first year. That is countable. You just add up the income. And it has a deadline, which most objectives are missing.

Five tests. Run every objective you have through them.

1. **Is it a number?** If there is no number, it is not an objective.
2. **Is there a date?** An objective without a deadline is a mood with a spreadsheet.
3. **Can you actually count it, cheaply, without a consultant?** Gross sales, units, customers, market share percentage. Those are countable on a Friday afternoon.
4. **Is it a challenge?** If you will hit it by doing what you did last year, it is a forecast, not an objective.

5. **Is it obtainable?** If it is impossible, your staff will know it in week three and stop trying. An objective that is too hard and one that is too easy are equally irrelevant.

Here is one of mine, so you can hold me to the same standard. When we packaged our operating system as a service, the objective was twenty health club clients in year one, with each of those clubs brought up to at least fifty thousand dollars a month in gross income. At three percent of gross, that is $0.03 \times \$50{,}000 \times 20 = \$30{,}000$ a month of gross income for us by the end of year one.

Every piece of that is countable. Number of clients. Client gross. Our fee. On December thirty-first I know whether I got there or not, and so does everyone who works for me.

The Plan Has a Shelf Life

The marketing strategy we work on is for one year. It will change or it will die.

Strategies must change in order to adjust to what is not working and to what the operator perceives is ahead. If the right adjustments are made, the business succeeds. If not, it dies.

That is not pessimism, it is maintenance. A one-year plan reviewed monthly is a living document. A five-year plan in a binder is furniture.

And build the last page early. Every small business should have an exit strategy that it may or may not ever use. Sell at the right time and price. Sell to an existing public company for stock. Take it public yourself at the appropriate time. I will spend a whole chapter on that near the end of this book. The reason it belongs in the plan now is simple. You will build a bad exit if you build it in the month you need it.

Instinct, and Where It Fits

One more thing, and it is a strange thing for a man with an MBA to write.

I said in the introduction that I believe brilliant business people are born with a sense that others do not have, and that it is very hard to teach.

I have met both kinds. So a fair question is why bother with the plan at all, if the good ones just know.

Because instinct tells you what to do and the plan tells you whether it worked.

Instinct is fast, it is often right, and it is completely unaccountable. It cannot be handed to a general manager in Fernley. It cannot be checked in March against what you believed in January. It cannot be argued with by somebody who works for you and has better information than you do.

The plan is how instinct gets tested by reality instead of protected from it. Write the number down before you find out. Then you cannot quietly move it afterward, and believe me, you will want to.

The plan is a map. Draw it, carry it, and expect the road to be different.

The Tasks That Obtain It

Task	How you verify it
Write your main business claim as a hypothesis with a symbol and a threshold number.	The line is in the plan and a stranger can name the number that kills it.
Run the arithmetic that tests it on your own numbers, showing every step.	Somebody else can redo the steps and reach the same result.
Mark the one assumption you are least sure of and write your high figure and your low figure beside it.	The assumption is marked on the page with two numbers next to it.
Run the same hypothesis again at the low figure and write down whether it still passes.	Both results appear on the page with a yes or a no in writing.
Hand the plan to somebody who does not work for you and ask what they could not follow.	Their written objections come back to you with their name on them.

Do This Now

Take your three most important objectives. Do all three have a number and a date? Cross out any that do not, and see what is left.

Chapter 9: Your First Hire Is Your Whole Culture

The objective of this chapter: Turn your standard into a daily task with a number, and hire your first employee against it.

When I closed our Carson City ladies-only club in August of 2004, there were a handful of employees in that building, and they were the part of the decision I worked on hardest. They were placed in positions at other clubs before I announced anything. The response from all of them was positive, and I know that because I checked before I moved, not after.

Nobody wrote a press release about how we treated those employees. There was no poster in the break room about it. And every single person who worked for that company watched what happened and learned something permanent about who we are.

That is culture. Culture is not what is on the wall. It is what the company does in the week when doing the right thing costs money.

And the person who sets it is not you. It is the first person you hire.

Everybody Copies The First One

Here is why the first hire matters more than the tenth.

You are one person. You cannot be at the counter at six in the morning and in the back of the building at seven at night. The moment you hire somebody, that person becomes the working definition of what an employee here does. The second hire learns the job from the first one. The third learns it from the second. By the time you have twelve people, nobody is copying you anymore. They are copying a copy of a copy of the first person you hired.

You are not filling a position. You are setting the standard, in a person, and you only get to do it once.

Employees must be trained to perform their tasks the way the owner would do them and to treat customers the way the owner would.

That sentence is easy to agree with and hard to execute, because it means the standard has to be visible in a person, not in a document. Style and personality are a powerful influence on a group. Most people in a group will conform to the leader’s expectations. That works for you and it works against you with equal force.

So hire the first one like the company depends on it, because it does.

Hire For What You Cannot Install

What do you hire for? Not experience. I have paid a great deal of money for experience, and what it cost me is a later chapter about a general manager from Lake Tahoe.

Hire for what you cannot install.

I can install a checklist in an afternoon. Hand a new person the list and a two-hour clock and that person is running the position inside a week. That system is Chapter 16.

Here is what no list solves. I cannot teach a person to care whether the floor is clean at nine forty at night, after the last member is gone and nobody is left to tell me. Years later our members told us in a survey that cleanliness was the one weak thing about our clubs. That number is in Chapter 18.

A dirty floor is not a training failure. It is a person deciding it does not matter. Your business has its own version of that floor. It is the last thing that gets done at night, by somebody who knows nobody will check.

For the first hire, the three things I want are these.

1. **Will they do the task the way it is written, on a day when nobody is watching?** Not whether they agree with the task. Whether they will do it. A candidate who wants to improve your process in week one has improved nothing. There is no process yet.
2. **Are they pleasant to a stranger who is nervous?** Most people walking into a health club for the first time are embarrassed. That is a hard truth about this industry and there is a version of it in yours. Watch how a candidate treats the person in the room who decides nothing.
3. **Do they tell you when something went wrong?** A person who reports a mistake in hour one is worth three people who hide it until Friday. With two employees, you will not find it on your own.

Notice that none of the three is a skill. Skills I can teach. The three above I cannot teach at all.

Can They Do It The Way You Would?

All three collapse into one question.

Can this person do this job the way you would do it, in your building, on a Saturday, when you are not there?

That is the whole test, and it is answerable before you hire, not after.

So answer it. Write down the five things you actually do in that position and how you do them. Then pay your finalist for one shift and watch that person work the list. You are not measuring speed. You are measuring what happens when the list runs out and nobody has said what comes next.

And whatever you tolerate becomes permanent. If your first hire cuts a corner at closing time and nothing happens, you did not lose one corner. You published a policy.

There was no meeting and no memo. Your second hire watched the first one leave twenty minutes early, watched you say nothing, and drew the conclusion.

The Hire You Are Least Qualified To Make

Now the honest part.

The first hire is the most important one you will ever make, and it is the one you are least qualified to make. You have never managed anybody in this business, because the business has not existed long enough. You have nobody on staff to tell you the new person is a problem, because the new person is the staff.

And you are hiring in a hurry, because you are out of hours, and hiring cheap, because you are out of money. Those two pressures pull in exactly the wrong direction.

I have no trick that removes that. The wrong person hired fast costs more than another month working the desk yourself. I have paid both bills and they are not close.

A Mission Statement Nobody Can Recite Is Decoration

Every company I have ever seen has a mission statement. Almost none of the employees can say it.

That is not the employees' fault. It is the fault of whoever wrote a hundred and forty words when twenty would do.

Here is a test you can run this afternoon, and I recommend it even though you will not enjoy the result. Walk into your own business, find the newest person on the floor, and ask them to tell you the company's mission. Do not help them. Just wait.

Whatever they say is your actual mission statement. The thing in the frame is a decoration.

I told a classmate of mine once that her mission statement was good quality and way too long. My advice to her was to shorten it until her employees could memorize it and live it. That was not a writing note. A mission statement that cannot be recited cannot be used at two o'clock on a busy Saturday, and two o'clock on a busy Saturday is the only time it would have mattered.

Here is ours.

The mission of Nevada Fitness is to provide friendly fitness for every body and to go beyond the expectations of our members in order to provide a positive fitness experience and make Nevada Fitness the place where people want to be.

Look at the work the individual words are doing.

Friendly is first. Not best equipped, not most advanced, not lowest priced. Friendly. That is a word an eighteen-year-old at a front desk can act on within four seconds of reading it.

For every body is deliberate and it is two words on purpose. The person who is intimidated to walk in is the person we most want to walk in.

Go beyond the expectations of our members is the operational half. It is not an attitude. It is an instruction, and it turns directly into a task, which I will get to in a minute.

The place where people want to be is the outcome. If a member would rather be in our building than at home, everything else takes care of itself.

The Nine Components, and Why I Broke the Rule

There is a standard list, Fred David's, of nine things a mission statement is supposed to contain. Customers. Products or services. Markets. Technology.

Concern for growth and profitability. Philosophy. Self-concept. Public image. Concern for employees.

It is a good list. I use it as a checklist when I am helping somebody write one. Let me hold my own statement up against it honestly.

Component	In our mission statement?
Customers	Yes. Our members.
Products or services	Yes. Fitness.
Markets	No.
Technology	No.
Concern for growth and profitability	No.
Philosophy	Yes. Friendly, for every body, beyond expectations.
Self-concept	Yes. The place where people want to be.
Public image	Yes, by implication.
Concern for employees	No.

Four of nine missing. I know.

I left them out on purpose and I would do it again. My statement runs forty-one words, which is already longer than I like. Adding markets, technology, growth and profitability, and concern for employees would push it past eighty, and past eighty nobody memorizes anything.

And I will go further and admit something about my own forty-one words. The part our people actually say back to me is the first half. *The mission of Nevada Fitness is to provide friendly fitness for every body and to go beyond the expectations of our members.* Twenty-two words. That is the part that got memorized, because that is the part that tells a human being what to do.

The rest is good and true and it lives on the wall.

If I were writing it today I would write the twenty-two words and stop.

So use the nine components as a checklist, not as a recipe. Draft the long version, confirm you know your answer for all nine, then cut it to what a nervous new hire can repeat on day one.

One more thing about the writing of it. The staff should be part of the drafting. Have each manager and their department write one, then merge them. Two reasons. The obvious one is that people support what they helped build. The less obvious one is that when you read six drafts from six departments, you find out what your company actually thinks it is doing, and that is worth more than the finished sentence.

Two Favors Every Two Hours

Now, “go beyond the expectations of our members” is a fine phrase. On its own it does nothing at all. It is a mood.

So we turned it into a task with a number and a clock.

Every staff member in every club owes two favors to members every two hours.

A favor is going above and beyond what the member expects. A staff member walks up to a member, thanks him for his business, and hands him a t-shirt. Most favors cost nothing at all. Carrying a bag to the car counts. Two of those, every two hours, by everybody in the building.

Watch how the mission statement becomes arithmetic.

A club open for a ten-hour staffed shift has five two-hour blocks. Two favors per block is $5 \times 2 = 10$ favors per staff member per day. A club with ten staff members completing that cycle produces $10 \times 10 = 100$ favors a day. Over a month that is $100 \times 30 = 3{,}000$ favors.

Our clubs averaged about three thousand members each.

Three thousand favors a month, three thousand members. Roughly one unexpected good thing per member per month, produced not by inspiration but by a task on a list.

Now run that arithmetic in your own business, because the shape of it carries and the words do not. Whatever your mission says you do for people, turn it into a countable act, attach a number to it, and hang a clock on the number. A restaurant might land on one table a shift that gets something nobody ordered. A shop might land on two calls a day to a customer who already bought and owes you nothing. Then multiply it out against your customer count the way I just did, and see whether the promise on your wall is physically possible.

That is what I mean when I say a mission statement has to be executable. Ours is not a sentiment. It is a production requirement with a two-hour clock on it, and every employee knows the number.

I am introducing it here and I am deliberately not explaining the whole system yet. There is more to it, and all of it is Chapter 16. Right now I only want one thing understood.

Your culture is a set of tasks with a clock on them, or it is a decoration.

Not Telling Somebody What to Do Is Not Respect

I have written elsewhere in this book that most people, left undirected, will do nothing, and I have been challenged on it more than once. Chapter 16 is where I answer that challenge in full. Here I only want the smaller version of it.

Not telling somebody what to do is not respect. It is abandonment with a friendly face. Then, at review time, you sit them down and grade them on standards they were never given. I have seen more good employees ruined that way than by any amount of structure.

If you have the power to tell somebody exactly what winning looks like today, and you keep it to yourself, you have withheld something that was theirs.

So the checklist is not surveillance. It is the answer to a question every honest employee is quietly asking, which is: what does a good day look like here, and how will I know if I had one?

And the second honest thing. I have not always hired well. I have hired experience over fit and paid for it in real dollars. I have promoted people because they were loyal and available rather than because they were right for the seat. The system does not make bad hires stop hurting. It makes them visible faster, which is a smaller claim than the one most consultants make, and it happens to be true.

Hire the first one like everybody after them will be a copy. Because they will be.

The Tasks That Obtain It

Task	How you verify it
Write the five things you do in the position you are hiring for, and how you do each one.	A candidate can work that page for a shift without asking you a question.
Cut your mission statement until a new hire can repeat it on the first day.	Ask your newest employee to say it back with no help, and count the words.
Turn the mission into one task with a number and a clock on it, and post the number where the staff works.	The number is on the wall in the building and every employee can state it.
Multiply the two-hour blocks in a shift by that task number, by your people, by the days in a month, and set the total beside your customer count.	The arithmetic is on one page and somebody else can redo it.
Pay your finalist for one shift and watch what happens when the list runs out.	The shift appears on your payroll record and your notes say what the person did next.

Do This Now

Ask your newest employee to recite your mission statement without help. What did they say, and what does that tell you about the one you wrote?

Part Two

Run It

Chapter 10: Money Is Labor Stored

The objective of this chapter: Put a dollar figure on one hour of every position you pay for, and name the hours that produce nothing.

Hard work has no value.

I have said that in front of a room of managers and watched the temperature drop. It sounds like something a lazy man would say to excuse himself. It is the opposite. It is the most demanding sentence in this book, and everything in Part Two rests on it.

Here is what I mean. A man can take a shovel behind the Sparks club and dig a hole all day. He can dig until his hands bleed. At six o'clock he has a hole. Nobody will pay him for that hole. Nobody wants that hole. He worked harder than every person inside the building and he produced nothing.

Now put that same man on the floor for eight hours booking appointments to show the club. Same sweat, same eight hours, same paycheck. This time there are people on the membership list at six o'clock who were not on it at nine.

The work did not change. The production changed.

The value of labor is equal to what it produces. Not what it costs you. Not how tired it made somebody. What it produced.

That is as true in a bakery, a body shop or an accounting office as it is in a gym. It is true of the owner too.

Money Is Not Green Air

Before we run a single number in the next five chapters, you have to know what a dollar is, because most people do not.

Most people treat money as a substance. It sits in an account and it either grows or shrinks, and it seems to have a life of its own that has nothing to do with anybody's hands. That is why people say things like "the money just disappeared." Money does not disappear. It goes somewhere, and it went somewhere because somebody worked or somebody did not.

A dollar is stored labor. That is the whole definition. Somebody did something another person valued, and instead of hauling around what they made, they took a claim ticket for it. The ticket is the dollar. When you spend it you are handing somebody else a claim on work that has already been done.

This is why every number in a business is really a number about people and hours.

Payroll is not an expense line. Payroll is you buying somebody’s hours and hoping those hours produce more than they cost. Rent is not an expense line. Rent is you buying the hours somebody spent building a building. Your bank balance is not a number on a screen. It is a pile of stored work sitting there waiting for you to decide what it becomes.

Once you see money that way, waste stops being an accounting problem and starts being an insult. Every wasted dollar is somebody’s afternoon, thrown in the trash.

The Seventy-Nine Thousand Dollars Was Not Mine

In 1994 I borrowed seventy-nine thousand dollars, and Chapter 3 is what I did with it. I want you to see what actually happened at that bank.

That seventy-nine thousand dollars was not the bank’s money either. It was the stored labor of hundreds of people in Northern Nevada who had gone to work, gotten paid, and put some of it away. A loan officer handed me a stack of other people’s mornings and afternoons and asked me to give it back with a little extra on top.

That is the entire transaction. Strip out the paperwork and that is what a loan is.

I have thought about that every time I have signed a note since. It is not an abstraction. Somebody stood on a line, or ran a register, or drove a truck, and the residue of that is what I was holding.

If you understand that, you will not spend borrowed money the way most first-time owners spend it.

The Two Tests

If the value of labor equals what it produces, then you need a way to tell, on any given day, whether an hour produced anything. Two questions do most of the work.

First question. Did somebody outside the building get something they would pay for?

Not something you like. Not something that felt productive. Something a stranger would open a wallet for.

Second question. Would the business be different tomorrow if this hour had not happened?

If the answer to both is no, that hour was a hole in the ground.

The two questions do not care what you sell. Run them on a delivery route, a dental practice or a print shop and they behave the same way.

Here is what they looked like in my clubs. A staff member walks up to a member, thanks her for her business, and hands her a t-shirt. That is one of the two favors we require every two hours. Did somebody outside the building get something they would pay for? Yes. Would tomorrow be different? Yes, because that member is less likely to be one of the thirty-five cancellations that club runs in a month.

Now run it on a different hour. A manager reorganizes the supply closet at three in the afternoon on a Tuesday. Nothing wrong with an organized closet. But no member paid for it, and tomorrow is not different.

Here is the same idea in a table, using the two production requirements we put on every position.

Eight hours of work	Appointments booked	Favors done	What a customer got	Value of the labor
Sales rep A, on the floor	8	8	Tour, follow-up, two t-shirts	Real
Sales rep B, at the desk	0	0	Nothing	Zero
Man with the shovel	0	0	Nothing	Zero

Now put a price on one of those hours. In my clubs in that era, two appointments every two hours was one appointment an hour. Every appointment that turns into a membership hands the club thirty-seven dollars and eighty-three cents a month after billing, a figure Chapter 11 works out, and hands it over again the next month, and the month after that. I do not have our close rate written down and I will not invent one for you. Run yours. Close one appointment in four and one hour of that rep’s time is worth nine dollars and forty-six cents a month, every month, against a wage you paid one time.

Your version of an appointment might be an estimate, a quote, a tasting or a first consultation. The arithmetic does not change. Count what one of them is worth, and you have priced an hour.

Sales rep B and the man with the shovel cost you exactly the same amount of money. Both of them are on payroll. Both of them worked. Only one of them looks like he is loafing, and it is the wrong one.

There is a second thing that table shows, and it is the one owners hate to look at. Sales rep B is not necessarily lazy. Nine times out of ten, sales rep B is a decent person who was never told what the next two hours were for. He came in, he tidied the desk, he answered the phone twice, he was pleasant to everybody, and he went home. He will tell his wife he had a busy day and he will be telling the truth.

You did that. Not him.

This is the reason our whole company runs on two-hour checklists. It is not because I distrust people. It is because of what the table above shows, and Chapter 16 is where I defend it.

Pay for Production, Not for Presence

If labor is worth what it produces, then the smartest thing an owner can do is tie the two together on purpose.

Years ago I worked through a real case from 1984. Hormel offered its workers in Austin, Minnesota a contract cutting wages from ten dollars and sixty-nine cents an hour down to eight dollars and twenty-five cents, and cutting pensions by thirty percent. The company had just declared a twenty-nine million dollar annual profit. You can imagine how that went over.

Both sides were arguing about the wrong thing. Labor was arguing about the price of an hour. Management was arguing about the price of an hour. Nobody was arguing about what the hour produced.

So I ran the numbers. The cut was two dollars and forty-four cents an hour. At about fourteen hundred employees working forty hours a week, I figured the company would save roughly seven million two hundred and twenty-four thousand dollars a year, plus payroll taxes. Honest note: when I work that multiplication again today at a straight two thousand and eighty hours a year, I get about seven million one hundred thousand. Close, not exact. Call it seven million and change either way, because the point survives the rounding.

Take that saving and lay it on top of a twenty-nine million dollar profit. That gets you thirty-six million two hundred thousand. I wrote thirty-seven million at the time. Call it thirty-six and change.

Then here was my proposal. Pay twenty percent of the profit back to labor.

	Before	After the cut	After the cut, with 20% profit share
Company profit	$29,000,000	~$36,200,000	~$36,200,000
Paid to labor from profit	$0	$0	~$7,200,000
Company keeps	$29,000,000	~$36,200,000	~$29,000,000

The company ends up right about where it started at twenty-nine million. But now every hour on that floor has an upside attached to it. If labor works harder and produces more, the company makes more and labor makes more than they do now. And the company has a safety net, because if profit is less, labor makes less.

That structure puts management and labor on the same side of the same number for the first time.

We built the same idea into our own arrangements. The WebFit payroll offset in Chapter 7, where an employee who earned five thousand dollars from the new company took twenty-five hundred less from the parent that month, is exactly this. He made more. The clubs paid less. Nobody had to be talked into anything.

Money follows production, or you are just moving stored labor around and calling it management.

Who It Belongs To

I will say this once here and then get back to arithmetic.

If money is stored labor, then the question of who owns the money is really the question of who owns the labor. And I did not manufacture my ability to work. I did not choose my health, my energy, or whatever business sense I was handed. Those showed up.

Deuteronomy puts it in one line. It is God who gives you the power to get wealth. Whatever you believe about the source, the structure of the sentence is worth sitting with. It does not say wealth is handed to you. It says the *power to get it* is. The digging is still yours to do.

That framing has done more for how I run a business than any technique in this book. If the ability is a gift, then efficiency is not greed. Profit is not a dirty word. It is a return on something I was handed, and I owe somebody an accounting for it. I will come back to that in Chapter 27 and I will not push it on you in between. You can run every number in Part Two without agreeing with a word of this section.

Nobody Loafed in the Ladies-Only Clubs

The two ladies-only clubs had staff who worked as hard as anybody in our company. I want that on the record, because when I closed one of them in 2004 and converted the other, it would have been easy to let people believe somebody had loafed.

Nobody loafed. The work was there. The production was not, because I had put those people in a building serving a market that did not exist in the size I thought it did.

That is what “hard work has no value” costs when you say it honestly. It does not only apply to the man with the shovel. It applies to the owner who pointed the shovel.

An owner’s job is not to get people to work harder. Almost everybody who works for you is already working. An owner’s job is to make sure the hours land on something a stranger will pay for.

Money is labor stored. Spend it like it took somebody a week to make it, because it did.

The Tasks That Obtain It

Task	How you verify it
List every position on your payroll on one page, with what one hour of it costs you.	The page exists, it has a date on it, and the hourly figures match your last payroll register.
Write beside each position the one thing a customer received because of that hour.	The sentence is on the page, and the person in that seat reads it and agrees that is what they did.
Count last month’s sales conversations and last month’s sales, and divide the second by the first.	Both counts are written on the page, and a second person can pull the same two numbers.
Multiply that close rate by what one sale pays you in a month, and price one hour of selling.	The arithmetic is written out and dated, and you can say which sale price you used.
Name one recurring hour that fails both tests, and take it off somebody’s list in writing.	The item is crossed off a written checklist on a date the employee can confirm.

Do This Now

Pick one employee and one eight-hour shift last week. Can you name the specific thing a customer received because of that shift? If you cannot, whose fault is that?

Chapter 11: The Only Number That Tells You Whether Growth Helps

The objective of this chapter: Know how many cents of the next dollar of sales you keep, for every product you sell.

If you sell one more, are you better off? By how much? And how do you know?

Most owners cannot answer the second question, which means they are guessing at the first one. They know their sales. They know their bank balance. They watch both go up and down and they assume the two are connected in some reliable way.

They are not.

I have watched businesses grow their way straight into the ground. Sales up, profit down, owner confused. It happens because the owner is tracking the top line and the top line does not tell you what you keep.

There is one number that does. It is called contribution margin, and once you have it you can answer a whole shelf of questions you have been answering by feel.

What Contribution Margin Actually Is

Sell one more unit. Some of that money immediately walks back out the door to pay for the thing you just sold. Whatever is left over is yours to put against your fixed costs, and after those are covered, it is profit.

That leftover is the contribution margin. It contributes. That is the whole reason for the name.

Two ways to say it. **Per unit**, it is the price minus everything that varies with selling one more. **In total**, it is your sales minus all your variable costs. Divide the total by sales and you get the contribution margin ratio, which is the useful form, because it tells you how many cents of every new dollar of sales you actually keep.

That is it. That is the whole idea. The rest of this chapter is arithmetic.

The Nutcracker Company

I am going to work a real example all the way through, and then I am going to run the identical arithmetic on a health club membership so you can see it is the same math wearing a different hat.

In my managerial accounting coursework I spent a term working a company called Drosselmeier Corporation all the way through. It makes Christmas nutcrackers. The plant holds twenty-four hundred units a year. They sell two thousand.

Here are their numbers.

- Price: 90 per unit
- Variable manufacturing cost: 26 per unit
- Variable selling and administrative cost: 10 per unit
- Fixed manufacturing cost: 60,000 a year
- Fixed selling and administrative cost: 30,000 a year

Now build the statement. Not the statement your accountant hands you. This one, which is arranged so the contribution margin is visible.

Drosselmeier Corporation, 2,000 units	Total	Per unit
Sales (90 × 2,000)	180,000	90
Less variable manufacturing (26 × 2,000)	(52,000)	(26)
Less variable selling and administrative (10 × 2,000)	(20,000)	(10)
Contribution margin	**108,000**	**54**
Less fixed manufacturing	(60,000)	
Less fixed selling and administrative	(30,000)	
Operating income	**18,000**	

The contribution margin ratio is 108,000 divided by 180,000, which is .60. Sixty percent.

Now say that in plain English. **Every additional nutcracker Drosselmeier sells at ninety puts fifty-four in the company's pocket.** Every additional dollar of sales puts sixty cents in the company's pocket.

Notice what the operating income of eighteen thousand does *not* tell you. It does not tell you that. You could stare at eighteen thousand all day and never learn that the next sale is worth fifty-four.

Why This Is Not Gross Margin

People hear this and say, that is just gross profit with extra steps. It is not, and the difference will cost you real money if you miss it.

Gross margin is sales minus cost of goods sold. Contribution margin is sales minus everything variable. Cost of goods sold is a mixed bag. It has variable things in it, like materials, and it has fixed things in it, like depreciation on a machine that runs whether you make one unit or a thousand. And plenty of variable cost sits outside cost of goods sold entirely, down in selling expense, like a sales commission.

Here is the cleanest demonstration I know of, from Eastman Kodak's year 2000 numbers, in millions.

Kodak reported sales of 13,994, cost of goods sold of 8,019, and a gross margin of 5,975. Other operating expenses of 3,761 left operating income of 2,214.

Now split the costs the way an operator needs them split. Assume 1,800 of that cost of goods sold is fixed, and 3,000 of the other operating expenses is fixed.

Eastman Kodak, 2000 (millions)	
Sales	13,994
Less variable cost of goods sold	(6,219)
Less variable other operating expenses	(761)
Contribution margin	**7,014**
Less fixed cost of goods sold	(1,800)
Less fixed other operating expenses	(3,000)
Operating income	**2,214**

Same company. Same year. Same operating income of 2,214. But the gross margin is 5,975 and the contribution margin is 7,014, a difference of 1,039. That difference is nothing but fixed cost coming out of one bucket and variable cost going into the other.

The contribution margin ratio is 7,014 divided by 13,994, which is .50. Fifty cents on the dollar.

Now watch what that one number buys you. Suppose Kodak’s sales grow ten percent. Ten percent of 13,994 is 1,399.4. Multiply by the ratio: 1,399.4 times .50 is 699.7. Add it to the existing 2,214 and you get 2,913.7.

Sales up ten percent. Operating income up from 2,214 to 2,913.7, which is 699.7 divided by 2,214, or about thirty-two percent.

Ten percent more sales produced thirty-two percent more profit, and you can compute that on the back of a napkin the moment you know the contribution margin ratio.

You cannot do that with gross margin. You cannot do it with last year’s net income. You need the ratio.

The Same Math, Wearing a Health Club Uniform

Now let us do a membership.

A “unit” in my business is one member, for one month. We charged thirty-nine dollars a month in dues.

What varies when you sell one more membership? Almost nothing. That is not a figure of speech. The building is already there. The heat is already on. The front desk is already staffed. The forty thousand pounds of free weights are already bolted down. One more member walks in and uses equipment that was already sitting idle.

The one honest variable cost I can document is billing. Health club billing companies charge from one to five percent of the total amount billed monthly to draft dues and run the software. I shopped that industry hard when we were building WebFit, and I know those numbers cold. Call it three percent, which is right in the middle and is exactly what we later charged our own clients.

Three percent of thirty-nine dollars is one dollar and seventeen cents.

One membership, one month	
Dues	$39.00
Less billing at 3%	($1.17)
Contribution margin per member	**$37.83**

Thirty-seven eighty-three divided by thirty-nine is .97.

Ninety-seven percent. A health club membership is one of the highest contribution margin products in American small business, and almost nobody who owns one has ever calculated it.

Here is the honest part, and I want it in the open before you build anything on this. I am going to do this every time. When two of my own numbers do not line up, you will hear it from me and not from a reader. In 2004 I did not split my clubs' expenses into fixed and variable on paper. I ran a single monthly expenditure number. The ninety-seven percent above is me reasoning from the one variable cost I can genuinely document. There is a little more in there. Towels get washed. Hot water gets used. A heavier club costs slightly more to clean, which is why we later put a maintenance person in every club five hours a day. If you told me the real answer was ninety-four percent instead of ninety-seven, I would not argue with you. I would argue very hard with anybody who told me it was sixty.

Set that beside Drosselmeier and you are looking at the same idea in a different building. Price, variable cost, what is left. The labels changed. Nothing else did.

Now here is the sentence that should change how you spend an hour.

The next member who walked through that door and signed up at thirty-nine dollars handed us thirty-seven dollars and eighty-three cents a month, and handed it over again next month, and the month after that, until he cancelled. So that member was not worth thirty-seven eighty-three. He was worth thirty-seven eighty-three times however many months he stayed, and we kept people roughly twice as long as the industry did.

Run that same sentence on whatever you sell. If your product repeats, a service plan, a lawn contract, a standing order, a maintenance agreement, then one sale is not one sale. It is a payment that keeps arriving until somebody stops it.

That is why every sales rep in our company had to book two appointments to show the club every two hours. Not because I love appointments. Because of that ratio. When ninety-seven cents of the next dollar is yours, the only rational thing to do with an hour is go get another dollar.

When Growth Actively Hurts

There is one case that ought to be impossible and is not rare at all.

A negative contribution margin. The price is below the variable cost. Every single sale makes the business worse.

You would think nobody could miss this. People miss it constantly, because they price against a competitor instead of against their own costs. They see what the business down the street charges, they decide they have to be close to that, and they never sit down and work out what one more sale actually costs them. For me that meant the billing, the collections, the towels and the wear. For a caterer it is the food, the labor and the fuel. For a print shop it is the paper, the ink and the press time.

When your contribution margin is negative, every good thing that happens to you is bad. A great sales month is a disaster with a delay on it. You will hire more people to handle the volume, which raises your fixed costs, which makes the hole deeper. The owner will stand there watching record sales and a shrinking bank account, and he will conclude the problem is theft or accounting.

The problem is that he is selling dollar bills for ninety cents and doing it very efficiently.

Before you push volume on anything, prove the contribution margin is positive. Then prove it is big enough to be worth the effort. Those are two separate proofs and most owners do neither.

What the Ratio Changes About How You Run

Two businesses, both doing a million dollars. One keeps sixty cents on the new dollar. The other keeps fifteen. They should not be run by the same playbook, and if you run them the same way one of them will fail.

Here is the arithmetic that makes the point. Suppose both owners want sixteen thousand two hundred dollars of additional operating income.

	60% business	15% business
Additional profit wanted	$16,200	$16,200
Divide by contribution margin ratio	÷ .60	÷ .15
New sales required	**$27,000**	**$108,000**

Same goal. Four times the selling.

So the sixty percent owner should be spending his energy on volume. Advertise. Hire another rep. Open earlier. Every new dollar he drags through the door hands him sixty cents, so growth is a lever that actually moves.

The fifteen percent owner cannot get there on volume, or at least he cannot get there fast. His levers are price and cost. One dollar of price increase on a fifteen percent product is worth nearly seven dollars of new sales. One dollar shaved off his variable cost is worth the same. He should be in his purchasing and his pricing, not in his advertising.

There is a second difference, and it is the dangerous one. The low-margin owner has almost no cushion. If his variable costs creep up by three dollars on a twenty dollar item, his contribution margin does not fall by fifteen percent. It falls from three dollars to zero. He is done, and he will find out from his bank before he finds out from his books.

I lived on both sides of this line inside one company. A membership was a ninety-seven percent product. The pro shop was not. Say you buy a shirt for seventeen dollars and sell it for twenty. That is three dollars of contribution on a twenty dollar sale, or fifteen percent. Selling a hundred more shirts is three hundred dollars. Selling a hundred more memberships is three thousand seven hundred and eighty-three dollars a month, every month, until they cancel.

That comparison is why we never put a serious sales push behind the pro shop and why every rep in the building had a two-appointment-per-two-hours requirement on memberships. It was not a hunch. It was that ratio.

Personal training sits somewhere in between, and I will not quote you a number I cannot support. I do not have the 2004 trainer splits in front of me. But you can reason about the structure without the number: a trainer gets paid per session, so a training session carries a real, large variable cost, and a membership does not. That alone tells you the two products need different pricing discipline and a different amount of sales effort behind them.

Product	Contribution margin ratio	What moves the needle
Health club membership	~97%	Volume
Nutcracker (Drosselmeier)	60%	Volume, with a capacity ceiling
Kodak, 2000	50%	Volume and mix
Pro shop shirt	~15%	Price and purchasing

Ten Years Before I Ran the Number

I ran health clubs for about ten years before I ever wrote a contribution income statement. I managed by gross. I looked at the monthly gross of each club and I looked at the profit at the bottom, and I made decisions in the gap between those two numbers using instinct and experience.

Most of those decisions were right. I want to be straight about that, because I am not going to tell you a spreadsheet would have saved me from myself.

But instinct is expensive to build. It cost me ten years and more than one club. The ratio is free, it takes ten minutes, and it is close enough to be worth more than a decade of feel. If I had known in 1995 that a membership was a ninety-seven percent product and a pro shop shirt was a fifteen percent product, I would have made the same decisions ten years sooner.

Growth is not automatically good. Growth is good in exact proportion to your contribution margin, and if you do not know your contribution margin, you do not know whether the busiest month you ever had helped you or hurt you.

The Tasks That Obtain It

Task	How you verify it
Write down what one unit is in your business. A month of service, an	The definition is on the page, and whoever keeps your books agrees it is

Task	How you verify it
order, a seat, a job.	what your system counts.
List every cost that goes up when you sell one more of that unit, with a dollar amount on each.	Each amount on the list traces to an invoice or a contract you can put your hand on.
Subtract that total from your price, then divide the answer by the price to get your ratio.	The number is written down and dated, and you can say what you included in variable cost.
Run the same two steps on your other products and rank them on one page, highest ratio to lowest.	The ranked page exists, and a manager can read off which product is highest and which is lowest.
Multiply ten percent of last month's sales by your ratio, and write down what that growth would pay you.	The figure sits beside last month's sales on the same dated page.

Do This Now

If your sales went up ten percent next month, how much more would you keep? Answer with a number, not a feeling.

Chapter 12: Break-Even, and the Order You Should Take at a Loss

The objective of this chapter: Know the number of units you must sell this month to break even, and to hit your profit target.

In the fall of 2004 our Sparks club had 5,100 members. Our Reno club had 800.

Same company. Same brand. Same equipment lines, same checklists, same training. One building was packed at six o'clock on a Tuesday and one building had rows of empty treadmills at the same hour.

Now suppose a company across town calls both of those clubs on the same afternoon and says, we have two hundred employees, and we will sign all of them up if you cut the dues.

The right answer for the Reno club and the right answer for the Sparks club are not the same answer.

That is the whole chapter. Everything below is how you know which one you are.

The Formula That Answers "How Many"

Chapter 11 gave you contribution margin. Here is the first thing you do with it.

Every business has a pile of fixed costs sitting there at the beginning of the month with its hand out. Rent. Salaries. Insurance. Loan payments. That pile does not care how you did last month.

Each unit you sell throws its contribution margin onto that pile. When the pile is covered, you have broken even. Everything after that is profit.

So the number of units you need is the pile divided by what each unit throws on it.

Units to break even = fixed costs ÷ unit contribution margin

And if you want a specific profit, not just zero, you add the profit to the pile before you divide.

Units for a target profit = (fixed costs + desired profit) ÷ unit contribution margin

That is it. Two formulas. They will answer more real questions in your business than any other arithmetic in this book.

And they do not care what the unit is. A nutcracker, a membership, a haircut, a paving job, a night in a room. The formula never asks what you sell.

Working It on the Nutcracker Company

Go back to Drosselmeier. Fixed costs of 90,000. Contribution margin of 54 a unit.

Break-even is 90,000 divided by 54, which is 1,666.67. Call it 1,667 nutcrackers. Below that they lose money.

Now the real question. Management wants an operating income of 45,000. How many do they have to sell?

Add the desired profit to the fixed costs and divide.

(90,000 + 45,000) ÷ 54 = **2,500 units**

The Answer Created a New Problem

The plant holds 2,400 units.

Read that again, because this is the part that most people skip past and it is the most useful thing in this chapter.

The arithmetic gave a clean, correct, confident answer of 2,500. The building cannot make 2,500. The answer is one hundred units past reality.

A break-even calculation does not tell you what is possible. It tells you what would be required. Those are different sentences.

So now Drosselmeier has a second decision it did not know it had. Buy equipment. Hire more people. Pay for better training. Some combination. And every one of those adds fixed cost, which raises the pile, which raises the number of units required, which was the problem in the first place. There is also the question of where you store an extra five hundred nutcrackers, and whether your material costs stay flat when you suddenly need twenty-five percent more of everything.

That is what happens when you run the numbers honestly. You do not get an answer. You get a better question.

There were three other roads to 45,000, and each one of them opened its own hole in the floor.

Route to 45,000	What it takes	The new problem it creates
Sell more	2,500 units, up from 2,000	Plant holds 2,400. You are 100 short.
Raise price	90 to 103.50, a 15% increase	A 15% price increase may cut unit sales.
Cut fixed costs	90,000 down to 63,000, a 30% cut	Fastest route is paying off debt, and you may not have the cash. Renegotiating vendor contracts can carry penalties and cost you the relationship.
Cut variable costs	36 per unit down to 22.50, a 37.5% cut	Variable cost is mostly hourly wages and materials. You are talking about layoffs, wage cuts, or cheaper materials that customers can feel.

Every column ends at 45,000. Not one of them is free.

The Same Two Formulas on a Health Club

Now do a club.

From Chapter 11, a membership at thirty-nine dollars a month carries about thirty-seven dollars and eighty-three cents of contribution after billing. My unit model for a ten thousand square foot satellite club put total monthly expenditures somewhere between forty-five and fifty thousand dollars, and I will deal with that spread head-on in the next chapter.

Dues are not the only income. The worst month any club in our company ever had for new memberships, personal training and pro shop sales was well over ten thousand dollars. That ten thousand covers part of the pile before a single dues member is counted.

Take it off the top and divide:

- At $45,000 fixed: (45,000 − 10,000) ÷ 37.83 = 925.2, call it **926 members**
- At $50,000 fixed: (50,000 − 10,000) ÷ 37.83 = 1,057.4, call it **1,058 members**

Now look at what that brackets.

For years I told anybody who asked that a ten thousand square foot satellite club needs one thousand members. That was not a calculation. That was ten years of watching clubs, and I wrote it down in 2004 as a flat statement: one thousand members are needed in the new Reno location in order to maintain a significant monthly profit.

The formula says 926 on the good assumption and 1,058 on the bad one.

One thousand sits right in the middle.

I did not know that when I said it. I am glad the arithmetic agreed with me, and I am not going to pretend I did it in that order.

Now the target-profit version. Say you want ten thousand dollars a month of profit out of that club. Add it to the pile.

(45,000 + 10,000 − 10,000 in other income) ÷ 37.83 = 45,000 ÷ 37.83 = **1,190 members**

So the distance between a club that survives and a club that pays you ten thousand a month is about two hundred and sixty-four members. Not two thousand. Two hundred and sixty-four.

When your contribution margin is high, the gap between break-even and a good living is smaller than you think it is, and every customer inside that gap is worth chasing personally.

So put the two hundred and sixty-four somewhere a person can reach it. Cut into two-hour blocks and handed to the people working the floor, it stops being a target and becomes a list. Two hundred and sixty-four members is not a growth target. It is a stack of two-hour blocks somebody has already been told about.

The Order You Should Take at a Loss

Here is the situation every operator eventually gets. Somebody offers to buy a batch from you at a price you would never advertise.

Drosselmeier gets an order for 300 additional units at 90 each. That is 27,000 of additional gross.

Do not build a whole new income statement to answer it. Multiply the gross by the contribution margin ratio.

27,000 × .60 = **16,200**

Sixteen thousand two hundred dollars, straight onto operating income. Eighteen thousand becomes thirty-four thousand two hundred, on one multiplication.

Why is the whole thing profit? **Because the fixed costs were already paid.** The 90,000 was covered by the first 2,000 units. The rent is paid. The salaried people are paid. The insurance is paid. Those three hundred nutcrackers walk out the door carrying nothing but their own variable cost of thirty-six dollars, and everything above thirty-six is yours.

Which is why you can take an order at a price that looks like a loss and still be right.

Suppose the buyer will only pay fifty a unit instead of ninety. Your accountant looks at a full cost of ninety thousand fixed spread over the units plus thirty-six variable and tells you fifty is below cost and you are losing money on every one.

He is wrong, and here is the arithmetic. Fifty minus thirty-six of variable cost is fourteen dollars of contribution. Three hundred units times fourteen is 4,200. Your operating income goes from 18,000 to 22,200. You did not lose anything. You made forty-two hundred dollars you would not otherwise have made.

On a special order, the only question is whether the price beats your variable cost per unit. Full cost is irrelevant, because you already paid the fixed part.

Now the Trap, and I Want This One in Bold

A special order is only good business while you have spare capacity.

Drosselmeier had room. Two thousand plus three hundred is 2,300, and the plant holds 2,400. The order fit in a building that had the room to make it.

Change one thing. Suppose they were already running at 2,400.

Now those three hundred units cannot be made out of thin air. They come out of somebody else's order. You give up three hundred units at full price to make three hundred units at the discount.

Taking the 300-unit order at 50, when the plant is full	
Contribution gained (300 × 14)	4,200
Contribution given up (300 × 54)	(16,200)
Net effect on operating income	**(12,000)**

Twelve thousand dollars, gone, on an order that felt like found money.

And that is only the number you can see. The customer whose order you bumped has now learned that you are not reliable. You did not just lose twelve thousand dollars. You sold your best customer's seat at a discount, and he found out.

What That Looks Like in a Health Club

Back to the two clubs from the first page.

A corporate deal is a special order. A company calls with two hundred employees and wants a rate below thirty-nine dollars. Say they want twenty-nine.

Twenty-nine dollars minus about eighty-seven cents of billing is roughly twenty-eight dollars of contribution. Two hundred members is fifty-six hundred dollars a month of contribution that did not exist before, and the club's fixed costs do not move one dollar.

For the Reno club at 800 members, in a ten thousand square foot building that could hold far more, that deal is a gift. Take it. Take it before lunch.

For the Sparks club at 5,100 members, you have to think much harder. Because a health club has a capacity, and it is not the square footage. It is the parking lot at five thirty and the number of treadmills at six o'clock on a Monday in January.

Every business has one of those. A restaurant's capacity is its tables at seven o'clock, not its dining room at three. A plumbing company's capacity is two trucks and two drivers on a Tuesday. Find the thing that runs out first, because that is the thing a discount is really spending.

When a full-price member cannot get a machine, he does not file a complaint. He just stops coming, and about four months later he cancels.

We ran about thirty-five cancellations a month per club against a national average of about seventy. That gap was the most valuable asset in the company, and it was built out of empty machines at peak hour and two favors every two hours. Selling two hundred discounted seats into the busiest hours of a full building spends that asset to buy fifty-six hundred dollars.

That is the same twelve thousand dollar mistake Drosselmeier would make. It just takes ninety days to show up instead of showing up on the invoice.

I Never Ran This Before I Opened a Club

I never ran a formal break-even calculation before opening a health club. Not once, not in ten years.

I ran "a satellite club needs a thousand members," which I got from watching clubs succeed and fail, and which turned out to sit inside the band the formula produces, never more than seventy-five members from either end of it. I am not going to pretend I did the arithmetic and then act on it. I acted, and years later I checked.

But here is the part I want you to take seriously. The break-even math would not have saved me from my worst decision. When I opened a ladies-only club, my error was not in the divisor. It was in believing there were enough women in Carson City who wanted a ladies-only club. You can compute a perfect break-even on a market that is not there, and it will be perfectly, confidently, precisely wrong.

The formula tells you how many you need. It has nothing at all to say about whether they exist.

That is Chapter 2's job, and this chapter's job only starts after Chapter 2 has answered.

So run the two formulas, and then go look at what they are standing on. The pile you divided by is not a number. It is a stack of promises somebody signed, most of them signed before you needed them. Find out what that pile is made of before you trust anything it produced. That is Chapter 13.

The Tasks That Obtain It

Task	How you verify it
Add up on one page every cost that arrives this month whether or not you sell anything.	The page is dated, and every obligation on it has an amount beside it.
Divide that total by your contribution margin per unit and write the answer in units.	The number is written in units, not dollars, and you can say which margin figure you used.
Add the monthly profit you want to the fixed total and divide again.	The second number sits under the first, with the profit you added written next to it.
Write your variable cost per unit at the top of that page as the lowest price you may ever accept.	The figure is on the page, and you can say what is inside it and what is not.
Post the break-even number and the target number where the people who sell can see them.	The two numbers are on the board, and a salesperson says both of them without looking.

Do This Now

What is your break-even, in units, this month? Not in dollars of sales. In units, because units are what your people can actually go get.

Chapter 13: Fixed Cost Is a Promise You Already Made

The objective of this chapter: Know every fixed promise you have made, what each one costs a month, and the date it ends.

A fixed cost is not a cost. It is a promise.

Accountants put it in the expense column and that is fine for accounting, but it hides what actually happened. You did not incur an expense. You gave your word. You signed a piece of paper that says a specific person gets a specific amount of money on a specific day, and that paper does not contain a single clause about how your sales are going.

Variable costs are honest. They show up when business shows up. Sell nothing and you buy nothing.

Fixed costs are loyal to nobody. They arrive on the first of the month in January when the building is packed and they arrive on the first of the month in August when the parking lot is empty. They do not know the difference and they do not care.

I closed our Carson City ladies-only club on the fifteenth of August, 2004. Doors locked. Equipment loaded onto a truck and moved to Reno. Members transferred. Staff placed in other clubs.

The most rent I could owe on that empty building ran to March of 2005.

The equipment leases on machines that were no longer in that building ran to March of 2005 too.

Seven months of worst-case exposure on a business that had stopped existing. I only escaped half of it because we found a tenant for half the space. That is not a failure of the closing. The closing worked. That is what a fixed cost is. Somebody in 2001 or 2002 signed a lease, and in 2004 that signature was still collecting.

The moment you sign a lease or hire a salaried manager, you have made a promise that does not care about your sales.

The Promise Comes Before the Production

Here is what makes this dangerous, and it is not complicated.

You make the promise first. The production comes later, if it comes.

We once hired a general manager for our Carson North club at a premium salary because of his experience. We agreed to that number before he ever set foot in the building.

Sales went the wrong direction from the day he took over. The salary did not adjust. It could not. It was a promise.

That story is Chapter 22. The piece that belongs here is the sequence. We committed to a fixed cost on the strength of a résumé, which is a projection, and the projection was wrong, and the promise was not.

Every fixed cost in your business has that shape. You promised on the strength of a number you had not yet earned.

My Own Pro Forma, With the Crack Showing

In September of 2004 I wrote up the case for a sixth club in Reno. I want to walk you through my own numbers, including the part that does not hold together, because that crack is the most instructive thing in the document.

Here is what I wrote, in my own words, about the unit model.

> *"According to Nevada Fitness current health club statistics, one thousands [sic] members are needed in the new Reno location in order to maintain a significant monthly profit. The total monthly expenditures will be fifty thousand dollars. Nevada Fitness charges thirty-nine dollars a month for dues. These numbers are based on a ten thousands [sic] square foot satellite club."*

Fifty thousand dollars a month in expenditures. Plain as day.

Then a few pages later, in the same paper, I stated my second hypothesis. A new location will be profitable, which I wrote as monthly gross minus monthly expenditures being greater than zero. And then I tested it.

> *"Hypothesis 2: 85,504 − 45,000 > 0."*

Forty-five thousand.

Same club. Same paper. Same author. Two different numbers on the line that matters most.

The Reno satellite club, monthly	Narrative version	Hypothesis version
Dues (1,936 × $39)	$75,504	$75,504
New memberships, personal training, pro shop (floor)	$10,000	$10,000
Total monthly gross	**$85,504**	**$85,504**
Total monthly expenditures	($50,000)	($45,000)
Monthly profit	**$35,504**	**$40,504**

Five thousand dollars a month. Sixty thousand dollars a year. On the one line I was least sure of.

And it does more than change the profit. It changes the number of members the club has to sell to survive. Using the contribution margin of $37.83 from Chapter 11, and crediting the ten thousand dollar floor, break-even moves from 926 members to 1,058, which is the calculation I ran in the last chapter.

One hundred and thirty-two members. About fourteen percent more selling, all of it created by a discrepancy in a document I wrote myself.

Nobody made me publish that. I am publishing it because I have read a lot of business plans and I have never once read one that admitted it.

A pro forma is only as strong as the assumption you are least sure of, and the assumption you are least sure of is almost always sitting on the fixed cost line.

Go look at your own. The revenue line has usually been argued over by three people. The expense line usually got typed by one person late at night, and the number came from a phone call.

A projection is not there to be right. It is there to tell you which promises you can afford to make.

Operating Leverage, in One Sentence

Here is the concept the whole chapter is built on, and it has a fancy name that hides a simple idea.

The bigger the share of your costs that are fixed, the more your profit swings when your sales move.

That is operating leverage. High fixed cost businesses make more money going up and lose more going down. They do not have a middle setting.

Two companies can sell the same thing at the same price, earn the same profit in the same month, and still be nothing alike. One carries most of its cost in rent and salaries. The other carries most of it in materials and hourly labor. At one exact volume they tie. On either side of that volume they come apart, and they come apart hard.

Any business that pays for a building before a customer walks into it is high-leverage. A restaurant. A dental practice. A machine shop with a floor full of equipment. A gym.

A health club is about as high-leverage as a small business gets. Almost every dollar we spent was a promise. Rent on ten thousand square feet. Equipment leases. Salaried general managers. Insurance. Utilities on a building that has to be lit and heated whether four people are in it or four hundred. And on the other side, a membership that carries almost no variable cost at all.

So watch what that does.

Members	Dues contribution (× $37.83)	Subtotal with $10,000 other income	Less fixed	Monthly profit
900	$34,047	$44,047	($45,000)	**($953)**
1,000	$37,830	$47,830	($45,000)	**$2,830**
1,100	$41,613	$51,613	($45,000)	**$6,613**

Start at a thousand members and add ten percent. Membership goes up a hundred. Profit goes from $2,830 to $6,613.

Ten percent more members. One hundred and thirty-four percent more profit.

Now go the other way. Lose a hundred members off a thousand and you go from $2,830 of profit to $953 of loss. Same ten percent. Same one hundred and thirty-four percent swing, pointed at your head.

That is the deal you signed. There is no version of this business where the good months are that good and the bad months are only a little bad.

What It Actually Did to My Company

I do not have to argue this from a table. I lived on both ends of it.

	One club	Five clubs
Monthly gross	about $50,000	over $400,000
Monthly profit	about $4,000	about $30,000 average
Peak monthly profit		$50,000, since declined

First, the way up.

One club made about four thousand dollars a month. Five clubs, if nothing else had changed, would have made twenty thousand. We averaged about thirty thousand.

Where did the extra ten thousand a month come from? From fixed costs being spread. Our regional managers could oversee an additional location without hiring additional upper management, so a new club contributed to salaries that already existed. Advertising got cheaper per club for the same reason. The promise had already been made. Adding a club made more people share the payment.

That is operating leverage working for you, and it is the honest business case for a multi-unit company.

Now the way down.

Our profit had been fifty thousand dollars a month. It fell to about thirty thousand, and I know exactly why. Competition and saturation of the market. Saturation limits new sales.

Now here is a piece of arithmetic I want to flag before I do it, because I am inferring and you should know that. I never wrote down what our gross was in the peak-profit month. What I wrote down was that profit fell because new sales slowed.

But if a membership carries roughly ninety-seven cents of contribution on the dollar, then twenty thousand dollars of lost profit implies somewhere around twenty thousand six hundred dollars of lost monthly revenue. Against a monthly gross of over four hundred thousand, that is about five percent.

A five percent slide in sales took forty percent of the profit.

I did not lay off half the company. I did not lose a club. Nothing dramatic happened. Sales got a little harder in a market where five health clubs had already closed and everybody left was fighting over the same people, and the fixed costs went right on being promises.

If you own a high-leverage business, that is the paragraph to reread. Not the good one above it.

And notice what leverage does to the *quality* of your decisions, not just the size of them. When profit is thirty thousand a month against four hundred thousand of gross, you are running on about seven and a half cents of every dollar. A single bad hire, a single lease signed at the wrong number, a single month of a manager who will not follow the system, and you are eating the whole margin. There is no fat in a seven-cent business. There is only fixed cost and the customers who cover it.

That is why the checklists matter. It is why a two-week delay on a transition, which cost us almost nothing, was worth listening to two managers about. In a low-leverage business you can absorb a mistake. In a high-leverage business, you correct it before lunch or you pay for it all quarter.

What To Actually Do About It

Five things, and they are all boring, which is why most people skip them.

1. Know your fixed number to the dollar. Not approximately. Add up every promise you have made that arrives whether or not you sell anything. Rent, salaries, insurance, loan payments, leases, the software subscription nobody remembers signing. Most owners underestimate this number by fifteen or twenty percent because they forget the small ones.

2. Know the date each promise ends. I knew the Carson lease ran to March of 2005 and I knew the equipment leases ran to March of 2005. That is why I could close a club in August and still tell my partners exactly what the worst case cost was. Put every fixed obligation on one page with its end date. That page is your real risk profile.

3. Before you sign anything, run it at a ten percent sales decline. Not at plan. Not at ninety-five percent of plan. Ten percent down, because that is a normal bad year, not a catastrophe. If the deal only works at plan, it is not a deal. It is a bet.

4. Turn fixed into variable wherever somebody will let you. Percentage rent instead of flat rent. Commission instead of base. Contract instead of salary. You will usually pay more in the good years for that, and that is exactly what you are buying. You are buying the bad year.

5. Keep a reserve, and do not touch it. Chapter 3 is the whole argument. The fifty-nine thousand dollars that sat in the bank in 1995 was not idle money. It was the thing that let me keep every promise I had made while the business figured out whether it was going to work. I would not have gotten the chance if I had spent it on a nicer sign.

There is an old and very plain idea that a man should count the cost before he starts building, so that he does not lay a foundation and then stand there unable to finish it. I do not know a better description of what a fixed cost commitment is. You are laying a foundation. The question is not whether the foundation is impressive. The question is whether you can finish the building in a bad year.

The Number I Could Not Prove

I gave you the forty-five thousand and the fifty thousand and I let you see both.

What I have not told you is which one was right, and the reason is that I do not know. I never opened that particular sixth Reno club under that particular model, and the two numbers came from two different conversations weeks apart. One of them was probably a careful build-up of rent and payroll and utilities. The other was probably me rounding up in a paragraph because fifty is a rounder number than forty-five and it felt appropriately conservative.

That is how it actually happens. Not fraud. Not incompetence. A tired man typing at eleven o’clock at night, being a little conservative in one place and a little precise in another, and never noticing the two did not match.

If I had built the club and the real number came in at fifty-two, my break-even would have been about eleven hundred and ten members instead of nine hundred and twenty-six, and every sales meeting for the first two years would have been about a gap I did not know existed.

So do this. Take your pro forma, find the line you are least sure of, and move it fifteen percent in the direction you would hate. Then look at the answer. That answer, not the one in the plan, is the promise you are about to make.

Fixed cost is a promise you already made. Make the next one at a number you could still keep in a bad year, because the good year does not need your help.

The Tasks That Obtain It

Task	How you verify it
Write your guess at your total monthly fixed cost on a page, before you look anything up.	The guess is on the page with the date and the hour you wrote it.
List every fixed obligation under that guess, with its monthly amount and the date it ends.	Every line carries both a dollar amount and an end date, and each one traces to a signed document.
Add the column and write the total next to your guess.	Both numbers are on the same page, and your bookkeeper can rebuild the total from the list.
Run your monthly profit again with sales down ten percent, and again at down twenty.	The two answers are written under the table, and you can say which costs you held fixed.
Divide your cash reserve by that fixed total to get how many months you could keep the promises.	The number of months is on the page, and a bank statement backs the reserve figure.

Do This Now

Write down every fixed obligation in your business on one page, with the amount and the date it ends. How long did that take, and why have you never done it?

Chapter 14: Profit Is Not Cash

The objective of this chapter: Know what your bank balance will be ninety days from today, and which five lines moved it.

In July of 2004 I sat down in a room with two men and decided when to close a health club.

John Gutierrez was our Regional Customer Service Manager. Bruce Gimple was our Regional Manager. The club in question was our ladies-only club in Carson City, about a half mile from the first club we ever opened in February of 1995. At the same meeting we decided to convert our Reno ladies club to co-ed and move the Carson equipment into it.

Here is how I wrote the problem down at the time. “The two ladies only health clubs have significantly under performed in comparison to our four co-ed clubs. This has caused a cash flow problem in these two units.”

Read that second sentence again. It does not say the clubs lost money. It says they caused a cash flow problem.

Those are two different sentences and they lead to two different decisions. If two clubs are simply unprofitable, you have a strategy conversation and you have it whenever you get around to it. If two clubs have created a cash flow problem, you have a calendar conversation, and the calendar is not yours. Cash flow is what put a date on that decision. Profit only told me the decision existed.

The mistake underneath it is mine, and Chapter 25 is where I take it apart. What belongs here is narrower.

But notice what forced the timing. It was not the mistake. It was the bank balance.

The Sentence That Saves Businesses

A profitable company can run out of money and close.

That is not a paradox and it is not rare. It is the ordinary way that good small businesses die. The owner is looking at a number on the bottom of one page while a completely different number on a completely different page runs to zero.

Profit is an opinion about a period of time. Cash is a fact about a Tuesday.

An income statement is somebody's reasonable judgment about what belongs in a month. Cash is what the bank will actually let you spend at nine in the morning. The two numbers are related. They are not the same number, they are not close in any given month, and the one that kills you is the second one.

I have been asked what I would do if I found a huge difference between the net income and the reported cash flow. My answer then is my answer now. Find out why. Start with the financial statements and do not stop until you can name the line that separated them.

There are five places they separate. Learn these five and you will never be surprised again.

Where the Two Numbers Come Apart

One. Receivables. You booked the sale. You have not been paid. The income statement says you made money in March and your bank says you will find out in June.

Health clubs are luckier than most businesses here, and you should know why. When a member signs up on monthly dues at thirty-nine dollars, we draft the account. The money moves. We are not mailing invoices and hoping. If you run a business that invoices, you have a whole category of problem I mostly do not have, and it hides inside a growing sales line. Growth makes receivables worse, not better. Every new customer is another pile of money you spent to earn and have not yet touched.

Nike is a big company but the arithmetic is the same arithmetic. In fiscal 2003 the change in their accounts receivable ate one hundred thirty-six million three hundred thousand dollars of cash. That is real money that never showed up as an expense anywhere. It just was not there.

Two. Inventory. Everything sitting on a shelf is a dollar you already spent that has not turned back into a dollar. It is not an expense until it sells. Until then it is your money, wearing a different hat, in a box.

For us that is the pro shop. It is also, in a bigger way, forty thousand pounds of free weights per location. That is an extreme case of the same idea, which is a thing you paid for that has to sit there before it earns.

Three. Capital spending. This is the big one for anybody in a physical business. When you buy a machine, you write a check for the whole machine on one day. The income statement will not agree to see it that way. It will spread that machine across five or seven years in little slices. Your bank account saw the whole thing on the first day.

For me the machine was a treadmill. For a printer it is a press, for a contractor it is a truck, for a dentist it is a chair. The check is the same shape.

Four. Debt principal. Here is the one that catches people, and I put it in writing years ago in exactly these words. If a company is paying off principal without depreciation, it will hurt their cash flow.

Say that slowly. The interest on a loan shows up on your income statement. The principal does not. Principal is not an expense. It is you giving back money you already borrowed. So you can have a month where you made eight thousand dollars in profit, wrote a check for nine thousand in principal, and are poorer than you started while your accountant congratulates you.

I lived on the other side of this in 1995, paying back the seventy-nine thousand dollar loan from Chapter 3. Every dollar of that principal repayment came out of the bank and none of it came off the income statement.

Five. Depreciation. This one runs the other direction, and it is the reason the two numbers are not simply "profit minus surprises."

Depreciation is a real expense on the income statement that did not move a nickel this month. It is a slice of a machine you bought three years ago. So when you go looking for your cash, you have to add it back in. A business can post a thin profit and still be throwing off good money, because a large slug of what it counted as an expense was a memory of a check written years ago.

Free Cash Flow, In One Sentence

Here is the definition. Free cash flow is the money left over after you have paid to keep the business the size it already is.

That is the whole thing. Not the money left after you paid the bills. The money left after you paid the bills *and* replaced what wore out. If you have to buy four machines a year just to have as many working machines next January as you have today, those four machines are not growth. They are rent on staying the same size. Pay for them before you call anything free.

Mine were treadmills. A bakery has ovens. A delivery route has tires and transmissions. A dental practice has chairs and a sterilizer. Every business is quietly paying rent on staying the same size, and most owners have never added it up.

The arithmetic is short.

Cash from operations, minus what you spent on equipment and buildings, equals free cash flow.

Running It On A Club

Now do it on something you can walk through.

Take the Reno satellite club from Chapters 8 and 13. Gross of at least $85,504 a month against expenditures my own documents put at forty-five thousand in one place and fifty thousand in another.

Call the operating cash somewhere between thirty-five and forty thousand a month and move to the part almost nobody puts in the pro forma.

Every one of those treadmills and every one of those six lines of selectorized equipment wears out. Whatever it costs you per month to keep your own equipment as good as it is on opening day, subtract it here. I am not going to invent that number for you, because it is on an invoice in your file cabinet and it is not on one in mine. Get it. Divide it by twelve. Put it in the table.

What is left is free cash flow. That is the money that is actually available for a sixth club, a distribution to owners, or a bad quarter.

And if you have equipment leases, subtract the principal portion of those payments too. Our equipment leases at the Carson ladies club were paid off by March of 2005. Until that month, those payments came out of the bank whether the club was busy or not.

The Same Company, Both Directions

Now watch a company a thousand times my size do exactly the same thing.

Here is why I do not want you to memorize a rule about which number is bigger. It goes both ways inside one company.

Nike fiscal year	Net income	Cash from operations	Gap
1997	$795.8 million	$323.1 million	Cash short by $472.7 million
1998	$399.6 million	$517.5 million	Cash ahead by $117.9 million
2004	$945.6 million	$1,514.4 million	Cash ahead by $568.8 million

In 1997 they earned nearly eight hundred million dollars and collected less than half that in actual cash. Twelve months later they earned half as much and collected more. Nobody got smarter and nobody got dumber. Receivables, inventory and working capital moved.

The 2004 column is worth taking apart once, because it is the reconciliation every owner should be able to run on his own business, and the full table is in Appendix A. Start at 945.6 of net income. Add back 310.4 of depreciation and 66.2 of other non-cash adjustments. Add 82.5 because receivables came down and 269.1 because payables went up. Subtract 55.9 because inventory went up and 103.5 of other operating items. You land on 1,514.4 of cash from operations. Nothing mystical happened between the two ends of that table. Five kinds of ordinary business activity happened.

Now run free cash flow on that same year. Cash from operations of 1,514.4 million, minus 213.9 million of capital spending, leaves 1,300.5 million.

That subtraction is the whole art of it. You are deciding which spending is the price of standing still and which spending is a choice. Treadmill replacement is standing still. A sixth club is a choice.

What Cash Flow Actually Bought Us

Now back to the room in July.

Because we treated it as a cash problem instead of a profit problem, we moved in weeks instead of quarters, and we moved on the right levers.

The building, the equipment leases, the members and the staff all had a plan before anything was announced, and Chapter 25 walks through every step of it. The target was ten to twenty percent positive cash flow each month at the Reno location by March of 2005.

And here is the part I will not leave out. The cash side of that decision beat my forecast and the sales side missed it. Both are true. If I only tell you the first half, I have written a brochure instead of a book.

Which brings me back to attention. Your cash position is a thing that changes while you are not looking. Counting it once a quarter is not attention.

I Framed a Symptom as the Problem

There is one more thing I got wrong and it belongs to a later chapter. I framed the problem as the timing of the change, and the timing was a symptom. Chapter 24 is about why that distinction is worth a chapter. Cash flow is what dragged me back to the real problem, because a cash problem will not let you hold a meeting about scheduling. It just keeps subtracting.

Watch your profit so you know whether the business works. Watch your cash so you know whether it survives until the answer arrives.

The Tasks That Obtain It

Task	How you verify it
Write last month's profit and last month's change in bank balance at the top of one page.	Both figures come off statements somebody else printed, and both are on the page.
Split the gap between them across five lines. Receivables, inventory, equipment, principal, and depreciation added back.	Each of the five lines carries a dollar amount, and the five of them add up to the gap.
Add up what you spent last year only to replace what wore out, and divide by twelve.	The total came from invoices in your own file, and the invoice dates are listed on the page.
Subtract that monthly figure from your monthly cash from operations to get free cash flow.	The subtraction is written out and dated, and you can say what you left out of it and why.
Write down what your bank balance will be on this date next month, then check it that day.	The projection is dated before the day arrives, and the actual balance is written beside it.

Do This Now

Do you know, without calling anyone, what your bank balance will be thirty days from today? What about ninety?

Chapter 15: What a Dollar Costs

The objective of this chapter: Put a number on what your money costs you a year, and make every project clear it.

Your own money is the most expensive money in your business.

Every owner I have ever met believes the opposite. Borrowed money costs you nine percent and your own money costs you nothing, because nobody sends you a bill for it. So the owner who is putting his own cash into the business feels thrifty, and the owner who is borrowing feels exposed.

That is backwards, and the reason it is backwards is the whole point of this chapter.

Debt has a rate printed on it. You can read it off the note. Equity has a rate too. You just never get an invoice for it, so most people set it at zero and then wonder for twenty years why the business never seems to get anywhere.

Here is the test. If you took the same money and put it somewhere else, what would it earn? That is what your money costs you to leave in this business. It is a real number, you are paying it every single month, and the fact that it does not appear on your income statement does not make it smaller.

What I Actually Did in 1994

In 1994 I borrowed seventy-nine thousand dollars and spent twenty thousand of it. Chapter 3 told that as a lesson about not running out of money. Now I want to tell it as a lesson about price.

I paid interest on the entire seventy-nine thousand dollars. Not on the twenty I used. On all of it. That reserve was not free insurance. It had a printed rate on it and I paid that rate every month for the privilege of not needing it. And I would do it again, because the alternative price of running out of cash in year one is one hundred percent of the business.

That is what a cost of capital decision actually feels like. It is not a formula. It is you deciding what you are willing to pay for money, and then finding out whether what you built with it earned more than that.

The Plain Version, With the Greek Taken Out

There is a standard way to price the money in a business. It has letters in it. I am going to name each piece once in plain English and then never use the letters again.

Start with the risk-free rate. This is what money earns when nobody can lose it. Long government paper. When I ran these numbers on Nike in 2005, that rate was 4.6 percent. If a business cannot beat 4.6 percent, the owner should sell the business, buy the government paper, and go fishing.

Add the market premium. This is the extra return investors demand for owning businesses instead of government paper, because businesses sometimes fail. I used 5 percent.

Now multiply the premium by how much your business swings. Some businesses swing harder than the market and some swing less. A company that swings less than everybody else is cheaper to own, because it scares people less. Nike's swing factor was 0.727, which means it moved about three quarters as hard as the market.

Put those three together.

4.6% + (5% × 0.727) = 4.6% + 3.635% = **8.235%**

Call it 8.24 percent. That is the price of the equity in that business. Nobody invoices for it. It is the return the owners are entitled to expect before anybody should say the business is working.

Then blend in the debt, which is cheaper for two reasons. First, the lender takes less risk than the owner, so he charges less. Nike's pre-tax borrowing rate was 8 percent. Second, and this is the part people forget, interest is deductible. At a 35 percent tax rate, an 8 percent loan really costs you 8% × 0.65, which is 5.2 percent. The government is paying a third of your interest bill.

That business was funded 14.6 percent by debt and 85.4 percent by equity. Blend the two prices in those proportions and you get the weighted cost of all the money in the business, which is the only number that actually matters.

Here is where I have to be straight with you. My spreadsheet printed 7.10 percent. When I run that same blend by hand off those same five inputs, I get something different.

$(0.146 \times 5.2\%) + (0.854 \times 8.24\%) = 0.759\% + 7.037\% = \mathbf{7.80\%}$

Those are my two numbers about the same company and they are seven tenths of a point apart. I am showing you both instead of picking the pretty one. Somewhere in that sheet a cell is pointed at the wrong place, and I did not catch it at the time.

I am leaving it in for a reason. If a man with an MBA and more than thirty years of running businesses can hand you a cost of capital that is off by seven tenths of a point, then you should never take one on faith, including mine. Do it on paper. Five inputs, two multiplications, one addition. It takes ninety seconds.

The number is somewhere around seven or eight percent. That is what the money cost.

Your Bar Is Yours

Do not go write 7.8 percent on a wall. That number belongs to a shoe company in 2005.

I have run that same arithmetic on a project instead of a company, borrowing the swing factor from firms that already do what the project was about to do, and the answer came out at 10.4 percent. Same arithmetic, same inputs in the same order. Seven to eight percent for a shoe company. Ten point four for a project. Two bars, and neither one is yours.

Your bar depends on what the market pays for safety this year, on how violently your business swings, and on how much of your money is borrowed. Nobody can hand it to you. You have to build it, and you have to rebuild it when rates move.

What The Bar Is For

Now the useful part, and it is one sentence.

If a project cannot beat the cost of the money, do not do the project.

That is it. That is what all of that arithmetic buys you. Not a valuation. A door with a height on it.

Substitute your own project for mine and the sentence does not change. A second location. A second truck. A bigger oven. If it cannot beat the cost of the money, do not do it.

Here is the club version. Should we open a sixth club in Reno?

I framed that question in 2004 as two hypotheses. The first was that a new club would get more than one thousand members. The second was that it would be profitable, which I wrote as gross minus expenses greater than zero.

Look at that second one. Greater than zero.

That is the wrong bar and it is my own handwriting. Greater than zero only asks whether the club makes money. It does not ask whether the club beats what that money would have earned somewhere else, including in the five clubs I already had. If it takes six hundred thousand dollars of our capital to open a sixth club, and our money costs us ten percent, then that club has to throw off more than sixty thousand dollars a year of free cash flow before it has done anything for us at all. Sixty thousand and one dollar is the starting line, not the finish line.

I ran the members question three separate ways, as Chapter 2 shows. I was careful about the numerator. I was lazy about the hurdle.

Here is what that laziness actually looks like on a Tuesday. A hurdle rate is a number you set once a year. The two-hour report is the thing that tells you whether you are going to clear it. The reason I could not say whether that club would beat ten percent is that nobody in the company was reporting against a bar. We reported activity. Nobody reported activity against a number the money had to beat.

Say your money costs you ten percent all in. A project that returns eight percent is not a small win. It is a loss. You destroyed two percent of everything you put into it, every year, while feeling productive the entire time. The income statement will show a profit. You still went backwards, because you had a ten percent alternative and you took the eight.

I wrote this down about a company deciding whether to replace equipment, and it applies to whatever equipment you run. Treadmills in my case. An oven, a van, a chair, a press in somebody else’s. The rate of return you require on the new equipment has to be higher than the return you are already getting on the old equipment. If it is not, do not replace it yet. Wait until the return on the old stuff drops below what the new stuff would earn. Old equipment that still works is a competitor bidding against your capital, and most owners never let it bid.

The Krispie Krinkles Decision

Let me close with a decision where the arithmetic came out yes and the honest answer was still no.

The project was a new product line, and it comes out of my coursework rather than my clubs. I am using it because the numbers are complete. Here is the money.

What it costs to start, all on day one:

Item	Amount
Production facilities	$3,000,000
Introduction expenses	2,500,000
Inventory and working capital	500,000
Total	**$6,000,000**

What it brings in:

Year	Sales	Cash out	Net cash in
1	$1,200,000	$600,000	$600,000
2	2,400,000	1,200,000	1,200,000
3	4,000,000	2,000,000	2,000,000
4	5,200,000	2,600,000	2,600,000
5	6,300,000	3,150,000	3,150,000

At the end of year five you sell off what is left for eight hundred thousand dollars, so year five is really 3,150,000 + 800,000 = 3,950,000.

Now discount all of that back at a 16 percent hurdle. A dollar five years out is worth about forty-eight cents today when money costs sixteen percent.

Year	Cash	Worth today
1	$600,000	$517,241
2	1,200,000	891,796
3	2,000,000	1,281,315
4	2,600,000	1,435,956
5	3,950,000	1,880,646
Present value		**$6,006,955**
Less what you put in		(6,000,000)

Year	Cash	Worth today
Net present value		**$6,955**

The internal rate of return came out at 16.0379 percent against a hurdle of 16 percent.

So it passes. Write the memo, get it approved, break ground.

No.

Look at what you are actually holding. Six million dollars of present value with six thousand nine hundred fifty-five dollars of margin sitting on top of it. That is twelve hundredths of one percent. The rate of return beats the required rate by four hundredths of a percentage point.

Now stress it. The whole net present value lives in the fifth year, five years out, in a business that does not exist yet.

- The eight hundred thousand dollar salvage assumption alone is worth $380,890 in today's money. That is fifty-five times the entire net present value. Change your guess about what used equipment sells for in five years and the answer flips.
- And the sales forecast in the front of that same analysis says year four is $5,000,000 and year five is $6,000,000, while the cash flow schedule uses $5,200,000 and $6,300,000. Those are two of my own numbers about the same two years, two hundred thousand dollars apart in year four and three hundred thousand apart in year five. The year five gap by itself is forty-three times the net present value of the project.

A net present value of about seven thousand dollars sitting on top of a six million dollar present value is not an opportunity. It is a coin flip with a spreadsheet stapled to it.

The honest move is to say so out loud. Not "the model says yes." The model says the model cannot tell. And the right answer to "the model cannot tell" is almost never "then let us spend six million dollars," because a project that only clears the bar when every one of five years goes exactly as forecast will not clear the bar. Over ten businesses and more than thirty years, not one of my forecasts ever came in exactly as written.

That is the real value of running the cost of capital. It does not usually tell you yes. It tells you when yes is too thin to trust.

I Never Checked My Own Cost of Capital by Hand

Two things I got wrong here, and I have already shown you both.

I handed myself a weighted cost of capital I never checked by hand, and it was off. And when I tested whether to open a sixth club, I wrote the profit test as greater than zero, which is not a test at all. It is a hope with an inequality sign on it.

There is one more thing worth saying, and then I will get out of the way. Money that costs nothing does not exist. Somebody is going without the use of that money while you have it, whether that somebody is a bank, a partner, or you and your family ten years from now. Two of our ladies-only clubs had an owner who was not an owner of the co-ed clubs. When I priced that decision, I was not just spending my money. Knowing the price of a dollar is not a finance exercise. It is the arithmetic of not wasting what belongs to somebody else.

Put a number on your money. Then make everything you build clear it.

The Tasks That Obtain It

Task	How you verify it
Write today's long government rate at the top of a page, with the date you looked it up.	The rate and the date are on the page, and a second person looking the same day gets the same rate.
Write your own borrowing rate off the note in your file, and your tax rate under it.	The rate on the page matches the note, and you can produce the note.
Multiply the borrowing rate by one minus your tax rate to get what your debt actually costs.	The multiplication is written out, and a second person working from the same two inputs gets your answer.
Blend that against what your own money would earn elsewhere, in the proportions you owe and own.	The hurdle rate is written by hand, dated, and somebody else checked the arithmetic and initialed it.
Take your last three purchases over one thousand dollars and write what each one returns against that rate.	Three percentages are on the page under the three purchase amounts, and the amounts match the checks.

Do This Now

Write down your hurdle rate. Not a feeling. Five inputs and two multiplications, on paper, this week. What did you get?

Chapter 16: Two Hours at a Time

The objective of this chapter: Set the length of your block, put a written list in front of one position, and verify every report it produces.

Chapter 1 built a ladder and then left it hanging in the air.

It ran a ten-year goal down through eight divisions until it arrived at a task, and there it stopped. A task is not the bottom of anything. A task has to happen somewhere. It happens to a particular person, on a particular morning, inside some block of time, and either it gets done inside that block or it does not.

So two questions are still open, and this chapter is the answer to both.

How long is the block?

And how do you know that the task inside it actually happened?

The second question is the one that matters, and it is the one almost nobody asks. The equation this book is built on is not tasks equal objectives equal goal. It is completed tasks equal objectives obtained equal goal achieved. Completed means confirmed by somebody who was not the person doing the work.

This chapter is not the argument of the book. Chapter 1 was the argument. This chapter is the proof.

I did not get from one club to five with a vision. I had the same vision the whole time.

Vision is the easy part. A vision is a sentence. A business is a set of tasks that somebody has to actually perform on a Tuesday.

I got there with a series of tasks that need to be done every two hours by all staff members, and a report that says whether they were done.

This is that system. It is the most valuable thing I own and I am going to hand it to you in one chapter.

Daily, Weekly, and Monthly, for Every Position

Start with the part that is not glamorous and is not optional.

Every position you pay for needs a written list, in three time frames.

Nevada Fitness has daily, weekly and monthly checklists for every position in the company. Every position. Front desk. Sales representative. Personal trainer. Maintenance. Assistant manager. General manager. Regional manager. There is no seat in the building where the answer to "what is my job today" is a shrug or a personality.

Three time frames, because work comes in three sizes.

Daily is production and service. Favors done. Appointments booked. Phone calls made. Money counted. Floor walked. The daily list is the one with a clock on it, and it is the one this chapter is really about.

Weekly is upkeep. Follow-up on the customers you have not heard from. Equipment inspection. Scheduling. The things that will not kill you today and will absolutely kill you in a quarter.

Monthly is the business itself. Numbers reconciled. Your recurring revenue base checked. Payroll against gross. Retention against last month. Your largest accounts called.

Most owners have some version of the daily list in their heads and nothing else written anywhere. That is the same as having none. The thing in your head is not available to the newest person you hired at six in the morning.

Decisions are made according to the priorities on the checklist. The list is not a to-do list. It is a priority order. When two things want the same twenty minutes, the list already decided. That is worth more than the tasks themselves, because the single most expensive thing an untrained employee does is spend an hour on the fourth most important thing in the building.

The Two-Hour Cycle

Now the clock.

Here is the whole mechanism, and I will give it to you as a chain, because a chain is what it is. Read it from the bottom up.

Level	What they do every two hours
Staff member	Completes and records the tasks on their own checklist
General manager	Confirms every staff checklist is complete, files the club's report

Level	What they do every two hours
Regional manager	Pulls all club reports, spots what is missing, directs the general manager
Owner	Pulls the same reports from anywhere, on any club, at any hour

Four levels and the whole loop closes in two hours.

That chain is easy to read as reporting. It is not reporting.

That chain is the verification step in the equation.

Look at the second row again. The general manager does not do the tasks. He confirms that they were done. That is the row that turns a task from something a man says about himself into something a second man says about him. Take that row out and you have claimed tasks, and claimed tasks do not multiply out to anything.

Those two middle rows had names. Bruce Gimple was our Regional Manager and John Gutierrez was our Regional Customer Service Manager, and in 2004 the three of us could see all five clubs at any hour of the day. Not a summary of the five clubs. The actual checklists, filed that morning, by name.

What that buys is not a feeling. It is arithmetic.

Say a club is staffed for ten hours a day. That is five two-hour blocks. Find out about a problem at month close and three hundred staffed hours of production already happened and cannot be recovered.

300 ÷ 2 = **150**

The two-hour cycle finds the same problem up to one hundred fifty times faster. I correct a club before lunch instead of after the month closes.

What gets entered automatically generates projection reports for new monthly dues sold, new monthly membership sales, and total daily gross. By the third or fourth block of a day, the system is telling you where the month is going to land.

Immediately is the word I want to defend. Most owners believe they run their business daily. They do not. They run it at whatever interval they actually receive information, and for most small businesses that interval is a month. You are not running a business monthly. You are reading a history of it monthly.

What Is Actually On the List

A checklist full of vague instructions is not a checklist. It is a mood board with lines on it.

Everything on ours is countable. Here are the two most important items, in general form first and then in club language, because the general form is the part that transfers.

Item one. Every person you pay owes something to a customer inside every block.

Not just the people whose job title says sales or service. Everybody.

Here is our version. One task for all staff members every two hours is to do two favors for members. A favor is going above and beyond what the member expects. A staff member could walk up to a member and say, thank you for your business, I would like to give you a free t-shirt, and then hand over the t-shirt.

It is small, it is specific, and it costs almost nothing. Our mission statement says we go beyond the expectations of our members. This is that sentence turned into something a person can do at 9:40 in the morning.

A server, a service writer at a body shop, a receptionist at a dental practice. Every one of them can do two small unrequested things for a customer in two hours. The t-shirt is mine. The two is yours.

Item two. Whoever brings in new work owes a counted number of new conversations inside every block.

A number, not an adjective. Two of something a stranger has to agree to.

Here is our version. A sales rep must make two appointments every two hours to show the club. That is the number. It is not “prospect actively.” It is not “focus on new business.” It is two, before eleven o’clock, and two more before one.

For a contractor that is two estimates on the calendar. For a print shop it is two quotes out the door. Pick the thing that has to happen before money can happen, and require two of it.

Now compare that to the alternative, which is a sales rep who is told to do his best. His best is not a number, so it cannot be missed, so it cannot be coached, so it will not be repeated. At the end of the month you will have a conversation about attitude. Attitude conversations are what managers have when they forgot to set a number.

The ten thousand dollar monthly floor I have mentioned more than once in this book was built out of required activity rather than hoped-for effort.

Here is roughly the shape of a two-hour block for four seats in my company. The exact list belongs to your business.

Position	Every two hours
Front desk	Two favors. Walk the floor once. Check-ins reconciled. Phone messages cleared.
Sales representative	Two favors. Two appointments booked to show the club. Follow-up calls logged.
Personal trainer	Two favors. Floor introductions. Assessments scheduled.
General manager	Two favors. All staff checklists confirmed. Club report filed. Anything missing, corrected now.

Notice that two favors appears in every row. That is on purpose. There is exactly one item every person in the building owes, from the newest part-timer to the man who runs the club, and it is the one that touches a member.

What Is on the List Now

That was the list in 2004. It is not the list today, and the difference is the best argument I can make for the system.

We do not pressure sell anymore in the health club business.

Look at what changed and what did not.

What the block was for then	What the block is for now
Favors done for a member	Services done for a member
Appointments booked to show the club	Personal training presentations given
Phone calls made	Social media posts made
Floor walked	Club walked and kept clean

What the block was for then	What the block is for now

Everything in the right column is new. Everything holding the two columns up is the same. Same three time frames. Same two-hour block. Same report, filed by the same position, read by the same people. Every item still carries a number, and every item is still confirmed by somebody who did not do the work.

Two of the tactics this system was built to serve are gone. The pressure sale is gone and the cold call is gone. The structure did not wobble.

A method that outlives the tactics it was built to serve is a method worth having.

So do not copy my items. Copy the shape. Write down the objectives your business actually has this year, put a number on each one, and name the person who confirms them. When the objectives change, and they will, you rewrite the items and keep the machine.

If You Do Not Have a Front Desk

The block does not need a counter. It needs a seat that touches a customer and a seat that brings in new work. Every business has both, even if one man is sitting in both of them. Name the seats you have. Then write what each seat owes in two hours.

The objection I hear most comes from the owner whose people are in vans and on job sites across a county. He tells me you cannot run blocks when nobody is in the same building.

He has it exactly backwards.

The further apart your people are, the more the report is the only thing you have. I could walk into a club and see. Nobody can walk into a county. A crew leader can send four lines from the cab of a truck at the end of a block. Job started at this hour. Change order signed or not signed. Next stop and the hour I expect to be there.

That report is worth more in a van than it ever was at my front desk.

The Checklists Change Every Month

Here is the piece that most people who copy this system leave out, and it is the piece that keeps it alive.

Every checklist in the company is rewritten once a month.

Twelve rewrites a year.

Why bother? Because a checklist that never changes turns into wallpaper in about six months. And the business moves. A task that mattered in January because a competitor opened in December is dead weight by June, and it is taking two minutes out of every block from every employee in five buildings.

The monthly rewrite is also how you push improvement into the company without calling a meeting. Somebody at the Sparks club figures out a better way to hand off a tour. It goes on next month's list and it is in all six buildings at once.

That is how the list survived the changes I described a few pages ago. Nobody had to tear the system down and build a new one.

Fourteen DVDs, So the Best Person Trains Everybody

Now the second half of the machine, and it is the half most owners have never considered.

The checklist tells a person what to do. It does not tell them how to do it. Left alone, they learn how from whoever is standing nearby, and that is your most available employee rather than your best one.

So we made fourteen different training DVDs. The topics include data entry, collections, customer service, personal training sales, and membership sales. Each topic features an expert or the person most qualified to train in that given area.

That is the entire idea in one sentence. The best closer in the company trains every salesperson in the company. Not once, at a meeting somebody missed. Every time, forever, in every building.

The recordings also train all staff members on how to plan and complete the tasks on their individual checklists. The format is dated and the principle is not.

Employees must be trained to perform their tasks the way the owner would do them and treat customers the way the owner would. I said that in Chapter 9. This is how you actually hit it.

You cannot hit it by hoping. You hit it by recording the right person doing it right, once, and then playing it for everyone.

Does This Not Treat Grown Adults Like Children?

I get this question every time I explain the system, and it is the strongest objection there is. My answer starts with the least flattering thing I have ever said about human beings, including myself.

Most people procrastinate. The two-hour updates are production requirements. Each employee is required to do a counted number of things inside every block. If nobody ever tells a person what the block is for, the block produces nothing.

I have had that sentence read back to me in a tone. Look at what it actually says and does not say.

It does not say people are lazy. It says that a person standing in a building where forty things could be done, with no statement of which two matter in the next two hours, will do the easiest one, or the one the loudest customer asked for, or nothing. That is what happens to every human being without direction, and it happens to owners worse than it happens to staff, because nobody gives the owner a list.

A checklist is not surveillance. A checklist is clarity.

Surveillance is watching a person to catch them. A checklist is telling a person the truth about their job before the day starts, rather than grading them on it after the day ends. One of those is a trap and the other one is a fair deal.

The same goes for the report, which is what people are really objecting to.

The report is not there to catch anybody. The report is there because “I did it” and “it was done” are two different statements, and a business can only be built out of the second one.

Verification is not an accusation. It is what you do because memory is not evidence.

And here is what I have watched happen for more than thirty years. Employees under this system are calmer. Not more anxious. Calmer. They do not have to read my face across the room. They can read the list.

Business plans are maps. So are checklists. A map does not insult a driver.

In Habakkuk, the prophet is told to write the vision and make it plain on tablets, so that he may run who reads it. The vision is not enough by itself, and the writing is not enough by itself. It has to be written *plain*, and the reason given is not tidiness. It is speed. So he may run. A person can only move fast on something they can read fast. If your people cannot read your vision, do not blame them for walking. Get back to your list and make it plainer, because that is the actual job.

Finally, the proof, and it is expensive. Chapter 22 is about the most experienced general manager we ever hired, who would not run this system, and what that cost.

Where the Checklist Does Damage

Now the part where the objection is right, and I have watched this go wrong in my own buildings.

A checklist can be used to micromanage. When it is, it does real damage. It stifles a staff member's creative juices, and people need some freedom to create. A list that accounts for every minute of a person's day does not leave them any.

I have seen a manager take a working system and turn it into a cage. He kept adding items. Every problem that came up that month became another line, and nothing ever came off. Within about a year his people were not running a club. They were completing a document.

The system was the same one running in the other buildings. He used it differently and it produced a different result.

Here is the line, and it is the whole difference.

The list says what has to happen. It does not say how the person does it.

Two favors every two hours is a requirement. What the favor is belongs to the employee. Carrying somebody's bag out to the car. Remembering that a member's daughter had a game on Friday and asking how it went. Noticing a man about to hurt himself on a machine and saying so kindly enough that he listens.

I never wrote any of those down. I could not have. I found out about most of them later, from members, at the front desk.

The checklist is a floor, not a ceiling. It is the minimum that has to happen before anybody goes home. Everything above the floor is where the job actually lives, and a manager who leaves no room above it has built something nobody can grow in.

Do Not Take All of Their Time

You may have caught me contradicting myself a few pages ago, so let me settle it before I go on.

I said that a person who is not directed will do nothing. Now I am about to tell you to leave part of the day unassigned. Both of those are true, and the thing that decides which one you get is the floor.

An open hour in a day with no floor is a hole. Nobody ever told that person what the day was for, so the hour goes to whatever is loudest or easiest. An open hour in a day that has a written floor is a different thing entirely. The list already said what mattered, the person already did it, and what is left over is a trained man with time on his hands and a standard in his head.

Direction is not the opposite of freedom. Direction is what makes an employee’s free hour worth something to you.

That leads to something I want to say plainly, because it took me too long to learn it.

Every employee needs some free time to use their own skills and abilities to make the company better. You cannot monopolize a person’s whole day with your tasks.

Read that again as an owner. Every hour I assign is an hour spent on something I already thought of. I am not the smartest person in any of my buildings, and on most subjects I am not close. The trainer knows things about how members quit that I will never see from an office. The front desk knows which machine is about to break because they hear it. The nineteen-year-old knows exactly why the new members from the March promotion are not coming back, and nobody has ever asked him.

None of that reaches me if every hour of their day already belongs to me.

The tasks buy you the floor. The unassigned time is where anything better than the floor comes from.

Three Warning Signs

Three things tell you somebody has crossed the line.

The list gets longer every month and nothing ever comes off. A list that only grows is a manager solving his own anxiety, not the club's problems.

Items start describing manner instead of action. Be friendly. Show enthusiasm. Have a positive attitude. Those are not tasks. Nobody can verify them and nobody can finish them, and they read as an instruction to perform a personality.

Your best people stop suggesting things.

That third one is the expensive one. Go back to the monthly rewrite. That door is the only way the list gets better, and I did not think of most of what ended up on those checklists. The people doing the work did. A staff that has stopped suggesting things has nothing to put through that door, so the cage does not just cost you a few unhappy employees. It costs you every improvement your people would have found and did not bother to mention.

Keep the list short enough that there is room above it. Then leave the room alone and find out what your people do with it.

What This Costs, and Who Has to Pay It

Now the part the consultants leave out.

This system has a price and the price is not software. The price is that somebody at the top has to actually read the reports.

I mean that literally. If the general manager files a report every two hours and nobody above him opens it, then within about three weeks he will begin filing a report that is not true. Not because he is a liar. Because he is a busy man who has correctly determined that nobody is reading.

And the moment that happens you have built something worse than nothing.

A checklist nobody reads teaches every person in your company that the paperwork is theater. If the report is theater, the safety rule is probably theater too, and so is the cash-handling procedure. There is no more expensive lesson you can teach a company, and you teach it by installing a system and then not looking at it.

So before you build this, answer one question honestly. Are you going to read them?

If the answer is no, do not build it. Build three items instead and read those. Three items that are checked every day by a person who knows you look are worth more than a forty-item system nobody opens.

The second cost is time. Somebody has to rewrite the checklists every month for every position, twelve times a year, and it has to be somebody qualified to know what belongs on them. If you are not prepared to spend that, your system will calcify and you will have a beautiful monument to how you ran the business two years ago.

The third cost is that the machine is completely indifferent to what you put on it. It will verify a wrong task just as faithfully as a right one, and it will verify it every two hours, in every building, for years. Determining the correct tasks is critical, and that argument is back in Chapter 1 where the ladder gets built.

Three Things I Will Own About This System

It took ten years and it did not arrive finished. The design of the tools was developed over three years. The concepts behind them were developed over ten, by me and by my staff, and most of that was learning what did not work. When I show this to somebody now it looks like a designed thing. It was not designed. It was accumulated. Do not compare your first month to my tenth year.

It did not save me from myself. I still hired the wrong man for Carson North. What the system did was make the failure visible in weeks instead of quarters, and then I ignored what it showed me for four months anyway. A system that reports the truth to a man who does not want to hear it is only half a system.

I have been wrong about the pace, in one direction. Two hours is the right interval for a health club, where a member walks through a door every few minutes and a lost hour is lost forever. I am not going to tell you it is the right interval for a machine shop or a law office. Whatever interval you pick, it needs to be short enough that the day is still fixable when you find out. Most owners have picked a month. A month is not an interval. It is an autopsy.

You do not build a business in a decision. You do not build one in a year. You build it in the smallest block of time in which a person either produces something or does not.

For us that block is two hours.

Completed tasks = objectives obtained = GOAL achieved.

The two-hour report is where the word completed comes from. It is the one step in the equation that turns a claim into a fact.

Take the report away and everything above it is still true and none of it is checkable. You have a ladder in the dark.

Find your block. Write down what has to happen inside it. Name the person who confirms it. Then read what comes back, because the reading is the verification, and the verification is the whole thing.

The Tasks That Obtain It

Task	How you verify it
Write down the number of hours it now takes you to find out something has gone wrong, and beside it the length of the block you intend to run.	Both numbers sit on one dated page, with the last three problems you caught listed under them.
Pick one position and write three countable things that must happen inside every block.	Three items, each with a number in it, sit on one page, and the person in that seat read it back to you.
Multiply one of those three numbers by the blocks in your day and the days in your month, and write down what the list produces in a month.	The arithmetic is written out on the same page.
Name the person who confirms each of those three items, and it cannot be the person who does them.	A second name is written beside every line, and that person can tell you which items are theirs to confirm.
Run it for five working days, with the	You are holding one filed report for

Task	How you verify it
named person filing every block, and read every report the same day it is filed.	every block of those five days, or you can name each missing block.
Read your own list back and strike any item that describes manner rather than a countable action.	Every surviving line has a number or a named thing in it, and somebody other than the writer agrees none of them describe attitude.

Do This Now

Write down what the newest person in your company is supposed to accomplish in the next two hours. Could that person write the same list without your help?

Chapter 17: Measure What Moves

The objective of this chapter: Know which of your problems is the largest in dollars, and which four numbers you run the business on.

What are you counting? Who decided you should count that? And what would you actually do differently if the number moved?

Most owners cannot answer the third one, which means the first two do not matter.

The last chapter gave you the machine. That system will run whatever you put on it. It is a very good machine and it is completely indifferent to whether the things on the list are worth doing.

So this chapter is about what goes on the list.

I got a Six Sigma Green Belt through Villanova after I had already been running clubs for years. Most of what is in that material is written for factories, in a vocabulary designed to keep people out. I am going to hand you the three pieces of it that changed how I run a business, and I am going to leave the vocabulary in the box.

A Complaint Is Not a Problem

“The service is slow.”

That is a complaint. You have heard some version of it every week you have been in business. You cannot fund it, you cannot assign it, you cannot tell when it is finished, and you cannot tell whether the person saying it is right.

Here is a ladder for turning a complaint into something you can put money against. Each rung adds exactly one thing. I am going to walk it on a restaurant, because that is where I first saw it done and because the arithmetic is beautiful.

Rung one. Add the standard and the actual.

From the time a customer is seated until the menus are delivered and the drink orders are taken, customers expect to wait no longer than four minutes. Our process averages seven minutes.

Now it is a fact instead of a mood. Two numbers, one of them from the customer and one of them from the process. Notice that four minutes did not come from management. It came from asking customers what they expect.

Rung two. Add when and where.

Customers seated between 7:00 and 8:30 in the morning expect menus delivered and drink orders taken in four minutes or less. Our processing time averages seven minutes during that window.

One sentence and you just cut the project in half. This is not an all-day problem. It is a ninety-minute problem. Everybody who was about to go rewrite the dinner service can sit down.

Rung three. Add the extent, in dollars.

We are losing an average of 24 customers per day. Average revenue per customer is $16. Annual hard cost loss is $140,160.

Show the arithmetic, because the arithmetic is the whole reason anybody will listen.

24 × $16 = $384 a day

$384 × 365 = $140,160 a year

Nobody funds “the service is slow.” Everybody funds one hundred forty thousand dollars.

Rung four. Add the gap and the goal.

By cutting the average from seven minutes down to one minute, we could keep all of those customers.

Now the whole thing is one paragraph, and it tells you the standard, the actual, the window, the money, and where you are trying to land.

Three rules go with that ladder, and every one of them is a rule about what you leave *out*.

No cause. Do not write “the service is slow because we are short staffed.” You do not know that yet. The minute you put a cause in the problem statement, everybody stops looking.

No solution. Do not write “we need another server.” That is an answer, and you have not done the work to earn it.

No blame. Do not name a person. The second a problem statement has a name in it, everyone in the building starts managing their exposure instead of the problem.

The Same Ladder On a Health Club

That was a restaurant. Now watch the same four rungs on my clubs, and then go walk them on whatever you sell.

Our clubs averaged about thirty-five cancellations a month. The national average is about seventy, so we were running at half the industry rate, and I was proud of that number for years.

Watch how fast pride turns into a project when you finish the arithmetic. Dues were thirty-nine dollars a month.

35 cancellations × $39 = **$1,365 a month** off the dues base

If the average one of those members would have stayed another year, one month of cancellations cost us:

35 × $39 × 12 = **$16,380**

Across five clubs, one month of cancellations is $81,900 of dues we would never collect. Run it for all twelve months the way the restaurant did and the annual number is $982,800. If we had performed at the national average of seventy a month instead, one month would be $163,800 and the annual number would be $1,965,600.

I want to be careful here, because I just made an assumption and I am not going to hide it inside the answer. I assumed the average canceling member would have stayed another twelve months. Your number is different. Go pull it. But the shape of the sentence is now right, and the shape is what you were missing.

The complaint was “we lose too many members.” The problem statement is eighty-one thousand nine hundred dollars.

Your version of that sentence uses your own words. Customers lost per month, times what one of them pays you, times how long they would have stayed. A dentist can run it on patients who do not rebook. A landscaper can run it on accounts that do not renew in the spring. The ladder is the same four rungs.

Measuring the Wrong Thing Is Worse Than Not Measuring

I have a story about this and it cost me thirty thousand dollars. It is Chapter 22, and the short version is that for four months we let the thing we could see outrank the thing that mattered.

The lesson is not “watch your numbers.” The lesson is that a business always has a set of things that are easy to notice and a set of things that are worth noticing, and they overlap less than you would think.

Too Scattered, Or Aimed Wrong

Now the second piece, and this is the one I wish somebody had explained to me in 1995.

A process can be wrong in two completely different ways, and the two problems look identical on a complaint form and need opposite fixes.

Here is the example that made it click for me. An order-entry job is supposed to take seven minutes, plus or minus two. So anything from five to nine minutes is acceptable. Somebody watched that process for twenty-five sample groups of five, and found it was stable and its average time was exactly seven minutes.

Exactly seven. Dead center of the target. If you only look at the average, that process is perfect.

It was not perfect. The spread of the results was such that the process actually produced a range of about eight minutes wide.

The allowed window is 9 − 5 = **4 minutes**. The process actually produces about **8 minutes** of spread. 4 ÷ 8 = **0.5**

The process is producing twice the variation it is allowed. A large percentage of those orders were late or wildly early, even though the average was on the money. You could fire a manager over that average and never touch the problem.

That is failure by scatter. Now picture the mirror image. Same tight spread, but the average sits at nine minutes instead of seven. Every single order is consistently near the edge. That is failure by aim.

Two different diseases.

Bad aim is a setting. You move it. The process itself is fine, it is just pointed at the wrong place. Change the step, cut a form, move the target, and it is done in a week.

Bad scatter is a system. There is no knob. If your results are all over the map, it is because the work is being done a different way by different people on different days, and no amount of pushing the average around will help. You fix that with training, with a written way of doing the job, with the same person doing the same step the same way.

The quality people call this process capability. Call it whatever you want. What you have to be able to answer is one question.

Is the thing my customers wait on slow on average, or is it wildly inconsistent?

Every business has one of those. A table. A callback. A quote. A repair. In my clubs it was the front desk, so I will use that.

If a member waits two and a half minutes to check in every single time, you have an aim problem. The process is too long. Add a station, cut a step, move the towel rack.

If members wait ten seconds at ten in the morning and four minutes at five thirty, you do not have a slow front desk. You have two different front desks wearing the same shirt. Training and staffing will fix that and a faster computer will not.

Put your own thing in place of the desk and the two diagnoses do not change.

Now the management version of the same idea, which is where most owners lose money.

When somebody has a bad day, you have to know whether it was a bad day or a bad system. If that job normally runs between thirty seconds and three minutes and today somebody waited three minutes, that is the system doing exactly what the system does. Chewing out that employee is not management. It is noise, and the staff learns that results are random and punishment is not.

But if the process runs thirty seconds to three minutes and today someone waited eleven minutes, something specific happened. Go find out what. That one is worth a conversation.

Here is the sentence to carry out of this section. A process can be perfectly stable and still be no good. Stable only means predictable. Predictable garbage is still garbage.

From What They Say To What You Build

The third piece is about translation, and it is the shortest.

Customers do not tell you what to build. They tell you how they feel. “The staff is friendly.” “It is clean.” “They helped me.” Those are the right things for them to say and they are useless as instructions.

There is a tool for this. A bank wanted to improve teller training and boiled customer satisfaction down to three things. The teller is friendly and helpful. The teller is knowledgeable. The teller is efficient. Then they laid their actual training options across those three and scored how strongly each training option moved each thing the customer cared about. The options that moved the most customer wants got built first. The ones that moved nothing got cut, no matter how much somebody in the building liked them.

That is the entire idea. On one side, what the customer says. On the other side, what you would actually do. In the middle, an honest score of whether the second one moves the first one.

I built the club version of the left-hand column myself and I will show it to you in full in the next chapter. Our five member statements, each rated one to ten, were these. The club is clean. The staff is friendly. The staff handles problems promptly. The staff helps me with my fitness goals. I am satisfied with the club.

Those are the whats. Everything on our checklists is a how. Two favors for a member every two hours is a how. Two appointments booked every two hours by every sales rep is a how. Fourteen training DVDs so that the best person in the company trains everybody, instead of the nearest person, is a how.

Every how on your checklist should be traceable to a what on that list. If you cannot draw the line, take it off the list.

Now go back to the man in Chapter 22 and the list of things he asked me to buy for his club.

Draw me the line from any one of those to “the staff handles problems promptly.” You cannot. That is why granting those requests did not work, and I should have known it in the first meeting rather than the fourth month.

Balanced, So Nobody Can Cheat

Here is the last piece, and it exists because of a specific kind of dishonesty that is not really dishonesty.

Give a manager one number and he will move it. He will move it by wrecking something you are not looking at, he will not think of it as cheating, and he will be right that you never told him otherwise.

So you measure across four different areas at once, which is Kaplan and Norton's balanced scorecard. Financial. Customer. Internal process. Learning and growth. Four perspectives, and a manager has to hold all four.

Perspective	What we watched
Financial	Monthly gross, monthly profit, the dues base, free cash flow
Customer	Member satisfaction scores, cancellations per month, cleanliness score
Internal process	Checklist completion, appointments booked per rep every two hours, favors done, wait at the desk
Learning and growth	Training DVDs completed, staff scores of their own supervisors, managers promoted from inside

Watch how the cheating works when you only keep the first column.

A general manager wants his profit line up this quarter. He cuts the maintenance person. Payroll drops immediately, profit rises immediately, and he looks like the best manager in the company for about four months. Then the cleanliness score falls. Then customers stop coming back. Then the recurring revenue base falls, and that base is the financial number that actually mattered all along. He won on the number you were watching by breaking the three you were not.

Two more rules on this and I am done.

Keep the list short. Limit the number of objectives and measures, or you will prioritize nothing. I would rather a general manager know four numbers cold than have twenty on a wall that nobody reads.

Make every one of them countable. I have told this to people's faces and I will tell it to you. Your objectives are not real if you cannot count them. You cannot measure happiness. It is an emotion. An objective must be a challenge, it must be obtainable, and you have to be able to know whether you got there. It is like counting. You will know when and if you get there.

There is a line in Proverbs about the Lord detesting dishonest scales and delighting in accurate weights. That verse is usually read as a warning to merchants not to cheat customers, and it is. It is also the oldest measurement standard in writing. A business runs on weights, and the first person your scale lies to is you. If you build a scorecard that only weighs what makes you look good, you have not fooled a customer. You have fooled the one man who cannot afford to be fooled.

The Weakness Nobody Mentioned

For years I ran our clubs on complaints. Somebody would come to the desk unhappy, it would get to me, and I would go fix that thing. It felt responsive. It felt like listening.

Then we finally surveyed our members properly, and of the five areas we asked about, exactly one came back a weakness. It was not the one anybody had been complaining about, and the next chapter has the numbers.

So every year I spent chasing the loudest voice in the lobby, I was working on the four things we were already good at. The complaints were real and they were not representative, and I had no way to know the difference because I had never counted anything.

That is what this chapter is for. Not so you can build a dashboard. So you can tell the difference between the loudest problem and the biggest one.

A complaint tells you somebody is unhappy. A number tells you how many, how much, and whether it is worth your Tuesday.

Which brings us to the obvious question. If you are going to measure what your customers and your staff actually think, how do you ask them, and how do you make sure they tell you the truth? That is the next chapter, and it cost me nothing but paper.

The Tasks That Obtain It

Task	How you verify it
Write your loudest complaint as one sentence carrying the customer's standard and your actual performance.	Both numbers are in the sentence, and the standard came from a customer you can name and not from you.
Add the window to that sentence. The hours and the days it happens.	The sentence names a start time and an end time, and the shift schedule shows who was working then.
Count the customers it costs you a day, multiply by what a customer is worth, and multiply by three hundred sixty-five.	The three inputs and the annual figure are written out and dated, and you can say where each one came from.
Take thirty measurements of one thing your customers wait for, and write the highest and the lowest.	Thirty times are on the page, each with the date and the hour it was taken.
Write the four numbers your managers are judged on, one from each of the four areas.	The four are posted where the managers work, and each manager says all four without looking.

Do This Now

Take the loudest complaint in your business this month and walk it up all four rungs. Standard and actual. When and where. Dollars per year. The goal. Can you finish it, or do you not have the data?

Chapter 18: Ask, Don’t Assume

The objective of this chapter: Know in numbers what your customers and your staff think, and act on the lowest score.

In 2004 I wrote a memo to the owners of Nevada Fitness recommending we run our own research project on the satisfaction of our staff and our members. I told them I would design both surveys myself.

Then I wrote the sentence that got it approved in about a day.

The only cost will be the cost of paper.

Five clubs, three hundred members surveyed in each, every manager in the company rated by the people who worked for him. Fifteen hundred sheets of paper for the member side. That was the budget. No consulting firm, no focus group, no vendor, no line item anybody had to defend at the next owners’ meeting.

The main reason small businesses do not know what their customers think is that they believe finding out is expensive. It is not. What it costs is the willingness to read the answer.

Why We Did It At All

The problem was retention, of staff and of members. We could improve profitability by keeping both longer, and I could not improve either one because I did not know which part of the experience was weak.

I thought I knew. I had run those clubs for ten years. I heard complaints at the desk and I fixed the ones I heard.

That is the trap, and almost every owner I have ever met is sitting in it. Complaints are not a sample. Complaints are the loudest handful of your unhappiest customers, filtered through whether they felt like saying something that day.

I made a related mistake that same year, and I take it apart in Chapter 24. I wrote a memo that pointed at a symptom instead of a problem, and I had to write a second one correcting myself.

A survey replaces the symptom you happened to hear with the weakness you actually have.

Five Questions for Customers

Five questions. Not twenty. It has to be short and easy, because it must not be an inconvenience to the person answering it. A customer on his way out the door will give you ninety seconds. Mine were standing at the desk in workout clothes. Yours may be waiting on a check, signing for a delivery, or sitting in a truck. Ask any of them for six minutes and you will hear only from the people who love you and the people who are furious. Both are useless as a picture of the middle.

Everything rated one to ten, ten being the best. Numbers, not comment boxes. You cannot average a paragraph, and you cannot compare Sparks to Minden with a stack of paragraphs.

Here are our five, exactly as they were asked.

1. The club is clean.
2. The staff is friendly.
3. The staff handles problems promptly.
4. The staff helps me with my fitness goals.
5. I am satisfied with the club.

Four of them are specific and operational, and the fifth is the overall one. That is deliberate. Ask only number five and you learn whether people like you and nothing about why. Ask only the first four and you cannot tell which of them drives the whole thing.

Your four will not be mine. Fitness goals mean nothing to a customer at a print shop. Write four things you actually control and could change on Monday, and make the fifth one the overall question. That structure is the part worth copying.

Three hundred members in each club, five clubs. Fifteen hundred members, seven thousand five hundred ratings.

Survey Up

The staff side is where I would push you hardest. It is the piece almost nobody does and the piece that changed how I ran the company.

We did not ask supervisors to rate their employees. Everybody does that already and it tells you very little you did not know.

We surveyed up. Each staff member evaluated their supervisor.

And it was anonymous, for one reason I put in my own memo at the time. It prevents staff members from writing things they think their supervisor wants to hear.

If you take nothing else from this chapter, take that. An evaluation with a name on it is a job-preservation exercise, and every person filling it out knows exactly what the safe answer is. You will get eights and nines across the board, you will feel good, and you will have learned nothing except that your people are not fools.

I proposed ten statements for the staff evaluation. We recorded and reported seven. I do not have a good record of which three were dropped or why, and I would rather tell you that than pretend the plan and the execution matched. They usually do not.

Here are the seven that were scored, each one rated one to ten.

1. The supervisor uses a positive inspiring approach in helping staff members grow and improve.
2. The supervisor is effective in communicating the business goals, objectives and vision.
3. The supervisor is well respected.
4. The supervisor manages people well.
5. The supervisor is fair and impartial.
6. The supervisor is well organized.
7. I am happy in my job.

The seventh is not like the other six and it is the most important line in the study. Six statements ask about the manager. The last one asks the employee about himself. On one sheet you can then see, for every manager in the company, whether the people under him are happy. Not whether he is well liked. Whether they are happy.

Eight managers were rated. The Regional Manager, the Regional Customer Service Manager, the Regional Maintenance Manager, and the general managers of Sparks, Reno, Carson North, Carson South and Minden.

What the Members Said

Here are the real numbers, by club.

Club	Clean	Friendly	Prompt	Helpful	Satisfied
Sparks	6.62	8.72	8.47	8.81	8.76
Reno	6.90	8.58	7.17	8.37	8.58
Carson North	6.42	8.52	8.19	8.14	8.69
Carson South	7.11	8.81	8.64	8.87	8.89
Minden	6.65	8.57	8.33	8.46	8.53
All clubs	**6.74**	**8.64**	**8.16**	**8.53**	**8.69**

Two notes on whether to believe it. The answers ranged the full width of the scale, from one all the way to ten, so we were not looking at a room full of people who all circled eight. And the median was within half a point of the average on every statement, which tells you no single furious member and no single delighted member is dragging a column around. We re-ran it and got the same answers.

Friendly, helpful and satisfied land in the mid-eights in every club. Prompt does too, everywhere except Reno, and I will come back to Reno. There is not a bad building in the company on those four.

And then there is the first column.

The Only Weakness Was the One Nobody Mentioned

Of the five areas surveyed, the cleanliness of the clubs is the only weakness.

Every club sits between 6.42 and 7.11 on clean. Every club sits between 8.14 and 8.87 on helpful. The best club in the company on cleanliness, Carson South at 7.11, is still below the worst club in the company on any of the other four statements.

The gap between our best column and our worst column:

8.69 − 6.74 = **1.95 points**

Nearly two full points out of ten, and it was not close, and it was not one bad building. It was all five.

Here is what makes that finding worth the price of this book. In ten years, cleanliness was not what people complained to me about. Nobody stood at the desk and demanded a cleaner locker room. They complained about the treadmill that was down, about a class time, about a billing question, about another member. I fixed those things one at a time for years and I was proud of how responsive we were. Every one of those fixes was in a category we were already good at.

Members do not complain about a locker room being not-quite-clean. They quietly decide how they feel about your business, and eventually some of them stop coming.

That is the whole argument of this chapter in one sentence. What your customers complain about and what your customers are unhappy about are two different lists.

The second finding is smaller and I will not hide it. The Reno club scored 7.17 on handling problems promptly, against a company average of 8.16 and 8.64 at Carson South. One club, one weakness, and it deserved a manager conversation rather than a policy. I could only tell the two findings apart because I had five buildings measured the same way on the same day.

What We Did About It

A finding is not a decision. Here is the decision.

We hired a maintenance person in each club to clean five hours a day. That is in addition to the cleaning companies that already came in and cleaned nightly in every club.

5 hours × 5 clubs = 25 hours a day

25 × 30 = 750 hours a month of cleaning added to a company already paying a nightly cleaning service in every building

That is real payroll, added permanently, on top of a contract we already had, to fix a problem not one member had put in writing. It looks expensive until you set it against the number that pays for it. Every cancellation we prevented was thirty-nine dollars that kept arriving, and it kept arriving the next month too.

Run the same comparison in your own business. Put the cost of the fix on one side and the customers you would keep on the other. If the second number is bigger, the fix is not an expense.

I cannot prove the maintenance hire moved retention. I did not run that test cleanly and I will not pretend otherwise. What I can give you is the reasoning. The nightly cleaning company was cleaning an empty building. The members were rating a building at four in the afternoon. Nobody was cleaning the club during the hours when anyone was in it.

That is very simple to see with a number in your hand, and invisible for ten years without one.

The Score I Did Not Want to See

Now the uncomfortable one.

Here is the manager table, in full, exactly as it came back.

Statement	Reg. Mgr	Reg. Service	Reg. Maint	Sparks GM	Reno GM	Carson N GM	Carson S GM	Minden GM
Positive approach	8.1	8.5	7.8	8.3	8.4	8.6	9.1	8.2
Communicates goals	9.3	9.1	7.6	9.0	8.8	**6.2**	7.3	8.4
Well respected	9.3	9.2	6.5	8.5	8.7	7.5	9.0	8.0
Manages people well	9.3	9.4	**6.3**	8.6	7.9	7.2	7.5	8.0
Fair and impartial	9.5	9.0	8.2	9.2	9.3	8.0	9.5	8.5
Well organi	**5.6**	8.6	7.4	7.0	7.5	6.8	8.0	8.5

Statement	Reg. Mgr	Reg. Service	Reg. Maint	Sparks GM	Reno GM	Carson N GM	Carson S GM	Minden GM
zed								
I am happy in my job	9.5	9.5	**6.4**	8.7	8.5	8.2	8.1	8.8

The Regional Manager is Bruce Gimple. He made the Lake Tahoe hire, and he is the man who told me the sales staff needed more time before I moved the ladies club, which was advice I took and was right to take.

Look at his column. Communicates goals, 9.3. Well respected, 9.3. Manages people well, 9.3. Fair and impartial, 9.5. His people are happy in their jobs, 9.5. His average across the seven statements is 8.66, the second highest in the company.

Well organized, 5.6.

That is the lowest single score in the entire company. Not the lowest for a regional manager. The lowest number anywhere in that table, by six tenths of a point, under any manager, on any statement. His own spread, best statement to worst:

9.5 − 5.6 = **3.9 points**

No other manager has a spread bigger than 2.4. So this is not a man his people dislike, and it is not noise. It is a specific, isolated, very large hole in a very good manager, reported by the people who work under him, who had no reason to say it except that it was true.

The other man in that table is the Regional Maintenance Manager. He is the weakest overall at a 7.17 average, and he is the only manager whose people scored below 6.5 on being happy in their jobs. That 6.4 ought to keep an owner awake more than any of the six numbers above it.

And here is a convergence I did not go looking for. Two surveys, run separately, one of members and one of staff. The members said the weakest thing about the company was cleanliness. The staff said the weakest-managed department was maintenance. I found that afterward, reading my own two tables side by side, which is an argument for putting them side by side.

One more pattern. Average every manager's score on each statement and you get this.

Statement	Company average
Fair and impartial	8.90
I am happy in my job	8.46
Positive approach	8.38
Well respected	8.34
Communicates goals	8.21
Manages people well	8.03
Well organized	**7.43**

Our members said the company's weakness was clean. Our staff said the company's weakness was organized.

Those are the same kind of failure. Neither one is about talent or attitude or effort. Both are about the unglamorous, repeating, nobody-thanks-you-for-it work. We were a company full of well-liked, fair, respected people who were not tidy, in the building or on paper.

That is a finding about me, not about them. I set the culture and I hire for what I value, and I had been valuing warmth and results and not valuing order. It took a stack of paper to tell me that.

What Do You Do With a 5.6?

This is where most owners either lose their nerve or lose their head.

The first wrong answer is to bury it. Read the 9.3s, congratulate the man, put the sheet in a drawer, and tell yourself the wording was confusing or people were in a mood. That answer is popular because it is comfortable and because nobody will ever know you took it.

The second wrong answer is to fire him, because some owners think that is what decisiveness looks like.

You do not fire a man who scores 9.5 on fair and impartial and 9.5 on his people being happy in their jobs. Those two are the hardest things in business to build and the easiest to destroy. I could hire an organized man tomorrow. I do not know how to hire a man whose staff says he is fair, respected, and that they are happy working for him, and I have tried.

Here is the right answer, and it is much less dramatic than either of the wrong ones.

You stop pretending you did not see the 5.6.

That means three things, in order.

1. **You say the number out loud to the man.** Both halves of it. Here is what your people say about how you treat them, and it is the best in the company. Here is what they say about how you are organized, and it is the lowest score anybody got.
2. **You treat it as a job design problem before a character problem.** A manager excellent with people and weak on organization is not a mystery. He spends his time on what he is good at, which is what his people need from him, and the paperwork loses. Take the organizing off his desk and put it where it will get done. He does not have to become a different man to stop costing you money.
3. **You measure it again next year.** If the number moves, the fix worked. If it does not, you have a second data point and a much harder conversation, and you have earned the right to have it.

That is one more thing the checklist system in Chapter 16 is for. A regional manager with a 5.6 on organization running a company with no system is a disaster waiting for a date. The same man inside a system where every checklist and every report has a defined time and a defined form is fine, because the system carries the part he is weak at.

Proverbs puts it hard. The wounds of a friend are faithful, and the kisses of an enemy are deceitful. An anonymous survey is a strange kind of friend. It gains nothing by flattering you, and it will tell you the one thing nobody in the building will say to your face. That is worth more than a room full of people telling you the club looks great. Take the wound, fix the thing, get back to work.

I Never Surveyed Myself

Three things.

I never surveyed myself. Look at the table again. Eight managers, and not one of them is me. Every person in that company was rated by the people under him except the one man whose habits set the standard for all of it. I did not leave myself off on purpose, and that is exactly the point. It never occurred to me. It is the most obvious hole in the study and it took me years to see it.

I designed the instrument I was going to be graded by. I wrote every statement on both instruments. A man who writes his own test has some influence over the result. The tomato grower whose research inspired this hired an outside firm precisely because his managers were all friends and family. I read that case, admired the reasoning, and then did mine internally anyway because it was free.

And I cannot prove the outcome. We hired the maintenance people. I believe it helped. I did not re-run the member survey a year later in a way that would prove it, and if a general manager brought me that same reasoning about one of his projects I would push back on him hard.

Now the discipline, and this is the whole chapter compressed.

Do not run a survey you are not prepared to act on.

A survey you ignore is worse than no survey, for the same reason a checklist nobody reads is worse than no checklist. You went to your customers and asked what they thought. You asked every employee, anonymously, for the truth about their boss. They did it. And then nothing changed.

You did not just waste paper. You taught fifteen hundred customers and every employee you have that being asked for your opinion here does not mean anything. The next time you ask, they will tell you it is fine, because they know it does not matter. You burned the instrument.

So before you print the first sheet, decide what you will do if the answer is bad. If your customers come back low on the one thing you assumed you were good at, are you willing to add payroll to fix it? If your best manager comes back with a 5.6, are you willing to sit down and say the number to his face?

If the answer is no, save the paper.

Ask, and then do something about the answer. Otherwise you did not ask. You performed asking.

The Tasks That Obtain It

Task	How you verify it
Write five statements your customers can rate one to ten. Four specific, and the fifth the overall one.	The five sit on one sheet, and a customer finishes it in ninety seconds without sitting down.
Write the statements your staff will use to rate their supervisors, and make the last one about their own job.	The sheet has no name line on it, and every supervisor in the company is on the list of those being rated.
Decide in writing what you will do if the worst score comes back, before you print one sheet.	The sentence is dated ahead of the survey, and one other owner or manager has read it and knows the date.
Hand out the sheets, average each column, then subtract your worst column average from your best.	The averages, the gap, and the number of sheets returned per location are on one dated page.
Say the lowest score in the company out loud to the person it belongs to, with their highest score.	The conversation is on the calendar with a date, and that person repeats both numbers back to you.

Do This Now

What are the five things you would ask your customers to rate one to ten? Write them down right now. Is the fifth one the overall question, and are the first four things you could actually change?

Part Three

Lead It

Chapter 19: A Leader Is Someone Who Has Followers

The objective of this chapter: Find out who your people actually follow, and count the commitments you made to them that you closed.

What is leadership? What does it actually look like on a Tuesday afternoon? And who decides whether you have any?

Not you. That is the answer to the third question and it is the only place this chapter can start.

A leader is someone who has followers. That is the definition. It is not a job description, it is not a personality, and it is not a line on a business card. Turn around and look. If people are behind you, you are leading. If nobody is there, you are taking a walk.

Part One of this book was about whether the business could exist. Part Two was about whether the numbers work and whether the work gets done. Part Three is one question asked nine different ways.

Will people follow you, and should they?

A Title Is Not Leadership

I have met a great many managers who were not leaders and a few employees who were.

The title is issued by the company. Followers are issued by the people themselves, one at a time, and they can be taken back without a meeting. You can put a man in charge of five people on Monday and by Friday those five people are checking with somebody else before they do anything. Happens all the time. Nobody filed paperwork. The followers simply moved.

Here is the test I use, and you can run it in your own company this week without telling anyone.

Pick a person in your company who has no title at all. Watch where the questions go when something goes wrong at four in the afternoon. Not the questions people are supposed to ask. The questions they actually ask. If they walk past a supervisor to get to a twenty-two-year-old with no title, you have just found out who is leading that afternoon. It works the same in a kitchen, on a job site, and in an office where everybody has the same desk.

That is not a crisis. That is information. What you do with it is a decision.

The mistake owners make is to treat the gap between title and followership as insubordination. It is not. It is a report, and it is more accurate than anything you will get in writing.

The Pen

I want to give you the clearest picture I have of how leadership actually moves through a company, and it is a picture of me behaving badly.

Here is the line I have used with our managers for years.

If I walk into the corporate office, pick up a pen and throw it at the Regional Manager, within 45 minutes, half of our General Managers will be throwing things.

Forty-five minutes. Not a quarter. Not a year. Forty-five minutes.

Now watch the mechanics, because the mechanics are the point. Five clubs, two regional managers above them, a general manager and a staff in each, and fifteen thousand members across all of it.

One pen thrown in one room by one man.

The regional manager does not throw anything. He is embarrassed for me. But he has a call with two of the general managers inside the hour, and he is short with them, because he is still holding what I handed him. Those general managers are then short with their front desks. The front desk is short with a member. Nobody in that chain did anything they would describe as throwing a pen. Every one of them passed along the temperature.

Our whole operating system ran on a two-hour reporting cycle, and I could read a club's report before lunch.

Two hours to move a number. Forty-five minutes to move a mood.

That is the ratio you are working against. Information travels at the speed of your system. Behavior travels faster than your system, because behavior does not need a system. It only needs a witness.

The style and the personality of the leader are a very powerful influence on a group. Most people in a group will conform to the leader's expectations. I did not make that up and neither did the person I learned it from. But there is a piece of it people miss, and the pen is what taught it to me.

They do not conform to your stated expectations. They conform to the ones you demonstrate.

You can hold a two-hour meeting on respect in the workplace and undo the entire thing in four seconds at the copier. The meeting is a claim. The four seconds is evidence. People are not stupid, and when a claim and the evidence disagree, everybody in the building believes the evidence.

Being a leader has taught me a lot. The first thing is this.

Do not throw things.

I am half joking and I am half not. Take the pen out and put anything you like in its place. Sighing when a manager asks a question. Checking your phone while somebody is telling you about a problem. Telling one manager, in private, that another manager is an idiot. Every one of those is a pen, and every one of them propagates on the same schedule. It does not matter whether your company sells memberships, sandwiches or square footage of roof.

Fear Works, Right Up Until It Does Not

In 2004 every employee in the company rated his supervisor, anonymously. The whole table is in Chapter 18, and one column in it belongs here.

Our Regional Maintenance Manager averaged 7.17 across the seven statements, the lowest of the eight. His people gave him a 6.3 on managing people well. They gave him a 6.4 on being happy in their jobs, and he was the only manager in the company whose staff came in under 6.5 on that statement. The next lowest happiness score in the building was 8.1.

He had the title. He had the department. He had the keys. Turn around and look, and there was nobody behind him.

Now put the other survey beside it. The same year, fifteen hundred members rated five things about the clubs, and clean was the only weakness they found.

The weakest-led department in the company produced the only thing our members marked us down for. I found that reading my own two tables side by side, after the fact.

Here is what it cost, and it is payroll, and it is permanent. We put a maintenance person in every club to clean five hours a day, on top of the nightly cleaning company we were already paying. A member who stays a year is worth $468 of dues. That is the arithmetic that pays for seven hundred fifty hours a month of cleaning, and I would run it again tomorrow.

But be clear about what I bought. I bought cleaning. I did not buy leadership, and the 6.4 was the leadership number.

Which leaves the question this section is for. How was that man getting anybody to do anything at all?

There are two ways to get followers, and both of them work.

You can produce followers with fear. It is fast, it requires no explaining, and in the short run it looks exactly like leadership from the outside. People do what you said. Reports come in on time. The room goes quiet when you walk in and you tell yourself that is respect.

Or you can produce followers with vision. That is slower. You have to say where you are going, say it more than once, and then go there yourself while people watch to see whether you actually will.

The difference does not show up while you have the power. It shows up the day the power moves.

Followers who buy into the vision will stay. Fear-based followers will become hostile when power shifts.

Read that again, because the word is *hostile*, not *gone*. They do not simply drift away. They turn. The person who complied for three years out of fear has been keeping a ledger the whole time, and the day you are weak is the day the ledger gets settled. I have watched it happen in other companies and it is not a pretty thing to see.

And the shift always comes. You get sick. You sell part of the business. A bigger competitor opens across the street. A partner with a different interest gets a vote. Something moves, always, and on that day you find out what you actually built.

So the question is not whether fear works. It works. The question is what you are holding when it stops working.

There is another version of this that is subtler and more common than outright fear, and it is worth naming.

If a leader goes left but expects her followers to go right, that is pushing, not leading.

That is the whole failure of most management I have seen. Not cruelty. Direction. You are asking people to go somewhere you are not going. You can push people a long way if you are strong enough, and every foot of it costs you something, and the moment you stop pushing they stop moving.

The Four Things That Earn Respect

I am going to give you four things, and then I am going to give you the operational version of each one, because a virtue you cannot schedule is a decoration.

One. Be open and honest.

Not honest when it is convenient. Honest when the number is bad. Tell your people the truth about the business, including the parts that scare you, at a level of detail they can actually use.

The operational version: when something goes wrong in your company, who finds out first, you or your staff? If the answer is that they hear it from you, you are open. If the answer is that they hear it in the parking lot two weeks later and you never mentioned it, you are not, and every future thing you say is discounted accordingly.

Two. Practice what you preach.

Leaders who always do what they say they will do earn respect and trust.

Look at the word *always*. Not usually. This one is not scored as a percentage. It is scored as a streak, and it resets at zero.

The operational version: keep a written list of every commitment you made to an employee this month. Not to a customer, not to a bank. To an employee. I said I would look at your schedule. I said I would get back to you on the raise. I said I would fix the thing that has been broken since March. Now go count how many you closed. That number is your reputation, and it is not the number you think it is.

Three. Take responsibility for your actions.

We will come back to this one in a minute, because it has a wrinkle in it that most people get wrong.

Four. Do not ask others for more than you would do yourself.

The operational version is simple and it is physical. Is there any task in your business you have decided is beneath you? Name it. Then go do it on a Saturday, in front of people, without announcing that you are doing it to make a point.

I will tell you what I actually think about this one, and it may be too blunt. If you will not clean a bathroom in your own building, you have not earned the right to require it of an eighteen-year-old for ten dollars an hour. You may still be within your rights as an owner. You have not earned it.

Those four things are the whole list. There is nothing on it about charisma, and nothing on it about being liked. Three of the four are about consistency, which is boring, and the fourth is about not being a hypocrite, which is also boring.

Leadership is mostly boring. The exciting version is usually somebody performing.

Fault and Responsibility Are Not the Same Thing

Now the wrinkle, and this is the single most useful distinction in this chapter.

Fault and responsibility are not the same.

Here is the case, and you can put your own business into it. A customer walks in at seven in the morning. An employee is rude to her. Genuinely rude, not a misunderstanding, not a bad reading of the tone. She leaves and she does not come back.

Whose fault is that?

His. It is entirely his fault. He is an adult, he chose his words, nobody instructed him to speak that way, and if it happens twice he should not work there anymore.

Whose responsibility is it?

Yours. Completely, and without any share of it going anywhere else.

Those two answers do not compete. Most owners think they do, and so they spend their energy establishing the first one. They want it on the record that they did not tell him to say it. Congratulations. Nothing about the business has changed and the customer is still gone.

Fault answers the question *who did it*. Responsibility answers the question *who fixes it*. You will notice that only one of those two questions has a future tense in it.

Once you accept that, the follow-up questions get much better, and they are all about you.

Did that employee know what a good greeting sounds like, stated as something specific he could do, or did he know it as a mood we hoped he would be in? Did he ever see it demonstrated by the person who trained him? Was he working a shift where being pleasant was possible, or was he alone at a desk with a line of nine people? Had anybody corrected the same behavior before and let it go? And what did he see happen the last time somebody in this company was short with a customer?

Every one of those is your responsibility. Not one of them is his fault.

I will give you a real one out of my own history. I opened two ladies-only health clubs on a belief about the market that did not turn out to be true. I eventually closed one and converted the other.

Now. Whose fault was it that those two buildings underperformed our four co-ed clubs for years?

Not the general managers'. Not the sales staffs'. They worked in a building I put them in, selling a thing I decided the market wanted. They executed a bad idea faithfully. The idea was mine.

I was the responsible party before the first day and I was still the responsible party when I signed the closure. There is no version of that where I get to point at a sales report.

Here is the part that surprised me. Taking that on publicly did not cost me anything with our people. It bought something. Employees can smell an owner looking for a place to set down a mistake, and they know that if there is a place to set one down, it will eventually be set down on them.

Luke puts it in one line. To whom much is given, of him much will be required. I do not read that as a threat. I read it as a definition of the seat you asked for. If you took the resources, the building, the payroll and the decision rights, you took the requirement that goes with them. That is not a religious add-on to business ownership. It is the job. Now back to the job.

What This Costs

The honest part of this chapter is that everything above is expensive in exactly one currency, and it is not money.

It is your right to have a bad day out loud.

An owner who leads by vision gives up the ability to walk into his own building in whatever mood he happens to be carrying. That is a real loss and I am not going to pretend it is not. Some mornings I have driven to a club, sat in the parking lot for four or five minutes, and gone in only when I was fit to be seen. There is nothing noble about it. It is maintenance, the same as unlocking the door.

The second cost is speed. Fear is faster. Explaining where you are going, to a nineteen-year-old in his second week, in words that mean something to him, takes longer than telling him to do it because you said so. It takes longer every single time, forever, and it does not get more efficient with practice.

You are buying something with that time. You are buying the version of your company that still functions on the day you are not the strongest person in the room.

I do not know when your day is coming. I know it is on the calendar.

So build for it now, while it is cheap.

A leader is someone who has followers. Everything else on your business card is furniture.

The Tasks That Obtain It

Task	How you verify it
Stand where your people work at four in the afternoon and write down the	The name is on paper, and it either matches a title on your org chart or it

Task	How you verify it
name of the person they actually take a problem to.	does not.
List every commitment you made to an employee in the last thirty days, one line each, with the date you made it.	The list exists and a manager could read every line of it.
Mark each commitment closed or not closed, divide the closed by the total, and write that percentage at the bottom of the page.	The percentage is on the page and somebody else can check the division.
Write the twelve-month value of one customer next to the monthly payroll it would take to fix your weakest department.	Both figures sit on one page and you can say out loud which one is larger.
Do the one task in your business you consider beneath you, on a Saturday, where the staff can see you.	Employees who worked that day can name the task and the date.

Do This Now

Write down every commitment you made to an employee in the last thirty days, and mark which ones you closed. What is your percentage, and what would your staff guess it is?

Chapter 20: Employees Come First, and They Know It

The objective of this chapter: Give every employee the rules in writing and a dollar limit, and reward the ones who hold the line.

Employees come first.

Not customers. Employees. And the second half of that sentence is the half that does the work, so here is the whole thing the way I say it to our people.

I think I might have a unique business philosophy in that employees come FIRST and they know it.

I have said that in rooms full of business owners and watched the temperature drop. It sounds like something a man says right before his company fails. Every book, every seminar, every sign hanging behind every counter in America says the opposite. The customer comes first. The customer is king. The customer signs your paycheck.

I do not believe it, and I have not run a business that way in more than thirty years.

Employees are everything for a business and I think they should come first. In a large company, nothing else matters without them.

Now let me tell you where I got that, because it did not come out of a book. It came out of my first job.

The Aerobics Room

My first job out of college was working in one of Marriott's spas.

I want to say something up front so you know I am being fair. The Marriott gives exceptional service. I have done a tremendous amount of business with that company since, by choice, with my own money. They are very good at what they do. This is not a story about a bad company. It is a story about one rule inside a good company, and that is exactly why it is worth telling. Bad companies teach you nothing. You already know not to copy them.

Here was the rule at the spa. Employees were not allowed to let customers into the aerobics room during a class if they were not participating in the class.

That is a sensible rule and you can reconstruct the reasons for it in about four seconds. There are people in there doing something physical. A person wandering through, watching, standing in the doorway, cutting across the floor, disrupts a class that other paying guests came for. It is a safety issue and it is a courtesy issue. Somebody thought about it and wrote it down.

I watched employees enforce that rule. Politely. Every time I saw it done, it was done politely, and I want to be precise about that, because it matters to the rest of this chapter. Nobody was throwing anybody out. It was a young person saying, I am sorry, sir, the class is in session, you are welcome to come back at ten.

And sometimes the customer complained.

Here is what happened when the customer complained. The customer was given free massages. Free night stays. Whatever it took.

And often the employee was written up for not following the customer-is-always-right rule.

Read that again. The employee followed the written rule. The employee was polite. And the employee got a piece of paper in her file for it, while the person who broke the rule walked out with a free massage.

I was fresh out of college and I did not have any theory to put around it. I just knew that something had gone badly wrong in that building and that nobody in charge could see it.

Everybody Else Is Watching

Here is what that write-up actually cost, and it is not what you would guess.

It did not cost one employee’s morale. That is what the manager thought he was spending, and he thought it was a fair price for a smooth afternoon.

What he actually did was teach a class.

Every employee in that building heard about it before the end of the week. That is not a maybe. Staff talk. They talk in the break room, they talk in the parking lot, and a story about somebody getting written up for doing the right thing is the single most portable story in any workplace. It travels farther and faster than any memo ever written.

And the lesson everyone took from it was correct. Do not enforce the rule. Enforcing the rule has a downside for you and no upside for you. Look the other way, let the man walk into the class, and if twenty people in that class are annoyed, they are annoyed at the man, not at you.

So now watch the chain, and I wrote this out once for somebody who did not believe me.

The employee will quit because she got written up when she followed the rules. Now when customers go in to take a class, there will not be an employee to teach the class. And there will be twenty angry customers.

Count them. One rule bent to satisfy one customer. Twenty customers unhappy, and one trained instructor gone.

I have found that if you let customers go too far and break too many rules, it sets a bad precedent. One of the biggest problems with this is that it can really damage employee morale. From there things just go downhill.

I do not think the manager who signed that write-up would have signed it if somebody had handed him that arithmetic first. He was not a bad man. He was following a rule he had been given, and the rule was stupid, and I will spend the whole next chapter on why.

Backflips and Trucks

Here is our rule, and it is two sentences that have to be said together or they mean nothing.

We expect our employees to do backflips for customers. And under no circumstance will we let a customer run over them with a truck.

The first sentence is not soft. I want to be very clear about that, because “employees come first” gets heard as an excuse and it is the opposite of one. We require two favors for a member every two hours from every employee and two appointments every two hours from every sales rep. That is production, it is measured, and nobody’s feelings are consulted about it.

Backflips. All day. That is the deal.

Write your own version of the backflip and put a clock on it. A server, a service writer, a hygienist and a delivery driver can each do a small unrequested kindness on a schedule. What matters is that it is a task with a number, not a hope about attitude.

The second sentence is the protection, and it has a specific mechanic in it that most people miss.

If the employee politely holds the customer to the rules, the employee is rewarded, not the customer.

Not tolerated. Not defended. Rewarded. And in front of people.

Because here is what happens if you do not do it that way. If it is not done this way, employees will not hold customers to the rules or even follow the rules themselves. This can cause a very big mess.

Look at the second half of that. *Or even follow the rules themselves.* That is the part that surprises owners. You think you are only losing enforcement. You are losing compliance. An employee who has learned that the rules do not survive a determined customer has learned that the rules are not real. A rule that is not real binds nobody. That includes the person you told to enforce it.

You did not soften a policy. You repealed the whole book.

The Word “Politely” Is Doing All the Work

I have to slow down on one word or this chapter becomes an excuse for rudeness, and there are people who would love to read it that way.

The employee is rewarded if she **politely** holds the customer to the rules.

That is a condition, and it is the only condition, and it is not a small one.

A little crow is always necessary. That is part of every job where a customer can reach you, and anybody who cannot eat a little of it should not be in one. Somebody is going to be unfair to you today and you are going to say “I understand, let me see what I can do” and mean it. That is the work.

But there is such a thing as too much. Boundaries must be set.

So the standard for an employee is this. Warm face, level voice, no argument, and the rule does not move. If she does that, she is right, and my job is to make sure she never has to wonder whether I am going to hold that position when the customer asks for me by name.

If she does it with a sneer, that is a different conversation and it is a real one. She was right about the rule and wrong about the job.

The distinction is not hard. The reason companies do not make it is that “the customer is always right” is easier to put on a sign than “hold the line and be pleasant while you do it, and we will back you.”

What It Looks Like on Paper

Enough philosophy. Here is how you actually run employees-first, in five things, and every one of them is something you can put in place this month.

1. Write the rules down, so the employee is never the one inventing them.

An employee who has to make up a rule on the spot in front of an angry man is a person you have abandoned. If the answer is no, the no should have been written before either of them got out of bed. Then she is not refusing him. She is reporting a fact.

2. Set the giveaway limit in dollars, in advance.

Every employee should know exactly how much they may hand a customer without asking anybody, and it should be a real number, not a feeling. Under that number, decide it yourself and tell me later. Over it, call.

Do the arithmetic on your own business. Our dues were thirty-nine dollars a month. A member who stays a year is worth 39 × 12 = **$468**. So if a twenty dollar concession keeps a member who was truly wronged, that is a very good trade and I do not want an employee spending twenty minutes and a phone call to find that out.

Now the other side of the same arithmetic, and this is the side nobody runs. Our clubs averaged about three thousand members each. If breaking a rule for one member degrades the experience of even one percent of that building, that is 3,000 × 1% = **30 members** affected. Thirty members at $468 is **$14,040** of dues at risk to protect one $468 relationship.

The number is not the point. The shape of it is. A concession is cheap. A repealed rule is not, because a rule is something all three thousand of them are standing on.

3. Reward the enforcement out loud.

When a general manager tells me an employee held a line politely and the customer left unhappy, that employee gets named. In front of the staff. That costs nothing and it is the single highest-return thing on this list, because it is the direct answer to the Marriott write-up. Somebody is going to teach a class in your company this week. Make sure it is you.

4. Never reverse an employee in front of the customer.

If your staff member got it wrong, you still back her while the customer is standing there. You fix it privately ten minutes later, and you make sure she understands you are not angry. The customer does not need to see the correction. Your other employees, who are all watching from about fifteen feet away, absolutely will see it if you do it in public, and they will draw the obvious conclusion about what happens if a customer asks for the owner.

5. Ask your people to rate you, anonymously, and read it.

We survey up. Every staff member evaluates their supervisor, and it is anonymous, because otherwise they write what they think their supervisor wants to hear. I showed you the whole instrument and the actual scores in Chapter 18, including the score that embarrassed me. Understand what it is. It is employees-first with a number attached, and a number is the only version of a philosophy that anybody believes.

Knowing What They Actually Want

One more thing, and it is the part I got wrong for a long time by simply not asking.

Employees-first does not mean giving your people what *you* would want. It means finding out what *they* want and taking it seriously.

There is a line in Colossians telling masters to give their servants what is just and equal. That is a two-thousand-year-old employment instruction and it does not say *generous*. It says *just and equal*, which is a harder standard, because just and equal means finding out what the thing is actually worth to the person in front of you instead of deciding from your own chair.

I had an employee for years whose family came before everything else, and I did not know it until I asked him. I would have guessed money. It was Thursday nights.

Once you know that about a person, a schedule that gets him home for a birthday is worth more to him than a plaque with his name on it. Both cost the company something. Only one of them lands. And if you hand him the plaque and take the birthday, he will thank you politely and know exactly what you are.

Employees Come First Is Not Employees Can Do Anything

Now the failure mode, and it is real, and I have seen owners drive their companies into a ditch with the first half of this chapter.

Employees come first is not employees can do anything.

Those are two completely different sentences and the distance between them is the entire management job.

Employees come first in *protection*. They do not come first in *direction*.

I will say the hard version, because I have written it before and I will not walk it back. Most people procrastinate. If they are not directed what to do each hour of the day, they will do nothing. The two-hour updates are production requirements.

That is not contempt, and I include myself.

Directed does not mean every hour of the day is mine. The list is a floor. The hours above it belong to the person doing the work, and Chapter 16 explains why I need them to.

So put the two sentences together and you have the actual doctrine.

I will protect you from a customer. I will not protect you from the checklist.

The checklist system from Chapter 16 is the thing that keeps employees-first from turning into a country club. Two favors every two hours. Two appointments every two hours. Filed, reported, and visible to me before lunch. That structure is what earns me the right to say “we back our people,” because our people are producing, on a clock, and everybody knows it.

Take the structure away and employees-first is just a nice thing to say while a business quietly stops working.

Here is the last honest thing. I do not do this because I am generous. I have never claimed to be generous.

I do it because it produces. An employee who knows she is backed will enforce your standards when you are two hundred miles away, and there is no supervisory system on earth that can replace that. I would rather have three hundred people who hold the line by themselves than a corporate office trying to watch them.

Employees come first because everything else in your company is downstream of them.

The Tasks That Obtain It

Task	How you verify it
Write your rules on one page and post it where the staff work.	The page is on the wall and an employee can hand you a copy.
Add up what one customer pays you over twelve months, then multiply one percent of your customer count by that figure.	Both figures are on one page and somebody else can check the multiplication.
Set the dollar amount an employee may hand a customer without asking, write it on the rule page, and tell every employee.	Ask three employees separately and all three say the same number.
Name, in front of the staff, one employee who held a rule politely and lost the customer anyway.	The employees who were standing there can name the person and what she did.
Hand every employee a numbered, unsigned form rating their supervisor, and average the scores yourself.	The completed forms exist with no names on them and the averages are written down.

Do This Now

Does every person on your payroll know, in dollars, how much they may give a customer without asking permission? If not, what are they doing right now when it comes up?

Chapter 21: The Customer Is Not Always Right

The objective of this chapter: Retire the customer-is-always-right rule and replace it with written rules, service defined as tasks, and a dollar limit.

About twenty years ago I went into a yogurt shop and ordered a yogurt. The topping cost three dollars and seventy-five cents.

The owner was behind the counter. I asked him if I could get a topping on the yogurt.

He said, “Yes, the customer is always right.”

I had been running health clubs for a while. I had heard that sentence more times than I could count. But something about hearing it right then, from a man four feet away with a scoop in his hand, made me want to find out whether he meant it.

So I asked him if he was serious.

His response was absolutely. Then he named the charge.

I flipped a quarter onto the counter and told him the price was a quarter.

I was the customer, so I was right and he was wrong.

What Happened Next

He did not have an answer. There is no answer. That is the entire point of the exercise, and I did not do it to be clever, although I will admit I enjoyed it more than I should have.

Understand what he had just done. In the space of about eight seconds he had stated a rule, and then he had broken his own rule, and he did not notice either one. He said the customer is always right. Then a customer told him the price and he said no.

He did not believe the thing he said. He had never once believed it. He had said it the way people say “how are you” in a hallway, as a noise that means *I am friendly*, and he had no idea that he had also handed me a loaded weapon and asked me to be polite about it.

I have thought about that man for twenty years, because he was not unusual. He was every business owner in America. Ask a hundred of them if the customer is always right and ninety of them will say yes without blinking, and not one of them means it, and every one of them has employees who have to live inside a rule the owner does not believe.

This is only the beginning of the problems with the customer-is-always-right philosophy.

The Stupidest Rule a Business Can Make

I am going to say this in the strongest form I have, and then I am going to defend it.

This is the stupidest rule a business can make. It contradicts all other rules. If you have a rule that the customer is always right, there are no other rules.

That is not a rhetorical flourish. It is a logical fact and I would challenge anybody to get around it.

A rule is a statement that something is not permitted. Every rule in your business exists to constrain somebody. No smoking. No refunds after thirty days. No entry into the aerobics class if you are not participating. Deliveries at the back door. Shirts required.

Now add one more rule to the list. The customer is always right.

Watch what happens. Any customer who wants to smoke is right. Any customer who wants a refund on day ninety is right. Any customer who wants to walk through the class is right. Every other rule on your list has just been repealed, not by a decision, but by arithmetic. You wrote a rule that automatically wins against all the others.

You did not add a rule. You deleted a chapter.

Which Right Customer Is Right?

Here is the harder version, and it is the one that finishes the argument.

Two customers want opposite things.

That is not a rare case. That is Tuesday. It is the loud table and the quiet table in a restaurant. It is the customer who wants the crew to start at seven in the morning and the neighbor who wants them to start at nine. In my business it was a group fitness class. Customers in the class complain about a customer who is disrupting the class.

Which right customer is right?

Take your time with it, because there is no answer inside the rule. The disruptive man is a customer, so he is right. The eleven people complaining about him are customers, so they are right. You have a rule that produces two contradictory answers to the same question, at the same moment, with an employee standing in the middle of it waiting for direction.

And notice who the rule actually favors in practice. Not the majority. The loudest one. The eleven quiet people will not complain to anybody. They will finish the class, say nothing, and quit in March, and you will never connect the two events. The one loud man will find a manager in ninety seconds.

So the rule does not mean *the customer is always right*. It means *the customer who complains is always right*. That is a very different sentence and it is the one your business is actually running on.

Every single day, in every business that has more than one customer, somebody has to choose between customers. The choosing is the job. A rule that tells you every customer is right is a rule that has taken the job away and left you the consequences.

The Other Side of the Ledger

Now I owe you the other half, because a chapter that only says no is not honest, and I have been on the wrong end of this myself.

Back in the five-club days I had unpleasant experiences with two television providers, first a cable company and then a satellite company. The cable product was not of the quality a satellite company delivered and their service was so bad that they never did get it working in my home properly. So I switched to Dish Network.

Their customer service was just as bad, if not worse. Their representatives could not help me with my reception problems. They did not have the knowledge and they were rude.

One of my receivers was not working, so eventually they asked me to send it back. Dish Network proceeded to send me three more bad receivers.

Three. Not one. Three more bad receivers, one after another, over two months.

I was paying Dish Network one hundred and twenty dollars a month. That did not seem to get their attention.

I asked for a one month credit for the two months this problem went on. That is what I asked for. Not a refund of both months. One month. The answer was no, and it was an upper supervisory decision, which means somebody with authority looked at it and said no on purpose.

I now pay DirecTV one hundred and twenty dollars a month.

Run the arithmetic on that supervisor's decision.

He protected **$120**. My home account was $120 × 12 = **$1,440 a year**, and I had been a customer who paid early every month. He gave up $1,440 a year in order to keep $120 one time.

And that is only the part he could see.

Here is the part he could not see. What they did not know was that I could have signed a contract with them for fifty receivers in my businesses if they had done a decent job.

Fifty. We had televisions running in five health clubs.

I do not know what fifty commercial receivers would have billed at. And neither did he, and that is the entire lesson. He declined a one hundred and twenty dollar credit without any idea what was sitting on the other side of the desk, because nothing in his process told him to ask.

I would have given the one month credit. That is all I, the customer, was asking for, and it was not unreasonable.

J & S Digital Satellite

Now the company that did it right, and I want you to notice exactly what they did, because it is not what most people think good service is.

J & S Digital Satellite is the company that installed all of the satellite hardware and wiring in my home. They did an excellent job. They came back multiple times and went beyond my expectations.

Here is the part that earned them everything. They addressed the Dish Network receiver issues. Those problems were not their fault. J & S did not make the receivers, did not sell me the service, and had no obligation to touch any of it. They fixed it anyway.

And they helped me with all of my surround sound components, which they did not have to do.

J & S will have me as a customer for life.

Now put the two companies side by side, because the comparison is the point of this whole chapter.

	Dish Network	J & S Digital Satellite
What I asked for	A $120 credit	Nothing. They offered.
What they gave	Nothing	Labor, repeat visits, work outside their scope
Whose fault was the problem	Theirs	Not theirs
What it cost them	$1,440 a year, plus fifty receivers they never knew about	Some hours
What they have now	A former customer writing about them in a book	A customer for life

Look at the row about what they gave.

J & S never said the customer is always right. Nobody at that company ever used that sentence with me. What they did was give me more of *their own effort* than the contract required.

That is the distinction this chapter exists for.

Great service and unlimited concession are two different things. One you produce. The other you surrender.

Service is something you generate. Time, attention, skill, showing up a fourth time, carrying a component you were not paid to carry. It comes out of your capacity and you decide how much of it to spend. It is the two favors every two hours. It is going beyond the expectations of the member, which is half of our mission statement and is written as a task on a checklist.

Concession is something you give up. The rule. The price. The line. It does not come out of your capacity. It comes out of your standards, and unlike hours, you do not get it back next Tuesday.

Dish Network refused to spend effort and refused a concession. J & S spent enormous effort and never conceded anything, because nothing was ever in dispute.

You can be the most generous business in your market and never once tell a customer he is right when he is not.

What to Put in Its Place

So take the sign down. Now you need something to say instead, and it has to be short enough for an eighteen-year-old to use at two o'clock on a Saturday.

Here is the whole replacement, in three parts.

1. Customers get great service, defined as tasks.

Not an attitude. Name two things, put a clock on them, and count them. In my clubs those two things were two favors for a member every two hours and two appointments booked every two hours by every sales rep. We also measured whether problems were handled promptly, and our members scored us 8.16 out of ten on it.

Yours will be two different things. A shop can require a call to the customer every time a repair passes an hour. A dental office can require a follow-up call the evening after every extraction. It does not matter what the two are. It matters that they are countable. Service that is defined as a task gets done. Service that is defined as a value gets discussed.

2. The rules are short, written, and every employee can name them.

If you cannot list your rules on one page, your staff are not enforcing rules. They are guessing, and their guesses will be shaped by who yelled last.

Every rule on that page needs a reason your staff can say out loud in one sentence. The aerobics room rule is not "because we said so." It is "because eleven people paid to take this class." An employee who knows the reason can hold the line politely all day. An employee who only knows the rule folds the first time somebody pushes.

3. There is a dollar limit, and above it somebody else decides.

Below the limit, the employee decides on the spot and tells you later. Above the limit, it goes up. And whoever is above the limit needs one question in front of him that the Dish Network supervisor never got asked.

What is this customer worth over the next twelve months, and do I actually know?

Chapter 20 ran that arithmetic. A member who stays a year is worth $468, so a twenty dollar concession to keep a $468 relationship is arithmetic, not kindness. A supervisor who says no to a $120 credit on a $1,440 account is not protecting the company. He is costing it twelve times the amount he saved, and he will be praised for it, because the $120 shows up on a report and the $1,440 never will.

That is the real reason companies get this wrong. Concessions are visible and lost customers are invisible.

I Have Been the Difficult Customer

Two admissions and then I am done.

The first one is in the heading. I am the man who flipped a quarter on a counter over a yogurt topping. I have asked for a credit and been told no and taken my business elsewhere over one hundred and twenty dollars, which some people would say is not proportionate. I know exactly what it feels like to be on the other side of the counter thinking that being the customer is itself an argument.

It is not an argument. It was not an argument when I did it either. It just happens to be true that I was right about the credit and the yogurt man was wrong about his rule, and those are two separate facts that I would rather not have people confuse.

The second admission is more useful. I am not saying a business should try to serve all customers at all costs.

That sentence takes something back from every marketing book you have ever read, so let me say what it actually means. There are customers whose business you should not want. Not many. A very small number, and you will know them within about four minutes. The customer who abuses your staff. The customer who wants a rule broken every visit and gets louder each time. Chapter 20 has the arithmetic on him. He is worth $468 a year to me, and by degrading the experience for one percent of a three thousand member building he puts $14,040 of other people’s dues at risk. Run that comparison in your own numbers before you decide he is worth keeping.

You are allowed to let that person go. Politely, with a refund if one is owed, and without a lecture. It is one of the most profitable things you will ever do and almost nobody has the nerve for it.

Customers should be given great service. But they are not always right.

The Tasks That Obtain It

Task	How you verify it
Find every place the sentence “the customer is always right” appears in your business and take it down.	The sign is off the wall or the line is out of the handbook, and a manager can confirm it.
Write your rules on one page, and beside each rule write the one sentence that says why it exists.	The page exists and no rule on it is missing its reason.
Write down the two service tasks every employee must complete on a clock, and post them beside the rules.	Two named tasks with a time interval on them are posted where the staff work.
Add up what one customer pays you over twelve months, then multiply one percent of your customer count by that figure.	Both figures are on one page, in your own numbers.
Hand the twelve-month figure, in writing, to whoever is authorized to refuse a customer a credit.	That person says the number back to you without looking it up.

Do This Now

What is a customer worth to you over twelve months? Write the number down. Does the person authorized to say no to a credit know that number?

Chapter 22: The Man from Lake Tahoe

The objective of this chapter: Hire against two numbers and a date, not against an adjective on a résumé.

Experience is the most expensive thing you can buy in a hire, and it is the least likely of all of them to be worth the money.

I paid about thirty thousand dollars to learn that. Here is exactly how.

What We Thought We Were Buying

The scenario was hiring a new general manager for the Carson North club.

We were all very excited about the opportunity to hire an extremely experienced general manager from Lake Tahoe. This man came highly recommended. He should be able to increase the level of professionalism in the Carson North club. And he would require a higher starting base salary because of his experience.

I want you to read that paragraph again, because I wrote it at the time, in those words, and every sentence in it is a mistake. Not one of them is a lie. They are all true statements. They are also, every one of them, the wrong thing to be thinking about.

Look at what is in there. Excitement. Experience. A recommendation. Professionalism. A salary premium justified by the experience.

Now look at what is not in there.

There is no number. There is nothing about what this club needed to produce, at what level, by what date. There is no statement of the problem this man was being hired to solve. There is not one word about whether he would run our system.

I hired an adjective. I hired *professionalism*, which is not a measurement, which nobody can be held to, and which I could not have proven or disproven on any Tuesday of his employment.

Bruce Gimple, our regional manager, made the decision to hire this candidate. I want that on the record and I am not putting this on Bruce. All of upper management knew about the new manager’s credentials and every one of us was in a position to escalate the commitment to that decision. And we all did.

Including me. I will come back to that at the end, because it is the part that actually matters.

What Happened

The new general manager did not put enough emphasis on new sales.

He resisted following the Nevada Fitness checklist, which has been proven to maximize new membership sales.

Understand what that means in our company. The checklist system in Chapter 16 is not paperwork around the job. It is the job.

He would not do it. He had run a club before, at Tahoe, with his own methods, and he had been hired at a premium precisely because he had done it before. So he did it his way.

New sales were cut in half from the time the new manager took over.

Cut in half. Not soft. Not trending down. Half, and it was visible immediately, because our system is built to make it visible immediately.

His excuse was that the club needed new televisions, paint, desks and chairs for the sales staff.

His request for these new items was granted.

One month later, sales were still at an all-time low.

At this point, the new manager requested additional equipment in order to increase sales.

His request was granted again.

The new manager had been in his position for four months and profits were going in the wrong direction. He was terminated at four months. Nevada Fitness profited approximately thirty thousand dollars less than it would have if this escalation had not occurred.

The Sentence I Wrote Afterward

When I sat down to work out what had actually happened, I wrote this, and it is the most useful thing I have ever written about my own judgment.

"The club looked nicer and the staff was dressing better. This did not justify the new manager's poor overall performance."

Both of the observations in that first sentence were true. I could see them with my own eyes. Every time I walked into Carson North, the building looked better than it had six months earlier and the sales staff looked sharper than any staff we had.

He delivered exactly what I hired him for. I hired professionalism, and I got professionalism, and it was worth nothing.

That is not his failure. That is mine, and it happened before he ever walked in the door, at the moment I wrote a job description with an adjective in it instead of a number.

There is a name for what upper management did over the following four months, and it is not stupidity. It is a specific, well-documented, extremely expensive thing that smart people do, and it has the whole next chapter to itself. I am going to leave it alone here.

This chapter is about the hire.

The Arithmetic

Let me rebuild the thirty thousand dollars, because it is worth seeing where a number like that actually comes from. I am reconstructing this from the figures I have, not reading a ledger.

Thirty thousand dollars over four months is $30,000 ÷ 4 = **$7,500 a month** in profit that should have been made and was not.

Now put that next to what our company was actually earning. The profit in one club was about four thousand dollars a month in the early days. Across five clubs it averaged about thirty thousand dollars a month.

So the thirty thousand dollars we gave up over those four months was approximately **one full month of the entire company's profit**. Five clubs. Everything.

Here is the other way to get there. The ten thousand dollar monthly floor from Chapter 3 is mostly new memberships. Cut them in half and you are giving up something in the neighborhood of four thousand dollars a month, before you count the dues those new members would have paid every month afterward, forever.

$4,000 × 4 months = $16,000, and that is only the front end. Add the televisions, the paint, the desks, the chairs, the additional equipment, and the salary premium we paid over what a normal general manager cost us, and thirty thousand dollars stops looking like an estimate and starts looking conservative.

One more number, and this is the one that should bother you.

New sales were cut in half in month one. We terminated in month four.

We had the information on day thirty. We acted on day one hundred and twenty. The system did its job. The people did not.

What to Hire For

So what should I have been looking for? Four things, and none of them is experience.

1. Will they run your system, or their old one?

This is the first question and it is not close. Ask it directly, in the interview, out loud.

Put your actual system on the table, whatever it is. A route sheet, a job board, a close-out procedure, a checklist. Mine sounded like this. Every staff member completes tasks every two hours, you will file this club's report every two hours, and the regional manager and I will read it before lunch. Say your version, then say nothing and let them respond.

You are listening for one specific thing. Does the sentence "at Lake Tahoe we did it differently" appear? It is not disqualifying by itself. Good people have good ideas and I want them. What matters is what comes next. If it is "so I would want to understand why yours works before I change anything," hire him. If it is "so I would want some latitude," you have your answer, and it is the answer I ignored.

2. Hire for fit and teach the skill.

I said this back in Chapter 9 about the first hire and it applies just as hard to a general manager. Will they do the task the way it is written on a day nobody is watching? Are they pleasant to a stranger who is nervous? Do they tell you when something went wrong?

Skills I can teach. We had the fourteen training DVDs from Chapter 16, the best person in the company teaching every subject. I can teach a good person our sales process in a month. You can teach yours in a month too, whatever it is.

I cannot teach a man to run a system he has already decided he is above.

3. Buy experience only in the thing you actually need.

Experience is not a general substance. It is specific, and it is only worth a premium when it is experience at the exact problem you have.

Our problem at Carson North was new sales. His experience was in running a nicer building. Those are not the same trade and I paid a premium for the wrong one.

Before you approve a salary premium, finish this sentence out loud. *We are paying more because this person has done ______ before, and ______ is the number this business has to move.* If the two blanks do not contain the same words, you are paying for something you do not need. That holds whether you are hiring a store manager, a shop foreman or an office administrator.

Jesus told a story about a man who wanted to build a tower and was told to count the cost first, so that he did not lay a foundation and then run out of money with everyone watching. I used it in Chapter 13 about leases, and it is exactly right about a premium too. We counted the salary. That was the only cost we counted. We never counted four months of a club running at half, or what a general manager who will not use your system teaches the four managers watching him.

Count that cost first. Then go build the tower, because the passage is not telling you to stay home.

4. Check references for behavior, not for praise.

He came highly recommended. Highly recommended by whom, and for what?

I never asked the second question. “He is terrific” is not a reference. Here are the three that are.

Was he ever asked to run a system he did not design, and what did he do? What did his sales numbers do in his first six months there, and in his last six? Would you hire him again for a job with a hard number on it?

Silence on the third one tells you everything, and you have to be willing to sit in that silence and not fill it.

The First Ninety Days

Everything above is prevention. Here is containment, and it is a procedure. Write it before the person starts, because you will not write it afterward.

A goal without a plan is just a dream. A new manager without a written ninety days is just an expense with a nice handshake.

1. Before day one, write down the two numbers this hire exists to move. Only two. For Carson North it was new memberships sold per month and the club's monthly profit. Write the current level and the required level and the date. If you cannot fill that in, you do not know why you are hiring, and you should stop.

2. Days one through thirty, they run the system exactly as written. No changes. Not their ideas, not yours. Thirty days of the system as it exists, so that when the numbers move you know what moved them. A manager who cannot give you thirty days of doing it your way has told you something important for free.

3. Put the day thirty, day sixty and day ninety reviews on the calendar before the first day. In writing, with the two numbers at the top of the page and nothing else. Not a conversation about how it is going. A page with two numbers.

4. Write the parting criteria before they start, and say them out loud in the interview. If the number is not at this level by day ninety, we will part company and it will not be a surprise to either of us. Every good manager I have ever hired appreciated hearing that. The ones who flinched at it are the ones I should have listened to more carefully.

5. In the first ninety days, no capital request gets approved by the person who made the hire. It goes to somebody who was not in the room. I will not explain the reasoning here because it is the next chapter, but put the rule in now, because it is free and it would have saved me most of the thirty thousand dollars.

The One Question

Now the specific thing this chapter exists to give you.

A struggling manager is going to ask you for money. It will not sound like an excuse. It will sound reasonable, it will be about the customer experience, and it will come with a real problem attached, because the televisions genuinely were old and the chairs genuinely were tired.

Before you approve it, ask yourself one question.

If my best-performing manager had asked me for exactly this, at his numbers, would I say yes?

That is the whole test. Take the request off the struggling manager and put it in the hands of the person in your company with the best results, and see whether it still looks like a good use of money.

If the answer is yes, approve it. It was a good idea all along and it does not become a bad idea because the wrong person asked.

If the answer is no, then you were never buying televisions. You were buying time, and time is not a thing you can purchase from a furniture company.

There is a second half to the question and it takes ten seconds. Make the request name a number and a date. *What will this do to new sales, by how much, and by when?* Write the answer down where both of you can find it in thirty days.

We never wrote anything down. So when the month passed and sales were still at an all-time low, there was no page to look at, no claim that had failed, and nothing to point to. There was only a man saying he needed more equipment, and it was easier to grant it than to admit what the last grant had bought us.

I Did Not Object Either

Bruce Gimple made that hire. I have said so in writing before and I am saying it again here for one reason only, which is that I am not going to pretend I do not know who signed it.

And I am not hanging it on him.

Every person in upper management knew that man’s credentials. Every one of us was in a position to escalate the commitment, and every one of us did. When the televisions were approved, nobody objected. When the additional equipment was approved after a month at an all-time low, nobody objected. I was in the company. I could read the two-hour reports from Carson North any day I wanted, and cut in half is not a subtle number.

I did not object either. That is the honest sentence in this chapter.

Two last things.

I said in Chapter 16 that our checklist system is not surveillance, it is clarity, and that its real defense is that it makes a bad hire visible fast. This chapter is my proof and it is also the limit of my claim. The system did exactly what I said it does. New sales were cut in half and the report told us so within weeks.

The system was not the problem. We were. A number on a screen cannot make you look at it.

And the last thing. I have been asked whether the man from Lake Tahoe was a bad manager. I do not think he was. I think he was probably a good manager of a club that was not ours, running a method that had worked for him somewhere else, hired by people who told him we wanted professionalism and never once told him we wanted new memberships.

He gave us what we asked for.

That is what makes it my failure and not his.

Hire for what a person will do on a Tuesday. A résumé will never tell you that.

The Tasks That Obtain It

Task	How you verify it
Write the two numbers this hire exists to move, with the current level, the required level and the date.	The page exists and is dated before you interview anybody.
Cut this unit’s monthly profit in half, multiply the difference by four months, and write that figure at the top of the same page.	The figure is on the page and a partner can check the multiplication.

Task	How you verify it
Put your own checklist on the table in the interview, ask the candidate to work it as written, and write down the words that come back.	The candidate’s words are in writing and the person reviewing the hire can read them.
Ask every reference whether they would hire this person again for a job with a hard number on it.	An answer is written next to each reference’s name, and a silence is written down as a silence.
Write the day thirty, day sixty and day ninety review dates on the offer letter before either of you signs it.	The dates are on the signed letter and both of you hold a copy.

Do This Now

Write the job description for your next hire. Does it contain a number, a level and a date, or does it contain adjectives? Cross out every adjective and see what is left.

Chapter 23: Why Smart People Keep Paying for a Bad Decision

The objective of this chapter: Write the kill number, the review date and the reviewer's name before the first dollar moves.

Why did you keep paying? Not why did somebody else. Why did you?

Nobody throws good money after bad.

That is not a defense of the practice. It is a description of what it feels like from the inside. No owner has ever sat at a desk and thought, this is bad money and I am going to throw it after worse money. What he thinks is that he is very close. What he thinks is that the last piece is missing and he can see it from here. What he thinks is that quitting now would waste everything already spent.

That last thought is the expensive one, and I want to take it apart in this chapter, because it is the most expensive bias in business and it is aimed directly at people who are good at their jobs.

Max Bazerman of Harvard Business School spent his career studying how managers actually decide, as opposed to how the textbooks say they decide. In Judgment in Managerial Decision Making he put a name on this one. He calls it nonrational escalation of commitment, which means you keep backing a course of action past the point where any honest look at the numbers would tell you to stop. I read him in 2002 and 2004 and I recognized myself immediately, because I had already paid for the lesson.

Here is the structural fact underneath the whole thing, and if you take one sentence out of this chapter, take this one.

The person being asked to approve more money is almost always the same person who approved the first money.

That is not a bias. That is an org chart. Fix the org chart and you fix most of the bias.

Four Months and Thirty Thousand Dollars

I am going to use the Carson North hire briefly and then leave it, because Chapter 22 has the full account. What I need from it here is the shape of the escalation.

Then came the requests.

He said the club needed new televisions, paint, desks and chairs. We granted it. A month later, with sales still at an all-time low, he asked for more equipment. We granted that too. Four months in he was gone, and so was about thirty thousand dollars of profit.

Now look at the sequence, because the sequence is the whole lesson.

Decision one was the hire. Decisions two and three were spending approvals, made after we had evidence. That is the part I want you to sit with. We did not get fooled once. We got fooled three times, and the second and third times we had a report in our hands that said new sales were cut in half.

Thirty thousand dollars over four months is about seven thousand five hundred dollars a month. I am averaging, and it was almost certainly not flat, because the hole gets deeper as the sales pipeline empties. But even at the average, killing that decision at sixty days instead of one hundred twenty would have saved us on the order of fifteen thousand dollars. Nothing new had to be learned to do that. Everything we needed to know was visible in month two.

That is what escalation costs. Not the original mistake. The months after you could have known.

The Two Forces

There are exactly two forces doing this to you, and they work on different parts of your brain.

One. You see what you expect to see.

Here is my own diagnosis, written at the time, and I have not softened it since. “Perception of the new manager’s performance was biased by the initial decision. The club looked nicer and the staff was dressing better. This did not justify the new manager’s poor overall performance.”

The club looked nicer. The staff was dressing better.

Both true. Both visible from the parking lot. Both completely beside the point. We had hired a man to raise the level of professionalism in that club, and then we went looking for professionalism and we found it. A tidy lobby is a very satisfying thing to notice when you have just paid a premium salary for a professional.

The number that mattered was on the report and the number was cut in half, and a number on a page cannot compete with a freshly painted wall you are standing in front of.

Two. You count what you already spent as a reason to spend again.

Same document, my own words. “Money had been spent upgrading the club in order to increase sales. Time and resources had also been spent on training the new general manager.”

Read that as an argument and it is nonsense. We had spent money, therefore we should spend more money. But nobody experiences it as that sentence. It is experienced as: we are already in for a lot, so let us not waste it.

The money is gone. It is gone in every branch of the decision. It cannot tell you anything about which branch to take, because it is identical on all of them.

Let me show it as a table, because it takes about four seconds to see and about four months to feel.

	Keep going	Stop today
Already spent on paint, TVs, desks, chairs	Gone	Gone
Already spent on training him	Gone	Gone
Already spent on the salary premium	Gone	Gone
Money from here forward	You spend it	You keep it
Sales from here forward	Half	Whatever a working manager produces

Every line in that table is identical except the last two, and the last two are the only lines you actually control. That is the entire mathematics of a sunk cost.

There is nothing more to it, and I have watched intelligent men argue with it for a full quarter.

Why It Gets Worse The Better You Are

Here is the part that makes this chapter necessary.

If escalation only happened to careless people, you could hire your way out of it. It does not. It is worse in good operators, and there are three reasons.

The first is that a good operator has a track record, and the track record is evidence. I had watched Nevada Fitness go from one club to five. I had watched more than ten health club competitors close their doors since we entered the Northern Nevada market. When you have been right that many times in a row, “give it another month” is not arrogance. It is pattern recognition, and pattern recognition is usually how you got here.

The second is that a good operator believes in effort. If you think most problems yield to work, then a problem that has not yielded yet has simply not been worked enough. That belief built your business. It will also hold a dying project on life support for a year.

The third is the one nobody says out loud. Killing a decision in public means telling everybody who watched you make it that you were wrong. Every person who was in the room when the hire was announced is going to be in the room when the hire is ended. That is not a financial cost and it moves more money than most financial costs do.

None of those three are character flaws. That is exactly why the fix is not moral.

The Fix Is a Procedure

You cannot decide to be less biased. I have tried it. It works for about a week, and then a Tuesday comes along with a manager standing in your office asking for eleven thousand dollars of equipment and a reason why it will work this time.

So do not decide to be better. Decide earlier, and decide it in writing, and hand the review to somebody else.

Here is the template. One page. I call it a decision charter and you can call it whatever you want, but it gets written before the first dollar moves, not after.

Line	What goes in it
The decision	One sentence. What we are doing.
Who owns it	One name. Not a committee.
What we expect, as a number	The result, in units or dollars. Not “improvement.”
By when	A date.
The kill number	The result below which we stop. A number, not a feeling.
Review date	On the calendar today. Before the deadline, not after.
Who runs the review	Somebody who did not approve this decision.
What happens if we hit the kill number	Written now, in a sentence, while nobody is upset.

Eight lines. Fifteen minutes. Now let me fill it in for the hire that cost us thirty thousand dollars, using only what we already knew on his first day.

Line	What it should have said
The decision	Hire an experienced general manager from Lake Tahoe for Carson North at a salary premium.
Who owns it	Bruce Gimple.
What we expect, as a number	New membership sales at or above the club’s trailing average by day 60, and above it by day 90.
By when	Day 90.
The kill number	New sales below the trailing average at day 60.
Review date	Day 60, on the calendar before he starts.
Who runs the review	Me, because Bruce made the hire.
If we hit the kill number	We end it and place the club under the Carson South general manager until we rehire.

I did not write that page before he started. Had I written it, the review would have happened at day sixty with new sales cut in half, run by a man who had not made the hire, against a number set before anyone had any feelings about it. The conversation would have taken twenty minutes.

Instead we granted televisions. Then we granted equipment.

Four Rules That Do the Work

The charter is the artifact. These are the rules that make it stick.

1. Set the kill number before you start, and make it a number. “If this does not work out we will revisit it” is not a kill criterion. It is a phrase people say to end meetings. New sales at or above the trailing average by day sixty is a kill criterion, because on day sixty it is either true or it is not and no amount of talking changes which.

2. Put the review date on the calendar before the first dollar moves. Not a reminder in your head. A date, on a calendar, with a person invited. A project that is never scheduled to be reviewed will be reviewed the day it becomes an emergency, and by then the only options left are expensive.

3. Give the review to somebody who did not approve the original decision. This is the single highest-return line on the page. A man reviewing his own hire is not reviewing a hire. He is reviewing himself, and he already knows the verdict he can live with. In our company that meant the regional manager reviewed my decisions and I reviewed his. It does not require an outside board. It requires two people and a rule.

4. Judge every follow-on request against the plan, not against last month. This one is subtle and it is where the money goes. When a struggling manager asks for equipment, the instinct is to compare his sales to last month’s sales, which are terrible, so anything looks like progress. Compare to the number in the charter. And then ask the question I now ask about every spending request from a unit that is behind.

Would I approve this request from a manager who was hitting his numbers?

If the answer is no, then you are not funding a business case. You are funding an excuse, and you are paying a premium for it because the person asking is behind. If the answer is yes, approve it and stop worrying. That one question would have saved us most of thirty thousand dollars, because we would never have bought desks and chairs for a manager who was hitting his numbers. He would not have asked.

Where This Meets the Two-Hour System

You already have the machine for this if you have been reading straight through.

The two-hour system in Chapter 16 is not surveillance, and it is not about distrust. It is about the length of time a bad decision gets to run unchallenged.

A monthly report gives escalation thirty days of oxygen. A two-hour report gives it two hours.

The interval is the point, not the industry. A restaurant can count covers by shift. A contractor can count hours against the bid by the day. Whatever your number is, the question is the same. How long is a bad decision allowed to run in your company before anybody has to look at it?

And notice the ugly thing that happened in Carson North. The manager would not work the checklist himself, so every conversation about him became a conversation about impressions, and impressions were exactly the thing his spending was improving. The club report still told us new sales were cut in half. The paint worked on the only instrument anybody was actually reading.

A man who will not be measured has removed the one tool that could have ended the argument quickly. That, all by itself, is a kill criterion.

I Got It Right for the Wrong Reason

I want to be careful not to make myself the hero of the ladies-club decision in the next two chapters, because I have looked at it hard and I got a piece of it right for the wrong reason. I had a kill criterion in my head, and I acted on it while acting was still cheap. But I never wrote it down, and Chapter 25 says what that cost.

Getting it right by judgment is not a system. It is a good day.

And I want to be plain, again, that I was in the room for the escalation in Carson North. Writing “all upper management was in a position to escalate the commitment” in a memo is a very tidy way of saying I was there and I said yes.

That is what escalation actually looks like. Not a fool doubling down. A group of experienced people, each with a reasonable-sounding sentence, agreeing one more time.

Decide when you will quit while quitting is still cheap, put the date on a calendar, and hand the decision to somebody who will not be embarrassed by the answer.

The Tasks That Obtain It

Task	How you verify it
Take the newest decision you have funded and fill in the eight lines of the charter on one page.	The page exists and not one of the eight lines is blank.
Write the kill number as a figure with a date beside it, not as a sentence about revisiting things.	On that date two people reading the report would agree whether the number was hit.
Divide what this decision has cost so far by the months it has run, then multiply by the months left until your review date.	The figure is on the charter and somebody else can check the division.
Put the review date on the calendar and invite somebody who did not approve the decision.	The invitation sits on that person’s calendar and they can name the project.
Write in one sentence what happens if you hit the kill number, and give that sentence to the reviewer today.	The reviewer holds the sentence in writing before the review, not after it.

Do This Now

Write the kill number for your newest project in one sentence, containing a figure and a date. If you cannot, do you actually know what success looks like?

Chapter 24: Decide Like It Matters

The objective of this chapter: Score your next real decision on a weighted page, so somebody who disagrees can point at the cell.

How did you make your last big decision?

Not what did you decide. How. Could you draw it on a page for somebody who disagreed with you, and could that person point at the exact spot where they think you went wrong?

Most owners cannot, and I include the good ones. They can tell you the answer and they can tell you the reasons, but the reasons were assembled after the answer, the way you clean the house after you decide company is coming. That is not dishonest. It is just not a method, and a thing that is not a method cannot be taught to a manager, handed to a partner, or checked.

I am going to show you a method on a real decision, with my real numbers, including the ones that make me look worse.

The six steps come from Max Bazerman, whose work on managerial judgment I mentioned in the last chapter. They are not complicated and that is the point.

1. Define the problem.
2. Identify the criteria.
3. Weigh the criteria.
4. Generate alternatives.
5. Rate each alternative on each criterion.
6. Compute the optimal decision.

Six lines. I have used that list on decisions worth a few thousand dollars and on decisions worth a few hundred thousand, and the only thing that changes is how long I spend on step one.

Nothing in those six lines is about health clubs. They work on whether to buy the building or keep renting, whether to add a second shift, whether to take on a partner, and whether to drop a product line that has been with you since the start. The example below is mine because it is the one where I kept the paperwork.

The Decision

In July of 2004 I sat down with two men to decide what to do about two health clubs.

We had a ladies-only club in Carson City and a second one in Reno. Neither one was working. John Gutierrez was our Regional Customer Service Manager. Bruce Gimple was our Regional Manager. Those two and I were the whole decision.

I will give you the outcome now so you are not waiting for it. We closed the Carson club, converted the Reno ladies club to co-ed, and moved the Carson equipment into it. The transition was completed on August 15, 2004. Chapter 25 is about how you actually execute a closing like that. This chapter is about how the decision got made.

Step One: Define the Problem

Here is how I wrote it down at the time.

> *"The problem is the two ladies only health clubs have significantly under performed in comparison to our four co-ed clubs. This has caused a cash flow problem in these two units. A decision must be made in order to get these clubs going in the right direction."*

Three sentences. A comparison, a consequence, and an obligation to act.

Hold on to that, because I am going to come back and tell you it was my second draft and that the first one was wrong in a way that could have cost me the whole analysis.

Step Two: Identify the Criteria

Criteria are the things you are actually trying to accomplish. Not the options. What you want the options to do for you.

I named five.

Maintain Current Market Share. If we close the ladies club in Carson, we run the risk of losing members. Even if we let those members use every other club nearby, some will not like that option and will cancel. Some women would prefer to remain in a ladies-only setting. That is a real cost and it belongs on the page.

Increase Future Market Share. We have a much better chance of increasing our future market share by broadening our market to include men. All clubs would also benefit from corporate sales with a co-ed club in Reno.

Lower Overhead. Combining the two ladies clubs lowers overhead significantly. The equipment leases in the Carson Ladies Club would be paid off by March of 2005. If the building was not re-rented immediately, the longest we would have to pay rent on it was March of 2005. That is a bounded worst case, and knowing the boundary is what let me score this criterion instead of worry about it.

Increase Profit. We should obtain at least a ten to twenty percent positive cash flow each month at the Reno location by March of 2005. And the harder half of the same criterion. If we leave the clubs the way they are now, experience tells us there will be no improvement. We have given these two clubs plenty of time to grow.

Ethics. This one affects the employees at the Carson Ladies Club, the members, and the limited partners. The employees at that club are few and can easily be placed in positions at other clubs. We must go beyond the expectation of our current ladies-only members by giving them more services and more value for their money. And there is a structural problem most books would never mention. The two ladies-only clubs had one owner who was not an owner of the co-ed clubs. The variable of this decision had to be structured to benefit all owners.

That last sentence is the reason ethics is on the list as a criterion and not as a paragraph of good intentions at the end. There was a specific human being whose entire position was in the two clubs I was proposing to fold into a company he did not own a piece of. You do not handle that with sincerity. You handle it by putting it in the model where it can outvote things.

Step Three: Weigh the Criteria

I weighed each criterion on a scale of one to ten. Ten is most important. One is least important.

Criterion	Weight
Maintain Current Market Share	7
Increase Future Market Share	10
Lower Overhead	7

Criterion	Weight
Increase Profit	10
Ethics	9

Now read that table as a portrait of the man who wrote it, because that is what a weight table is.

I weighted the future over the present. Increase Future Market Share is a ten and Maintain Current Market Share is a seven. I was willing to trade members I had for members I could get. Anybody who tells you weighting is objective has never done it, because right there in the gap between a ten and a seven is more than thirty years of temperament.

I weighted profit as high as anything on the page and overhead three points lower, which is correct and most people get backwards. Overhead is a lever. Profit is the result. If you weight the lever as heavily as the result, you will eventually cut your way to a smaller, tidier, dying company.

And I put ethics at nine, above every operating criterion except the two tens.

I want to be honest about that nine. Putting ethics on a numbered scale means it can be outvoted, and there are things that should never be outvoted. If an alternative required lying to members or breaking a contract with a partner, no weight of ten would have saved it. That alternative does not get scored. It does not get on the page.

What the nine actually measured was not right and wrong. It measured how hard each option was on people who did not deserve it. Those are different things, and if you use one of these matrices you had better know which one your ethics column is doing.

Step Four: Generate Alternatives

I generated alternatives and chose the four that seemed most practical.

1. Combine the two ladies clubs into a co-ed club in Reno.
2. Maintain the two ladies clubs.
3. Sell the Carson Ladies Club.
4. Maintain the Reno Ladies Club.

Notice that “maintain the two ladies clubs” is on the list. Doing nothing is always an alternative and it must always be scored, because doing nothing is what actually happens to most problems. If you leave it off the page, you have not eliminated it. You have just stopped measuring the thing you are most likely to do.

Step Five: Rate Each Alternative on Each Criterion

Now rate every alternative against every criterion, one to ten, without looking at the weights and without adding anything up.

The two full matrices, cell by cell, are printed in Appendix A. What matters here is the spread they produced and why.

Twenty judgments. Every one of them is mine and every one of them is arguable, which is exactly what makes this useful. If Bruce Gimple thought “combine two” deserved a 4 on maintaining current market share instead of a 6, he could say so, and we would be arguing about one cell instead of arguing about the whole future of the company.

That is the actual product of this method. Not the answer. The argument, made small enough to have.

Step Six: Compute

Multiply each rating by the weight of its criterion. Add across.

Take the first row so you can see the arithmetic.

6 × 7 = 42 | 9 × 10 = 90 | 9 × 7 = 63 | 9 × 10 = 90 | 8 × 9 = 72

42 + 90 + 63 + 90 + 72 = **357**

Do that for all four and you get 357, 272, 228 and 235, in the order I listed them.

Highest number wins. Combine the two ladies clubs into a co-ed club in Reno, at 357.

Why the Winner Won

Do not just read the totals. Read the gap.

Combining beat maintaining by 85 points. Where did 85 points come from?

Criterion	Combine	Maintain two	Difference
Maintain Current Market Share	42	49	**−7**
Increase Future Market Share	90	50	**+40**
Lower Overhead	63	42	**+21**
Increase Profit	90	50	**+40**
Ethics	72	81	**−9**
			+85

Two criteria produced eighty of the eighty-five points. Future market share and profit. Everything else was noise, and two of the five columns actually ran against the winner.

That is worth knowing, and you only get it by looking past the total. This was not a broad victory. It was a decision that rested on exactly two beliefs. If either one of those beliefs was wrong, the whole thing collapses, and I could have told you that on the day I built the table.

Which is the real use of a matrix. It tells you where your decision is load-bearing, so you know which assumption to go check first.

Why “Maintain Two” Was the Most Ethical Option and Still Lost

Here is the part of the table I find most interesting, and most books would skip it.

“Maintain the two ladies clubs” scored a 9 on ethics, the highest ethics score on the page, tied with selling Carson. It scored higher than the option I chose. And it finished second by eighty-five points.

So I picked a less ethical option. Sit with that sentence for a second before I explain it, because I think owners should have to sit with it.

Now let me tell you what that 9 actually meant, and why I still think the model was right.

Doing nothing scored highest on ethics because nothing bad happens today. No employee gets moved. No member gets a letter. No partner has to have an awkward conversation. Every cost of maintaining those clubs was in the future and every cost of closing them was in August.

That is not ethics. That is a timing preference wearing an ethics jersey.

The two ladies clubs had significantly underperformed and had caused a cash flow problem. A club that is bleeding cash is not a safe harbor for the people in it. It is a slower version of the same closing, run later, with less money to be decent with. Maintain those clubs another two years and the same employees get placed anyway, except from a weaker position, and the partner who was not an owner of the co-ed clubs watches his asset decline the whole time instead of being folded into something growing.

Doing nothing is not the ethical default. It is just the option whose costs arrive after the meeting.

That is the single most useful thing this matrix ever taught me, and I only learned it by writing down a 9 that argued against me.

Look at “sell Carson” the same way. Also a 9 on ethics. Dead last at 228, because it scored a 2 and a 2 on the two market share criteria. Selling would have handed a building, a membership base and a location half a mile from our first club to somebody who would then compete with us using our own former members. Clean exit, terrible strategy. The model caught it, and my gut, I will admit, had thought selling sounded tidy.

The Problem Is Not the Symptom

Now the part most books skip entirely, and it is the reason this chapter exists.

After the transition was done I wrote myself an evaluation. Not for a class, though it ended up in one. For me. Here is what it says.

> *“The problem was not well defined in the first email. The timing of the decision was a symptom. It is very important that symptoms of problems are not defined as the real problem. The problem was the two ladies clubs were not profitable. Swift action was needed. This was not communicated effectively in the first email. Defining the problem accurately would have made it possible to connect the criteria.”*

My first definition of the problem was about *when* to make the change.

That is not a problem. That is a variable of a solution to a problem I had not written down yet.

And here is why it is dangerous. Step one determines step two. If the problem is the timing, then your criteria are all about timing. How much notice do the members need? How long does the sales staff need? When is the marketing ready? Every one of those is a real question and not one of them tells you whether to close a health club.

I got lucky. I ended up with market share, overhead, profit and ethics as my criteria even though I had framed the problem as a scheduling question, because I have run health clubs since 1994 and those are the four things I think about in my sleep. Experience covered for a broken first step. Do not count on that. Your managers do not have more than thirty years, and neither did I on the first businesses I started.

Here is the test I use now, and it takes one minute.

Write down the problem. Then ask what would be different if it were solved. If the answer is "we would have made the change at a better time," you have written a symptom. If the answer is "those two units would stop losing money," you have written a problem.

Ask it three times if you need to. The service is slow, so what, so customers wait, so what, so they leave and revenue falls. Now you have a problem with a dollar sign on it. Slow service is a symptom. Falling revenue is a problem. Nobody funds a symptom and nobody should.

The Two Weeks

There is one more thing in this decision that the matrix never saw, and it may be the most valuable part of the whole story.

I originally chose to make this change immediately.

Before I finalized it, I met with John Gutierrez and Bruce Gimple to get their input. John's objection was about the members. He was concerned we were not giving them enough notice, which could anger members and cause an increase in cancellations. Bruce's objection was about the staff. He wanted more time to prepare the sales staff and get the marketing in place.

I delayed the transition a couple of weeks. It was completed on August 15, 2004.

The cancellations we got from the entire transition, and the next chapter has the count, were fewer than we lose in an ordinary two weeks with nothing going on. I do not claim the two weeks caused all of that. I do claim that the two men who told me to slow down were the two closest to the members and to the sales floor, that they were both right, and that neither of their objections appears anywhere in my five criteria.

Not one column in that matrix measured member notice. Not one measured sales staff readiness.

A decision model is only as good as its criteria, and your criteria will always be missing something that the people doing the work can see.

That is not an argument against the model. It is an argument for showing it to somebody before you execute it. The matrix told me *what* to do. Two managers told me *when*, and the when was worth more than it cost, because two weeks of delay against a bounded worst case of rent through March 2005 is cheap and a wave of angry cancellations is not.

The Most Overconfident Thing I Ever Wrote

I closed my self-evaluation with this sentence.

> *"There has been no weakness in the fully rational model of this decision."*

I wrote that. It is in my own memo, under my own name, at the bottom of a page where I had just finished explaining that I defined the problem wrong.

I am not going to pretend I did not write it, and I am not going to pretend it holds up.

Look at the order of events. I originally chose to make this change immediately. Then I built the model. The model agreed with me.

That is not proof the model was wrong. It is entirely possible to build a careful analysis that confirms an instinct, and if you have run something for a decade your instincts ought to be right more often than not. But a model that produces the answer you already wanted deserves a second look, every single time, and I am not exempt from that. Nobody who has ever been good at something is exempt from that. Being good at something is precisely what makes your prior answer feel like an analysis.

So here are three things I now do to keep a matrix from becoming a rubber stamp.

Write your gut answer down first, before you build anything. Then when the model agrees, you will know that it agreed, rather than telling yourself later that you had no opinion going in. You had an opinion. You always have an opinion.

Have somebody else fill in the ratings independently. Same criteria, same weights, different person, no conversation first. Then compare cells. Where you disagree by three points or more is where the real decision lives, and you will find those spots in twenty minutes instead of eight months.

Count how often the model has changed your mind. If you have run this exercise six times and it has confirmed you six times, you are not running a decision process. You are running a ceremony. Somewhere in a real business there is a decision where the arithmetic says the thing you did not want, and if you have never met it, you are rounding the cells.

I still believe combining those clubs was the right call, and the results in the next chapter say most of it worked. I also believe that the sentence “there has been no weakness in the fully rational model of this decision” is the most overconfident thing I have ever written down, and that leaving it in this book is more useful than editing it out.

A decision method does not make you right. It makes you specific, and specific is the only kind of wrong you can learn anything from.

The Tasks That Obtain It

Task	How you verify it
Write the problem in one sentence, then write underneath it what would be different if it were solved.	Somebody else reads both sentences and says whether the second one names money or only a schedule.
Write your gut answer on the back of that page and leave it face down until the totals are added.	The page is dated and the answer is still there when you turn it over.

Task	How you verify it
List your criteria with a weight from one to ten beside each, then list every alternative, including doing nothing.	Every criterion has a weight beside it and doing nothing is one of the rows.
Score each alternative against every criterion from one to ten, multiply each score by its weight, and add across.	The totals are on the page and somebody else can check one row of the multiplication.
Give a blank copy to somebody closer to the work, have them score it alone, and circle every cell where you differ by three or more.	Two filled sheets exist in two different hands and the circled cells can be counted.

Do This Now

List the criteria for your next real decision and weight each one from one to ten. What does that weight table say about you that you did not intend to say?

Chapter 25: Know When to Kill It

The objective of this chapter: Close a failing unit without losing the recurring revenue, the people, or the assets you are still paying for.

On the fifteenth of August, 2004, I closed a health club I had built.

It was our ladies-only club in Carson City, approximately one half mile from the first club we ever opened, in February of 1995. Same town. Same customers driving the same streets. On that day the doors closed, the equipment came out on a truck, the members were handed something better than what they had, and a building with my company's name on it stopped having my company's name on it.

Nobody teaches this. Every business book on the shelf will tell you how to start a thing. I have never found one that tells you how to end one properly. That is strange. A man who starts ten businesses is going to close some of them, and closing badly costs more than the failure did.

So this chapter is the one I wish somebody had handed me.

One word before the story, because it decides whether this chapter is yours. I am going to say unit, and a unit is not only a building. It is the second location. It is the product line you added four years ago. It is the department, the service, the truck, the territory, the shift you opened and have been feeding ever since. A restaurant killing its catering side, a shop dropping the brand it stocks least, a firm closing a practice area, a company shutting a satellite office. Every one of those is the same seven steps. My unit happened to have showers in it.

And if you run one location, do not skip this. The single most common version of this decision in a small business is not closing the doors. It is admitting that one of the things you sell has never made money and never will.

I Was Wrong

Before the mechanics, the mistake, and I am going to state it the way I stated it at the time.

> *"This is an indication that I made a mistake when I decided to open a ladies only club in the first place. We did not capture the market we were after. I thought there would be a significant number of women*

> *intimidated by co-ed clubs that would prefer the ladies only setting. This did not turn out to be the case."*

That is the whole thing. I had a theory about a customer. The theory was wrong. Nobody sold it to me, no partner pushed it, no consultant talked me into it. I believed it, I signed the lease, I bought the equipment, and I was wrong.

I will not dress that up, and I would ask you not to dress up yours either. Owners do a thing where the failure gets narrated into a market shift or a timing problem, and by the time the story is three years old the man telling it made no error at all, he was simply early. That story is comfortable and it teaches nothing, including to the man telling it.

Here is what I honestly do not know. I cannot tell you whether ladies-only clubs were a bad idea, or a bad idea in Carson City, or a bad idea half a mile from a co-ed club we already owned and already advertised. Ladies-only clubs existed then and they exist now and some of them do very well. What I know is that mine did not, that both of ours underperformed significantly against our four co-ed clubs, and that they caused a cash flow problem in those two units.

You do not get a clean explanation for most failures. You get a result. Take the result.

The Rule Underneath the Whole Chapter

Here is the sentence I wrote when I made the call.

> *"If we leave the clubs the way they are now, experience tells us there will be no improvement. We have given these two clubs plenty of time to grow."*

That second sentence is the rule of this chapter, and I want to look straight at what is right about it and what is wrong about it.

What is right is that it is a boundary. Somewhere in my head was a length of time that constituted a fair trial for a health club, and when that time had passed I stopped arguing with myself and acted. That boundary is the only reason those two clubs did not sit there for another three years quietly eating the profit of the other four.

What is wrong is that I wrote it in July of 2004 instead of on the day the club opened.

Chapter 23 gives you the fix. A number, a date, and a reviewer, written before you spend the first dollar. If I had written on opening day that this club needed a specific number of members by a specific month, then in that month I would have had an answer instead of a debate.

Set the deadline before you are emotional about it, because on the day you need it you will not be able to write one.

By the time a unit is limping, everybody involved has feelings. The manager has feelings. The members have feelings. You have feelings, because your name is on the sign and half the town knows you opened it. A deadline written in that condition is not a deadline. It is a negotiation.

Ecclesiastes has a time to plant and a time to uproot what is planted. That line usually gets read at funerals, softly. It is not a soft line. It is a farmer's line, and every farmer knows that leaving a failed crop in the ground does not make it grow, it only costs you the season you could have used for something else. Read as management, it says the same thing my sentence says with less style. There is a season for planting and there is a season for pulling it out, and the skill is not in loving one and dreading the other. It is in knowing which season you are in.

Now, the mechanics. This is what the chapter is really for.

Seven Steps to a Decent Closing

1. Decide what happens to the customers first, and make it better than what they had.

This is the whole game and almost everybody gets it backwards. Most closings begin with a notice that says what the customer is losing.

Every member of the club we closed could use all five Nevada Fitness clubs at no additional charge.

Read that carefully. They did not get a refund. They did not get an apology. They got four more buildings than they had the week before, for the same money. A woman who had one club now had five, including one in Reno, including our biggest club in Sparks.

That is not generosity. It is the cheapest possible way to protect the single most valuable thing in the whole transaction, and I will show you that value in a minute.

Write your version of that sentence before you write anything else. If you are closing a location, the customer gets the other one and something added for the trouble. If you are dropping a product, the customer gets help finding a replacement and a price on it. The rule does not change. On the day you take something away, the customer should end up with more than he had on the day before.

2. Move the revenue, not just the doors.

The Carson Ladies dues base, which is the residual monthly income from the dues-paying members, was moved to the new co-ed club in Reno.

The dues base is the asset. Not the building, not the treadmills, not the sign. In a health club the asset is a list of people whose bank accounts get drafted on the first of the month. That list can survive the closing of the building it was sold in. You have to give those people somewhere to go.

A closing that keeps the dues base is a consolidation. A closing that loses it is a write-off. Same locked door, two completely different financial events.

Find the equivalent in your business before you close anything. It is the recurring thing. The service contracts, the subscriptions, the standing orders, the accounts. Whatever it is, it does not have to die with the location, and it will if you do not plan for it in advance.

3. Move the assets to where they will earn.

We moved the equipment from the Carson Ladies Club into the new co-ed club in Reno.

There is a hard reason for that and it is worth stating. The equipment leases in the Carson Ladies Club were going to be paid off in March of 2005 whether that equipment was running in a club or sitting in a storage unit. I was going to pay for those machines for another seven months no matter what I did. Machines I am paying for should be under members.

That is the general rule. Look at every asset in the unit you are closing and ask whether you are still paying for it. Anything you are still paying for has to be earning somewhere else by the end of the week. A leased oven, a financed truck, a copier on contract, a software seat you are billed for annually. The payment does not stop because you stopped using the thing.

4. Place the people, and understand who is watching.

Here is what I wrote about the staff at the time.

> *"The employees at the Carson Ladies Club are few. They can easily be placed in positions at other clubs. The response from all employees seems to be positive."*

Placing four or five people is not a logistical achievement and I am not going to pretend it was. It goes in this list at number four because it was not really about those four or five people. Chapter 9 opened on why. Every employee in the other five clubs was watching how we treated the employees of the club we shut down.

You can talk about culture in a speech or you can demonstrate it on the worst day. Only one of those gets remembered. Place your people before you announce anything, and be able to say where every one of them is going in the same sentence as the news.

5. Know the worst case in advance, in dollars and in months.

> *"If the building is not re-rented immediately, the longest we will have to pay rent for the Carson Ladies Club is until March of 2005."*

I knew the worst case before I made the decision. That is a boring sentence and it is the reason I could make the decision at all.

The equipment leases ended in March 2005. The rent exposure ran to March 2005. So the most this closing could cost me, in the scenario where absolutely nothing went right, was seven months of two fixed obligations that I could add up on one page. I could tell my partners that number. I could tell myself that number at two in the morning.

We re-leased half of the building the Carson Ladies Club operated in within weeks.

Notice what that means. Half the worst case evaporated within weeks, not because of a clever negotiation, but because I had started looking for a tenant as part of the closing plan rather than after it.

6. Give notice, and let somebody talk you into more of it.

I originally chose to make this change immediately. The two managers closest to the members and the sales floor both told me to wait, for the reasons Chapter 24 gives, and I delayed a couple of weeks.

It appears here because it is a step in the procedure. In a closing, the last two weeks are almost free and the first two weeks after are not. You already know your worst case runs to March. Spend two weeks of it on notice.

7. Tell the partners, and structure it so nobody gets robbed.

The two ladies-only clubs had one owner who was not an owner of the co-ed clubs.

Think about what that means. I was proposing to take the dues base out of two clubs he owned a piece of, move it into a club he did not own a piece of, and close one of the buildings. There is a version of that transaction that is straightforward theft, and it would have been legal, and it would have been the end of my reputation in a small state.

What I wrote was this. “The variable of this decision must be structured to benefit all owners.” The mechanism was simple. A co-ed club in Reno wins corporate accounts, and corporate accounts feed every club. It raises the value of every membership we sell. That raises sales everywhere, including in the units he held.

Chapter 7 is about setting ownership up so this kind of decision is still possible later. All I will add here is that the day you have to close a unit is the day you find out whether you set it up well, and it is far too late to fix it then.

What Happened

	Result
Cancellations caused by the transition	**Two**
The building	Half re-leased quickly
Overhead	Down more than we expected at that point
Equipment leases	Off the books by March 2005
Rent exposure	Capped at March 2005, half of it gone early
Profit	Improved by the lower overhead
New sales	**Did not perform as expected**

Two cancellations.

Our clubs ran about thirty-five cancellations a month each in ordinary business. We normally lose many more members in the same time frame than we lost by closing an entire club and moving everybody. In my own words at the time, this could not be better as far as maintaining our original members, and it was an indication that the members were happy with the decision.

That is what step one bought. Five clubs for the price of one. It cost me almost nothing, since those women were now using buildings I already owned and already staffed, and it kept a dues base that would have taken years and a great deal of advertising money to rebuild.

And here is the number that makes it concrete. Dues ran thirty-nine dollars a month. Every member who did not cancel is thirty-nine dollars a month that kept arriving. A hundred angry cancellations would have been $3,900 a month off the dues base, which is $46,800 a year. That is very nearly the entire annual profit of my first club. That club made about four thousand dollars a month, or forty-eight thousand a year.

I did not have a hundred cancellations. I had two.

The Part That Did Not Work

Now the honest part, in the words I used at the time rather than the words I would choose now.

> *"We have not performed as expected in new sales. This is troubling."*

And alongside it:

> *"So far we do have a discrepancy in what we calculated for the increased market share."*

Go back to the matrix from Chapter 24, printed in full in Appendix A, and look at where the decision was load-bearing. Eighty of the eighty-five points that separated the winning option from doing nothing came from two criteria, and one of them was Increase Future Market Share, weighted at ten and scored at nine.

That was the belief. Broaden a ladies club to co-ed, add men to the addressable market, win corporate deals with a co-ed club in Reno, and new sales climb.

New sales did not climb the way I said they would.

So let me separate the two halves of this outcome, because they are separate and I think the distinction is the most useful thing in this chapter.

Everything under my control worked. The members stayed. The people were placed. The equipment earned. The building got re-leased. The overhead came down more than forecast, and the lower overhead improved profit. That is a defensive success and it is fully attributable to executing the seven steps properly.

The one thing that depended on the market did not work. Strangers had to walk into a converted club and buy memberships, and not enough of them did, at least not on the schedule I had written.

Killing something well protects what you already have. It does not create demand.

Those are two different jobs. A good closing is a subtraction problem and it is largely a matter of discipline. Growth is an addition problem and the market gets a vote. I closed a club competently and I did not thereby earn the right to a sales increase, and I confused those two things in my projections.

If you take one operating rule out of this chapter, take that one. When you build the case for shutting something down, count the savings hard and count the new revenue softly. The savings are yours to execute. The revenue is a request you are making of people you have never met.

What I Would Do Differently

Two things.

I would separate the two forecasts and hold them to different standards. Overhead reduction I would forecast tightly, because I control it and I can point at leases with end dates. Sales increases I would forecast at the low end and be pleased to be wrong, because I do not control them and neither do you.

And I would stop telling myself that a good ending fixes a bad beginning. It does not. It limits the damage, which is worth a great deal, and I would rather have two cancellations than a hundred. But a well-executed closing of a club that should never have opened is still a club that should never have opened, and the money that built it is not coming back.

Decide the date while you can still be objective about it, and close it in a way your remaining employees would want to watch. Then turn around and ask the harder question, which is whether what is left should grow, hold where it is, or be sold. That is the last decision in this book, and it is the next chapter.

The Tasks That Obtain It

Task	How you verify it
Add up every fixed obligation in that unit from today to the end date of each lease and contract.	One figure sits on one page and a lender or a partner could check it against the leases.
Count the paying customers in that unit, multiply by what each pays a month, and write down where that money goes instead.	A figure and a destination are on the same line, and somebody else can check the multiplication.
Write down what those customers get on the day you close, and make it more than they had the week before.	The offer is in writing and a customer could read it without asking a question.
List every asset in that unit you are still making payments on, and write beside each one where it will earn instead.	Each line has an end date from a lease or contract and a destination beside it.
Write the destination for every employee in that unit before you announce anything to anybody.	Every name has a place beside it and the list is dated earlier than the announcement.

Do This Now

For the newest thing you have started, what is the number and the month at which you will admit it did not work? If you cannot answer, you have not set a deadline, you have set a hope.

Chapter 26: Grow, Stop, or Sell

The objective of this chapter: Know your market ceiling and what each part of your business earns, then choose to grow, stop or sell on purpose.

One club made about four thousand dollars a month. Five clubs averaged about thirty thousand. It used to be fifty.

More is not a strategy.

Every business eventually arrives at a place where the thing that got it here will not get it any further, and at that place there are exactly three doors. Grow. Stop. Sell. Most owners never notice the second and third doors exist, because growth is the only one that gets applauded, and so they walk through the first one out of habit and find out later that it was a decision.

I want to spend the last operating chapter of this book on those three doors, using the only numbers I can vouch for, which are mine.

Say location in this chapter and hear whatever your version is. A second store. A second truck. A second crew. A second chair in a dental office. A branch, a franchise, a territory, a satellite office. The arithmetic of adding one is identical, and so is the arithmetic of adding one too many. If you have one location and have been wondering about a second, this chapter is aimed squarely at you, because the jump from one to two is the most dangerous one in the whole sequence. You go from a business you can stand inside to a business you have to run through somebody else.

What Five Clubs Actually Made

Here is the history of Nevada Fitness in three numbers, and Chapter 13 has the table. One club grossed about fifty thousand dollars a month and made about four thousand. Five clubs grossed over four hundred thousand a month, over five million dollars a year, and averaged about thirty thousand in profit, after peaking at fifty.

Over fifteen thousand members. More than six percent of the market in Northern Nevada, in a market with approximately forty health clubs in it, and Chapter 2 tells you what happened to the competitors.

By any reasonable measure we won.

Now do the arithmetic on the profit line, because that is where this chapter starts.

Five clubs, if a club is just a club, ought to make five times what one club made.

4,000 × 5 = **$20,000**

We averaged about thirty thousand.

That ten thousand dollar a month difference is the honest case for multi-unit ownership, and it is worth one hundred twenty thousand dollars a year. It did not come from being better at selling memberships. It came from fixed costs being shared, which I will break down in a minute.

And then the other number, which is the one nobody puts in a company history.

Our profit had been fifty thousand dollars a month. It fell to about thirty.

50,000 − 30,000 = $20,000 a month

$20,000 × 12 = $240,000 a year, gone

Here is my own explanation, written at the time, and I am going to leave it exactly as I said it.

> *"It has gone down from a profit of $50,000 per month because of competition and saturation of the market. Saturation limits new sales."*

Saturation Limits New Sales

Say that out loud, because most business books will not.

There is a ceiling. Not a health club ceiling. Yours. Your market is a finite number of human beings and when they are all somebody's customer, growth stops being about selling well and starts being about taking from somebody else.

Every business has one and most owners have never calculated theirs. A restaurant's ceiling is seats times turns times nights it is open. A dentist's ceiling is the number of people within driving distance times how often a person sits in a chair. A roofing contractor's ceiling is the number of roofs in the county times how often a roof gets replaced. None of those are opinions. They are multiplication problems with an answer, and the answer is finite in every one of them.

In my industry the ceiling has an actual number on it, and Chapter 2 shows both the number I used in 2004 and the one that is true today. Even at today's number, the other seventy-four percent will not walk in your door if you leave it open and turn the lights on for free. Your industry has its own version of that percentage, and it is the part you cannot sell to at any price.

And now hold two things in your head at once, because they are both true and they pull against each other. The ceiling is real. The ceiling also moves. Mine nearly doubled over twenty years while I was busy treating it as fixed.

What that means for the decision in front of you is not comfortable. A market that looks saturated on today's number may not be saturated in five years, and a market that looks wide open may be about to shrink. So when your sales flatten, you have to work out which of two things is happening. Are you full, or is the ceiling itself moving under you? Those look identical on a monthly sales report and they call for opposite decisions.

Full means stop building and start defending margin. A rising ceiling means the new customers are arriving and somebody else is signing them.

The only way to tell them apart is to re-pull the number.

Here is the part that should get your attention. We took market share the entire time our profit was falling. Competitors closed. We grew. And our monthly profit went from fifty thousand to thirty.

You can win a market and lose money at the same time. That is what saturation does. When there is nobody new left to sell, the only way anybody grows is by taking, and taking is done with price and promotion, and price and promotion come out of margin.

The Base Runner

So we sat there in 2004 with five clubs, a leveling sales line, and a decision to make. I wrote it out this way.

> *"Should a base runner try to stretch a double into a triple and run the risk of being thrown out at third? Will the third baseman miss the ball and allow the runner to go all the way home? Should Nevada Fitness add another club and run the risk of cutting into the profit of the other five clubs? Will the next club be even more successful than the others?"*

That is the question, and I have never found a better way to put it.

You are standing on second base. You have something. The question is not whether third base is better than second base, because obviously it is. The question is whether you get thrown out.

And the runner who never thinks about this at all is the one who ends the inning.

When More Locations Genuinely Help

There are four real reasons to add a location, and every one of them is arithmetic, not ambition.

One. Shared upper management. Here is how I put it when I built the case for a sixth club in Reno. "Our regional managers should be able to oversee an additional location without hiring additional upper management. This will lower the average cost of expenses because an additional health club will be contributing to upper management's salaries."

Bruce Gimple was going to be paid whether we had five clubs or six. So was John Gutierrez. So was I. A sixth club walks in and picks up a share of a bill that was already on the table. That is most of where our extra ten thousand a month came from.

Two. Shared advertising. Same mechanism. "The average cost of advertising will go down because an additional club will be contributing to advertising." A radio buy in Reno costs the same whether it sends people to one building or three.

Three. Corporate deals. This one is the least obvious and the strongest. "More locations give us a big advantage in completing corporate deals because most companies have employees that live in adjacent towns."

Think about who you are selling to. A company with two hundred employees in Reno does not have two hundred employees who live in Reno. They live in Sparks and Carson and Fernley and Fallon, and a benefits manager comparing a one-club vendor to a six-club vendor is not comparing prices. He is comparing how many of his people can actually use the thing he is buying.

We could not have won those deals with one great club. Not at any price.

Four. Every existing customer gets a better product. A member who can use six buildings has a better product than a member who can use five, and it costs you nothing to give it to her because you already own the buildings. The same thing is true of a second branch a customer can walk into, a second service counter, or a shorter wait for an appointment. In my own words at the time, an additional location "may increase sales in all clubs by increasing value for potential members. A potential member might be more likely to join one of our existing clubs because they now have an additional location to service their needs."

That is the same lever I used to close a club with two cancellations in the last chapter, pointed forward instead of backward.

When More Locations Do Not Help

Now the other side, and I named this risk myself before anyone named it for me.

> *"By opening an additional location in Reno we may be competing with ourselves for new business. It may take sales away from our existing clubs."*

There is a rule of thumb in my industry that the average member will drive ten to twelve minutes to get to a club, which is about five miles. Find your own radius before you draw anything. It is however far your customer will travel for what you sell, and for a specialist it may be an hour while for a sandwich shop it may be four blocks. Then draw that circle around your existing location and around the new one. Whatever the two circles have in common is not new market. It is your own market, about to be served by two buildings instead of one.

Let me put numbers on it with the unit model from Chapter 13. A ten thousand square foot satellite club needs about one thousand members, and at the forty-five thousand dollar expense figure it makes two thousand eight hundred and thirty dollars a month. At the fifty thousand dollar figure it loses two thousand one hundred and seventy. That is how thin a single club is until it carries more than the minimum.

Now introduce cannibalization. Suppose four hundred of those thousand members would have joined one of your existing clubs anyway.

400 × $39 = **$15,600 a month** that simply changed buildings

You did not add a thousand members. You added six hundred. And you added forty-five to fifty thousand dollars a month of brand new fixed cost, which Chapter 13 will remind you is a promise that does not care how the sales went.

A new door that moves revenue from one of your own doors is not growth. It is a very expensive way to rearrange your customers.

Here are the three questions I actually used, and you can steal them.

1. Will our average expenses for each location go down?
2. Will our average income for each location go up?
3. Will we increase market share in the region?

Question two is the cannibalization test in disguise, and it is the one people skip because it is uncomfortable. Total revenue almost always goes up when you open a location. Average revenue per location is the number that tells you whether anything real happened.

Guard Against the Reason It Sounds Like a Good Idea

One more thing before we leave the growth door, and it comes straight out of Chapter 2.

Here is what I wrote to myself in the middle of building the case for a sixth club.

> *"We have been very successful increasing market share in Carson City using this strategy. Five health clubs have closed their doors in the last 7 years. This has caused our market share in Carson City to behave like a snow ball rolling downhill. However, we should not let our biases emanating from our available heuristics influence us."*

Strip out the vocabulary and it says this. The reason "open another club" was sitting at the front of my mind is that opening clubs had worked spectacularly in a different town under different conditions against different competitors. That is a memory, not evidence. A strategy is most persuasive right after it worked, which is exactly the moment it is least likely to be examined.

You see what you expect to see. It applies to expansions the same way it applies to a general manager who repaints a lobby.

And while I am being honest about my own framing, look at how I stated the trigger for the whole research project. "The problem is sales and profits have leveled. We are not growing the way we want to."

That is a symptom. Chapter 24 spends a whole chapter on why that matters, and here I am doing it again, in the same year, on a different decision. Leveled sales are the fever. The problem underneath was that our market was saturating and a strategy built on an unserved pool was running out of pool.

I did the research and I built the case. That particular file does not have a tidy ending in my records and I am not going to invent one. What I can tell you is where it landed. Today Main Corp operates six clubs under Parkway Athletic Club, and it licenses the Fitness For $10 brand to operators in five states and Canada that I do not run.

The second of those two facts is worth more to you than the first, and I want you to notice why. Licensing a brand is growth that does not require me to sign another lease. When your own market saturates, the question is not only where else can I put a club. It is what else can I sell that is not a club.

The Second Door: Stop

Nobody writes this chapter, so I will.

You are allowed to stop opening locations.

A company that has stopped adding units has not stopped growing. It has stopped growing one way. Every customer you keep instead of losing is revenue that cost you nothing to acquire, and that is true of a repeat diner, a maintenance contract renewed, and a patient who does not switch practices. In my clubs every saved member was thirty-nine dollars a month. The maintenance hire in Chapter 18, five hours a day in every club to fix the one weakness our members found, was growth. It just did not come with a ribbon cutting.

Efficiency, price, retention, and the two-hour system are all available to a company that has decided not to build anything for three years. The best way to maximize the production of a business is by being efficient, and maximizing efficiency maximizes profit. That does not require a sixth building.

Stopping is a legitimate answer. It is not the same as quitting, and an owner who cannot tell those two apart will keep signing leases until one of them takes the company down.

The Third Door: Sell

Now the part I think almost no small business owner does, and I have started more than ten of them.

> *"It is important for a small business to have an exit strategy that it may or may not use in the future."*

That may or may not is the whole sentence. You are not building an exit because you intend to leave. You are building it because a business you could sell is a better business than one you could not, and because the day you need to sell is the worst possible day to start getting ready.

There are three routes.

Sell the business at the right time and price. The simplest one.

Sell to an existing publicly held company for stock, then sell the stock. A larger public company buys you and pays in shares, and you convert those shares to cash. And a caution I wrote down at the time. There are regulations on selling stock in these cases, so that must be planned for also. A man who accepts stock without understanding when he is permitted to sell it has not sold his company. He has traded it for a promise with a lock on it.

Take the company public. Taking a profitable company public at the appropriate time and selling the stock at the appropriate time can be an excellent exit strategy. Notice that the sentence contains "at the appropriate time" twice, and they are two different times.

And the trigger, in one line. The exit strategy is utilized if the competition begins to pose a big threat.

Build the Exit Before You Need It

Here is the practical argument, and it has nothing to do with wanting out.

Ask what a buyer is actually buying. Not your building. Not your equipment, which is depreciating and half of it is leased anyway. A buyer is buying five things.

1. **Clean books,** going back years, that an outside accountant can verify without an argument.
2. **Recurring revenue,** which in our case was the dues base, with a documented history of what it does when members leave.

3. **A system that runs without you.** Chapter 16, in writing, with the training on video. A business where the owner is the system is not an asset. It is a job with inventory.
4. **Contracts that transfer.** Leases, equipment, billing, the member agreements themselves.
5. **An ownership structure that does not blow up on contact.** We had one owner of the two ladies clubs who was not an owner of the co-ed clubs. A structure like that is fine right up until the day somebody wants to buy the whole thing.

None of those five can be assembled in the ninety days after a competitor opens across the street. That is the argument. Not that you should sell. That the work of becoming sellable is the same work as becoming well run, and you get the second one whether or not you ever do the first.

You build the exit before you need it, because you build it badly when you need it.

Everything in This Chapter Rests on a Projection

I have been doing budgets and sales projections for over ten businesses that I have started over the years. My projections have never been right. I have been close, but never perfect.

I am putting that here, in the growth chapter, on purpose.

Everything I have shown you about adding a location rests on a projection. One thousand members. Forty-five or fifty thousand in expenses. Ten percent of an available market that three of my own spreadsheets sized three different ways. Every one of those numbers was worked carefully, and not one of them was going to come in exactly.

Which means the point of the analysis in this chapter is not to produce the right number. It is to tell you how wrong you can afford to be. A base runner does not know whether the throw will beat him. He knows how far he is from the bag, how good the arm in right field is, and what the score is. That is what these numbers are for. Not certainty. Distance to the bag.

There is a question underneath all three doors, and it is not how big can this be. It is whose is it. I am going to name it here and leave the answer to the chapter that follows this one.

It is a better question than the one most owners ask, and a much better one than “how big is his.” It also produces cleaner decisions. If the resources are not really mine, then growing past the point where growth destroys value is not ambition. It is poor management of somebody else’s money.

Grow, stop, or sell. All three are legitimate. Pick one on purpose, with a number in your hand, and know which one you are in.

The Tasks That Obtain It

Task	How you verify it
Multiply the population of your market area by the share of it that buys what you sell in a year, and write the number down.	The figure sits on one page beside the population you used and the rate you used.
Divide total revenue by your number of locations or crews, for this year and for three years ago, and put the two figures side by side.	Both figures are on one page and somebody else can check the division.
Write down how far your customer will travel to you, then draw that radius around each existing location and around the one you are considering, on a real map.	The map exists with the circles on it and anybody can see the overlap.
Count the customers inside that overlap and multiply by what one of them pays a month.	The figure is written on the map, and that is revenue you would move rather than add.
List the five things a buyer buys and mark which ones you could hand over on Monday.	Five lines exist, each with a mark, and an accountant could check the marks.

Do This Now

Which of the three doors are you actually in right now, and when did you last choose it on purpose rather than by habit?

Chapter 27: Whose Business Is It?

The objective of this chapter: Write down the monthly figure at which you would say enough, and put a date on when you will read it again.

This business is not mine.

I want to be careful here, because that sentence can be read three or four ways and only one of them is what I mean. I am not being modest. Main Corp Enterprises, Inc. is a Nevada company I founded in October of 1994, I am the founding partner and chairman of its board, and if you look at the paperwork my name is all over it. In the ordinary legal sense it is absolutely mine.

I mean something else, and it is the last argument I have to make to you.

Every chapter of this book has been a method for producing a return on resources. Count the market before you sign the lease. Borrow more than you need and leave the rest alone. Know what one more sale is worth. Know your fixed number to the dollar. Know what a dollar of your own money costs. Write down what each person does in the next two hours, and then verify that it happened.

All of it points the same direction. Take what you were handed and produce more with it than you started with.

Which raises a question I have been circling since Chapter 10 and have not answered.

Handed by whom?

What I Actually Believe

I am a Christian. Three of my four other books say so at length, and this one has mostly not, because this one is about contribution margins and checklists and it should be handable to any person who works for me, whatever they believe. I have kept my faith to the places in this book where it was load-bearing. This is the last place, and here it carries the argument rather than walking alongside it.

Here is the position, plainly.

I did not manufacture my ability to work. I did not choose my health, my energy, my nerve, or whatever business sense I was handed at birth. I said in

Chapter 10 that money is labor stored, and I meant it as a definition, not as poetry. Follow that definition all the way back and you arrive somewhere uncomfortable. If a dollar is stored labor, and my capacity to labor showed up without my consent or my effort, then the dollar traces back to something I did not produce.

I quoted Deuteronomy back in Chapter 10. It is God who gives you the power to get wealth. I made the point there about the word *power*, and here is the consequence of it, which I left alone at the time. The digging was always mine to do. The capacity to dig was not something I built.

That is a description of a manager, not an heir.

The clearest picture of it is the one Jesus told about the man going on a journey. He hands one servant five talents, another two, another one, and leaves. Two of them go to work and double the money. The third buries his in the ground, because he was afraid, and hands back exactly what he was given. The master is not gentle about it. He calls the third man wicked and lazy and says that at a minimum he should have put the money in the bank where it would have earned interest.

Read that as an owner and it stops being a Sunday school story.

Start with the thing nobody in the story argues about. The property is not theirs. It never was. Three men are handed somebody else's money, they hold it for a while, and then they sit down and account for it. That is not a parable about ambition and it is not a parable about caution. It is a parable about a management agreement.

Then look at how the two producers are graded. They were not handed the same amount and they did not bring back the same amount. One returns ten and one returns four. The master says the same words to both of them. Neither man is measured against the other man's pile. Each is measured against what was put in his hand, which is the only fair way to grade a manager and almost never the way it is done.

Now the third man, because he is the one this book is about.

He did not lose anything. He returned one hundred percent of the principal. There is no shortfall on that balance sheet, and if you handed it to an accountant he would find nothing wrong with it. And he is the one who gets taken apart, because the standard was never "did you avoid losing it." The standard was "what did it produce."

Read the master's own alternative one more time, because it is the most practical sentence in the story. Put it in the bank and collect the interest. That is not a demand for brilliance. It is a floor. The man was not condemned for failing to double it. He was condemned for producing nothing at all with something that was not his.

That is the same standard I have been applying to a front desk for thirty years. Hard work has no value. Production has value. I did not get that from an accounting textbook.

The Content Point

Now the practical part, because a belief that never touches a bank statement is not a belief. It is a preference.

I set a content point.

A content point is a monthly income figure that I have decided, in advance and in writing, is enough. Not enough for now. Enough. I adjust it about three percent a year for inflation and otherwise I leave it alone.

Everything the businesses produce above that line does not come to me. It goes two places. Some of it goes to God's work. The rest of it goes back into investment, which mostly means back into businesses that employ people.

I am not going to print my number, because my number is not your number and a figure on a page would only start an argument about the figure instead of about the idea. Let me work an example instead, the way I have worked every other number in this book.

Say a man decides ten thousand dollars a month is enough for him and his family. Here is what the next five years look like on paper, at three percent a year.

Year	Content point	Business income	Above the line
1	$10,000	$10,000	$0
2	$10,300	$12,000	$1,700
3	$10,609	$15,000	$4,391
4	$10,927	$19,000	$8,073
5	$11,255	$24,000	$12,745

Look at the fourth column. In year five, more money is going past him than is going to him.

Most people, without a line, would have spent every dollar of that fourth column, and they would not have felt extravagant doing it. That is the part nobody warns you about. Lifestyle does not inflate through one big decision. It inflates two hours at a time, the same way everything else in this book happens. A better car when the lease is up. A bigger house because the kids need the room. A second house because the first one is paid off. None of those is a sin and none of those is a scandal. Add them up over ten good years and the man who was making twenty-four thousand a month is exactly as squeezed as he was at ten, and he cannot tell you where it went.

I have two more rules under the content point and they are both blunt.

I will own one residence. One. Not a rule I would impose on another human being, and I know men I respect who own two. It is my line and I do not spend time relitigating it.

I will not raise my standard of living in proportion to my income. If income goes up ten percent, lifestyle goes up three to five. That gap is not deprivation. That gap is the whole thing. It is where the giving comes from and it is where the next business comes from, and both of those employ somebody.

Why This Is Not Restraint

Here is the part I actually want you to take, and it is the opposite of what most people assume when they hear a man talk this way.

This is not restraint for its own sake.

I am not a frugal man by temperament. I am not sitting on my hands. I have started more than ten businesses. I chased the sixth club and I built the case for it. I built a system that required every sales representative in every building to book two appointments every two hours, and I meant it, and I checked. I have taken a business from about fifty thousand dollars a month in gross to over four hundred thousand and I enjoyed every dollar of that climb. The company runs six clubs today and does ten to twelve million dollars a year. Nobody who has met me has ever accused me of a lack of appetite.

The content point is what makes the appetite safe to have.

Think about what is actually happening in a man who has not drawn that line. Every gain he makes moves his own target. He gets to four hundred thousand a month and four hundred thousand becomes the new floor, and now he needs five, and the five is not for anything. It is just the next number. He will tell you he is building a company. What he is really doing is running from a floor that moves every time he steps on it.

That man cannot make a clean decision. He cannot close a location that is bleeding, because closing it means less. He cannot turn down a bad account, because it is still money. He cannot pay people what they are worth, because every dollar out is a dollar off his number. He cannot walk away from a project with a seven thousand dollar net present value on a six million dollar base, because a coin flip with an upside looks like an opportunity to a man who needs one.

I have watched greed make people slow, cowardly and stupid, in that order. It does not look like a man in a top hat. It looks like a decent owner who has quietly lost the ability to say no to money.

A man who has already decided what enough looks like can chase efficiency all day long without any of that. Maximizing efficiency maximizes profit, and I believe that as strongly as I believe anything in this book. I can push on a contribution margin without the pushing turning into something that runs me, because I know before I start where the increase is going. The number is not for me. That is precisely why I can be ruthless about it.

That is why a book full of break-even arithmetic and two-hour checklists arrives here instead of somewhere softer. The stewardship is not a nice sentiment stapled to the back of the operating manual. It is the thing that lets the operating manual be run at full speed.

Take the System and Leave the Theology

Now let me say the honest thing.

You may not believe a word of the last three pages.

You might have read the section on the content point and thought that the arithmetic is sound and the reason behind it is not for you. That is a perfectly reasonable place to land, and I want to be very clear about what I think of it, because I have been in businesses where the owner’s religion became a condition of employment and I found it distasteful every time.

Everything else in this book works without any of this.

Contribution margin does not care what you believe. Neither does break-even, operating leverage, free cash flow, or the cost of a dollar. The two-hour checklist does not require a conviction about God. It requires a manager who will pull the reports and somebody above him who will read them. Two favors every two hours works in an atheist's restaurant exactly as well as it worked in my clubs, and the customer receiving the favor does not ask.

So take the operating system and leave the theology if that is where you are. I would rather you run a good business than agree with me.

I will only ask you to do one thing, and it does not require any faith at all. Draw a line somewhere. Decide, in advance, what enough is, and write the number down before you get there rather than after. Whether you think you are accountable to God, to your family, to your employees, or only to the man you intend to be at seventy, the mechanism is the same and it works the same way. A number you set in advance protects you from a number that sets itself.

I have told you what I think. It might be wrong, but you know what I think.

The Tasks That Obtain It

Task	How you verify it
Write your content point as one monthly figure, date it, and write beside it the percentage you will raise it by each year.	The figure and the date are on one page and your spouse or your accountant has read it.
Write down where every dollar above that figure goes, by name and by share.	The destinations are named on the same page and a second person can add the shares to one hundred.
Do the one thing your part of this book assigns for Monday: count the unclaimed customers, subtract your fixed number from your contribution margin, or write what one person will accomplish in the next two hours.	The count, the subtraction, or the two-hour list exists on paper and the person it concerns has seen it.
Write in one sentence whose resources you are holding and what you are accounting for.	The sentence is written down and somebody who knows you can read it back to you.

Task	How you verify it
Read the report that comes back from that first two-hour list, then read the next day’s.	Two dated reports exist and somebody who did not file them has initialed both.

Do This Now

What is your number? Not your goal. The monthly figure at which you would say the word “enough” out loud and mean it. Have you ever written it down?

Conclusion: Your Decade Is Made Out of Tuesdays

What Each of You Does Monday

There are three kinds of people reading this, so let me not leave you with one undifferentiated you.

If you have an idea and no lease, do not write a plan on Monday. Go count. Get the population, get the percentage of it that ever buys what you sell, and go shop every competitor in that town yourself, in person, on a weekday. You are looking for one number, which is how many customers are genuinely unclaimed. Do not sign anything until you have written it down.

If you are already open and stalled, do not go looking for more sales on Monday. Go find your contribution margin on one unit and your fixed number for one month. Then subtract. Whatever separates those two figures is the whole distance between where you are and where you want to be, and almost nobody who is stalled can state it to the dollar.

If other people’s work runs through your hands, write down what one person in your company is supposed to accomplish in the next two hours. One person. Show it to them. Then read what comes back at the end of the day, and read it again the day after that, because the reading is the part everybody skips.

None of those three take a week. All three take about an hour, and every one of them can be started before lunch.

What a Decade Is Made Of

I am going to end where the book started.

A goal without a plan is just a dream. I have said that sentence for years, and the half nobody repeats is the half that costs people their decade. The plan must also have a timeline connected to it. Without a date on it, the plan is just the dream written down.

Here is the whole method in one line. It is the line I want you to keep.

Completed tasks = objectives obtained = GOAL achieved.

Every word in it is carrying weight. Completed, which means a person who did not do the work confirmed that the work was done. Obtained, which means counted and not felt. Achieved, which means a stranger could look at your business and tell you so without asking your opinion.

You do not get a business in one decision. There is no morning where you decide to be successful and then are. The five million dollars in annual gross was not a decision. It was about ten years of somebody at a front desk in Sparks doing two favors before eleven o’clock, and a sales representative in Carson City booking two appointments before one o’clock, and a general manager filing a report at three that said both of those things had actually happened. That report told me on Tuesday what I would otherwise have learned in the third week of the following month.

Nothing else built it. Not the vision. Not the plan, and I have written plans for more than ten businesses and never once had one come out right.

The discipline of the hourly task is what reaches the ten-year goal. There is no other road to it and there never was.

I constantly accomplish the objectives, so I reach my goals.

Read that as flatly as I wrote it. There is no luck in that sentence and there is no instinct in it either, and I am the man who told you at the start that instinct is the part I cannot give you. What is in that sentence is repetition, verified, over a very long time.

Which brings me to the last thing, and it is the reason any of the mechanics were worth the pages.

Your decade is made out of your Tuesdays.

Not out of your plans. Not out of your best year. Out of ordinary Tuesdays at ten in the morning, when nothing is at stake and nobody would notice either way. Fifty weeks a year, five days a week, ten years. That is two thousand five hundred working days, and you will not remember thirty of them. The other two thousand four hundred and seventy are the decade. There is no other material available and there never has been.

The same is true of the part of your life that is not the business. Nobody becomes generous in a single afternoon. Nobody becomes the kind of owner people will follow by announcing it at a meeting. You do not decide to be a man of your word. You keep your word on a Tuesday at four o’clock when it costs you something, and then you do it again Thursday, and thirty years later people describe you a certain way and you did not choose the description. You earned it in two-hour pieces without noticing.

So find out whose resources you are holding. Decide what enough looks like before the money arrives to argue with you. Then go get a return on what you were handed, and do not apologize to anybody for going after it hard.

Set the goal. Break it into objectives you can count. Break the objectives into tasks a person can finish. Do the tasks. Have them verified.

A goal without a plan is just a dream.

Completed tasks = objectives obtained = GOAL achieved.

Appendix A: The Numbers, Worked

This appendix exists so you do not have to hunt through the book to find a formula while you have a decision in front of you.

Each one gets the formula, one worked example with real numbers out of the chapters, and one plain sentence telling you what business question it answers. The arithmetic here is identical to the arithmetic in the chapters. If you find a place where it is not, the chapter is right and I owe you a correction in the next printing.

None of these are hard. Every one of them is something a reasonably bright fourteen-year-old could do with a pencil. The reason most owners cannot answer these questions is not that the math defeated them. It is that nobody ever told them these were the questions.

A formula does not care what you sell. Break-even works the same on a plate of food, a billable hour, a filling, and a pair of shoes. My examples come out of health clubs because that is where my numbers are. The examples in this appendix also come from a nutcracker manufacturer, an airplane maker and a shoe company, and the arithmetic does not change. Put your own unit in the place where mine is.

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1. Contribution Margin

Per unit: selling price − variable cost per unit

In total: total sales − total variable costs

Variable cost means everything that goes up when you sell one more. Not everything in cost of goods sold. Not everything that feels like a cost. Everything that moves when the unit moves.

Worked, on a nutcracker. Drosselmeier Corporation sells at 90. Variable manufacturing is 26 and variable selling and administrative is 10.

	Per unit	2,000 units
Sales	90	180,000
Less variable manufacturing	(26)	(52,000)

	Per unit	2,000 units
Less variable selling and administrative	(10)	(20,000)
Contribution margin	**54**	**108,000**

Worked, on one of my health club memberships. Dues are $39 a month. The one variable cost I can genuinely document is billing at three percent.

Your unit will be something else. A cover at a restaurant, a billable hour at a law office, a cleaning at a dental practice, a signed contract at a roofing company. Find the thing you sell one more of, then find what it costs you to sell that one more.

One membership, one month	
Dues	$39.00
Less billing at 3%	($1.17)
Contribution margin	**$37.83**

The question it answers: if I sell one more, how many dollars do I actually keep?

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2. Contribution Margin Ratio

Contribution margin ÷ sales

Same number, expressed as cents on the dollar. This is the more useful form, because it works on a business where “one unit” is not a clean idea.

	Contribution margin	Sales	Ratio
Drosselmeier	108,000	180,000	.60
Eastman Kodak, 2000 (millions)	7,014	13,994	.50
Health club membership	$37.83	$39.00	.97
Pro shop shirt at $20, cost	$3.00	$20.00	.15

	Contribution margin	Sales	Ratio
$17			

Almost every business sells a high ratio line and a low ratio line under one roof. The restaurant has drinks and it has steaks. The shop has labor and it has parts. Rank your lines by this ratio and you will usually find your salespeople working the wrong one.

The last two rows of that table were under the same roof at the same time. A membership hands you ninety-seven cents of every new dollar. A shirt hands you fifteen. Selling one hundred more shirts is three hundred dollars. Selling one hundred more memberships is $3,783 a month, every month, until they cancel. That is not an opinion about retail. That is a ratio, and it decided where every sales hour in my company went.

Here is what the ratio buys you in one step. Kodak's sales grow ten percent. Ten percent of 13,994 is 1,399.4. Multiply by .50 and you get 699.7 of additional operating income, which takes 2,214 up to 2,913.7. Ten percent more sales, about thirty-two percent more profit, computed on a napkin.

The question it answers: if sales go up ten percent, how much more do I keep?

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3. Break-Even

Units = fixed costs ÷ unit contribution margin

Dollars = fixed costs ÷ contribution margin ratio

Every business starts the month with a pile of fixed costs holding its hand out. Each unit throws its contribution margin on the pile. Break-even is when the pile is covered.

Worked, on the nutcrackers. Fixed costs of 90,000, contribution of 54 a unit.

- Units: 90,000 ÷ 54 = 1,666.67, call it **1,667 nutcrackers**
- Dollars: 90,000 ÷ .60 = **150,000 in sales**

Worked, on one of my satellite clubs. Ten thousand square feet, $37.83 of contribution per member per month, and monthly expenditures I have written down in two places as $45,000 and $50,000. I am not going to quietly pick the flattering one, so here is both. And the worst month any club of mine ever had in new memberships, personal training and pro shop was well over ten thousand dollars, so run it with and without that floor credited.

Fixed costs	Dues only	Crediting $10,000 of other income
$45,000	1,190 members	926 members
$50,000	1,322 members	1,058 members

For years I told anybody who asked that a ten thousand square foot satellite club needs a thousand members. That was not a calculation. It was ten years of watching clubs, and one thousand sits right in the middle of the two figures in the right-hand column. I am not going to pretend I did the arithmetic first.

Worked, on an airplane. A textbook airplane, built on Boeing's 757-300. Seventy million dollars a copy, annual fixed costs of nine hundred fifty million, variable cost of forty-five million per airplane. The figures are teaching numbers, not Boeing's books. 950 ÷ (70 − 45) = 38 airplanes, or 2,660 million dollars of sales.

The question it answers: how many do I have to sell before I stop losing money?

The warning that goes with it: a break-even calculation tells you what would be required. It does not tell you what is possible. Drosselmeier's plant holds 2,400 units. You can compute a perfect break-even on a market that does not exist, and it will be perfectly, confidently, precisely wrong.

---

4. Target Profit Volume

Units = (fixed costs + desired profit) ÷ unit contribution margin

Same formula as break-even. You add the profit you want to the pile before you divide.

Worked. Drosselmeier wants operating income of 45,000.

(90,000 + 45,000) ÷ 54 = **2,500 units**

Drosselmeier at 2,500 units	Total
Sales (90 × 2,500)	225,000

Drosselmeier at 2,500 units	Total
Less variable manufacturing (26 × 2,500)	(65,000)
Less variable selling and administrative (10 × 2,500)	(25,000)
Contribution margin	**135,000**
Less fixed costs	(90,000)
Operating income	**45,000**

The formula checks. And the plant holds 2,400, so the correct answer created a problem the company did not know it had.

Worked, on one of my clubs. You want $10,000 a month of profit out of the satellite club, at $45,000 of fixed costs, crediting the $10,000 floor of other income.

(45,000 + 10,000 − 10,000) ÷ 37.83 = **1,190 members**

Break-even was 926. A good living is 1,190. The distance between surviving and making ten thousand dollars a month is two hundred and sixty-four members.

The question it answers: how many do I have to sell to make the number I actually want, not just to survive?

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5. The Special-Order Test

Take the order if: offered price > variable cost per unit

Value of the order = (offered price − variable cost) × units

Full cost is irrelevant here. You already paid the fixed part.

Worked, three ways. Drosselmeier at 2,000 units, making 18,000. An order arrives for 300 more.

Scenario	Arithmetic	Effect on operating income
300 units at the full 90, plant has room	27,000 × .60	**+16,200**, income goes to 34,200
300 units at a	(50 − 36) × 300	**+4,200**, income goes to

Scenario	Arithmetic	Effect on operating income
discounted 50, plant has room		22,200
300 units at 50, plant already full at 2,400	4,200 gained − 16,200 given up	**(12,000)**

Read the second row and the third row together, because they are the same order at the same price and one of them makes you money and one of them costs you twelve thousand dollars. Nothing changed except whether you had a seat nobody was sitting in.

The version from my own clubs. A company calls with two hundred employees and wants $29 instead of $39. That is about $28 of contribution each, or $5,600 a month that did not exist, with fixed costs that do not move a dollar. For the Reno club at 800 members in a building that holds far more, take it before lunch. For the Sparks club at 5,100 members, think much harder. A club's real capacity is the parking lot at five thirty. It is the treadmills at six o'clock on a Monday in January. When a full-price member cannot get a machine he does not complain. He stops coming, and four months later he cancels.

The question it answers: should I take this order at a price I would never advertise?

The trap, and it is the most expensive one in this appendix: a special order is only good business while you have spare capacity.

Every business has a version of the parking lot at five thirty. The restaurant has Saturday at seven. The contractor has the number of crews he can put in trucks on Tuesday. The dentist has chairs and hours. Before you take a discounted order, find out whether you are filling an empty seat or pushing a full-price customer out of one.

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6. Operating Leverage

Degree of operating leverage = contribution margin ÷ operating income

Multiply a percentage change in sales by that number and you get the percentage change in profit.

Worked. Drosselmeier at 2,000 units has a contribution margin of 108,000 and operating income of 18,000.

108,000 ÷ 18,000 = **6.0**

So a ten percent increase in sales should produce a sixty percent increase in operating income. Prove it. At 2,200 units the contribution margin is 118,800, less 90,000 of fixed costs, which is 28,800. Eighteen thousand to twenty-eight thousand eight hundred is sixty percent exactly.

Worked, on one of my clubs. From Chapter 13, at $45,000 of fixed costs and the $10,000 floor of other income held flat:

Members	Dues contribution	Plus other income	Less fixed	Monthly profit
900	$34,047	$44,047	($45,000)	**($953)**
1,000	$37,830	$47,830	($45,000)	**$2,830**
1,100	$41,613	$51,613	($45,000)	**$6,613**

Ten percent more members. One hundred and thirty-four percent more profit. Ten percent fewer members and you go from $2,830 of profit to $953 of loss, which is the same swing pointed at your head.

One honest note, because the two numbers do not tie. Contribution divided by operating income there is 47,830 ÷ 2,830, which is 16.9, not 13.4. Here is why. I held the ten thousand dollars of other income flat while the members moved. So that table measures leverage against members, not against total sales. Both are correct, and you should know which one you are looking at. If you build a table like it for your own business, know which question you are answering.

The Boeing crossover, on the same teaching numbers. Two cost structures, both making exactly one hundred million dollars at forty-two airplanes. Sell forty-three and the heavier fixed structure makes 127 million against 125. Sell thirty-eight and the heavier structure is under water while the lighter one is exactly even. Below the crossover you want low fixed costs. Above it you want low variable costs. There is no structure that is right at both ends.

The question it answers: how hard will my profit swing when my sales move?

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7. Free Cash Flow

Cash from operations − capital spending required to stay the same size

The plainest sentence I can give you: free cash flow is the money left over after you have paid to keep the business the size it already is.

Worked, from net income to cash from operations. Nike's fiscal 2004 statement, in millions. This is the reconciliation Chapter 14 describes, and it is the one to run on your own books.

Line	Amount (millions)
Net income	945.6
Add back depreciation	310.4
Add back other non-cash adjustments	66.2
Receivables came down, freed up cash	82.5
Payables and other liabilities went up	269.1
Inventory went up, used cash	(55.9)
Other operating items	(103.5)
Cash from operations	**1,514.4**

I will give you one honest note on those numbers. The combined statement I worked from lists fiscal 2003 cash from operations at 917.4 million, and the ten-year summary in the same annual report lists it at 922.0. Those are the company's own two numbers about the same year and they differ by four and six tenths million dollars. That is normal. Presentations get restated. I mention it because you will find the same thing in your own books, and when you do, do not assume somebody is lying. Assume somebody classified something differently and go find out which.

Worked, the short way. Nike's fiscal 2004 cash from operations was 1,514.4 million and capital spending was 213.9 million.

1,514.4 − 213.9 = **1,300.5 million**

Worked, with the judgment call in it. For the nine months ended February 28, 2005, cash from operations was 1,081.1 million. Cash used by investing was 263.0 million, but a large piece of that was moving money into and out of short-term investments and buying a subsidiary, which is not the cost of standing still. Strip those out and the adjusted figure is 197.9 million.

1,081.1 − 197.9 = **883.2 million**

That subtraction is the whole art of this. You are deciding which spending is the price of standing still and which spending is a choice. In my business, treadmill replacement is standing still and a sixth club is a choice. In yours it might be replacing the delivery truck you already run against buying a second one. Same line on the same statement, and only one of them is optional.

Worked, building down from operating profit. Operating profit of 1,535, a 36 percent tax rate, depreciation of 400, capital spending of 500, and an increase in working capital of 160.

- 1,535 × (1 − 0.36) = 982.4
- Less capital spending over depreciation: 500 − 400 = 100
- Less the increase in working capital: 160
- **Free cash flow to the firm = 722.4**

That number carries a flag of its own. The raw capital spending input on that sheet was 550 and the model overrode it to 500. At 550 the answer is 672.4. That is a seven percent swing in the final number from one assumption most people never look at.

The question it answers: how much money is actually available to me, as opposed to how much profit I reported?

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8. Cost of Equity and the Weighted Cost of Capital

Cost of equity = risk-free rate + (market premium × how much your business swings)

After-tax cost of debt = interest rate × (1 − tax rate)

Weighted cost of capital = (share financed by debt × after-tax cost of debt) + (share financed by equity × cost of equity)

Debt has a rate printed on it. Equity has a rate too. You just never get an invoice, so most owners set it at zero and then wonder for twenty years why the business never gets anywhere.

Worked, on a shoe company in 2005. Risk-free rate 4.6 percent, market premium 5 percent, swing factor 0.727, borrowing rate 8 percent, tax rate 35 percent, funded 14.6 percent by debt and 85.4 percent by equity.

- Cost of equity: 4.6% + (5% × 0.727) = 4.6% + 3.635% = **8.24%**
- After-tax cost of debt: 8% × 0.65 = **5.2%**
- Blend: (0.146 × 5.2%) + (0.854 × 8.24%) = 0.759% + 7.037% = **7.80%**

My spreadsheet at the time printed 7.10 percent on the same five inputs. I am giving you both instead of the pretty one. I have an MBA and more than thirty years of running businesses, and I still handed out a cost of capital that was off by seven tenths of a point. Do not take one on faith. That includes mine.

Worked, on a project instead of a company. Three comparable firms averaged a swing of 0.747 with their borrowing stripped out. Load this project's own borrowing back on at 40 percent debt and 60 percent equity with a 40 percent tax rate and the swing becomes 1.046.

- Cost of equity: 6% + (7.4% × 1.046) = 6% + 7.74% = **13.74%**
- After-tax cost of debt: 9% × 0.60 = **5.4%**
- Blend: (0.40 × 5.4%) + (0.60 × 13.74%) = 2.16% + 8.24% = **10.40%**

Seven to eight percent for a shoe company. Ten point four for a project. Two businesses, two bars, and neither one is yours.

The question it answers: what does a dollar cost me, and therefore what is the lowest return I am allowed to accept?

What it is for, in one sentence: if a project cannot beat the cost of the money, do not do the project.

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9. Net Present Value

Present value of a year's cash = that year's cash ÷ (1 + hurdle rate) raised to the number of years out

Net present value = total present value − what you put in

Worked. A new product line. Six million dollars on day one, five years of cash, eight hundred thousand of salvage in year five, discounted at a 16 percent hurdle.

Year	Cash	Worth today
1	$600,000	$517,241
2	1,200,000	891,796
3	2,000,000	1,281,315
4	2,600,000	1,435,956
5	3,950,000	1,880,646
Present value		**$6,006,955**
Less what you put in		(6,000,000)
Net present value		**$6,955**

The internal rate of return came out at 16.0379 percent against a hurdle of 16 percent.

So it passes. And the honest answer is still no.

Six million dollars of present value with six thousand nine hundred fifty-five dollars on top of it is twelve hundredths of one percent. Miss year five by $14,608 and the whole thing is zero, and that is four tenths of one percent on a $3,950,000 forecast. The salvage assumption alone is worth $380,890 in today’s money, which is fifty-five times the entire net present value. And the sales forecast in the front of that same analysis uses $5,000,000 and $6,000,000 for years four and five, while the cash flow schedule behind it uses $5,200,000 and $6,300,000. Those are two of my own numbers about the same two years. They are two hundred thousand dollars apart in year four and three hundred thousand apart in year five. The year-five gap by itself is forty-three times the net present value of the project.

A net present value of about seven thousand dollars on a six million dollar base is not an opportunity. It is a coin flip with a spreadsheet stapled to it.

The question it answers: is this project worth more than the money it will consume, once I account for the fact that a dollar in year five is not a dollar today?

What it is really for: it does not usually tell you yes. It tells you when yes is too thin to trust.

The Weighted Decision Matrices, Cell by Cell

The two full matrices from Chapter 24. The chapter keeps the decision and why the winner won. This is the arithmetic underneath it, laid out so you can copy the form onto your own decision.

	Maint Share	Inc Share	Low Overhead	Inc Profit	Ethics
Combine two	6	9	9	9	8
Maintain two	7	5	6	5	9
Sell Carson	2	2	9	5	9
Maintain Reno	5	5	4	5	8

	Maint Share	Inc Share	Low Overhead	Inc Profit	Ethics	**Total**
Combine two	42	90	63	90	72	**357**
Maintain two	49	50	42	50	81	**272**
Sell Carson	14	20	63	50	81	**228**
Maintain Reno	35	50	28	50	72	**235**

One Page, All Nine

Calculation	Formula	Answers
Contribution margin	price − variable cost	What do I keep on one more?
Contribution margin ratio	contribution margin ÷ sales	What do I keep on one more dollar?
Break-even	fixed costs ÷ unit contribution margin, or ÷ contribution margin	How many, or how much revenue, before I stop losing?

Calculation	Formula	Answers
	ratio	
Target profit volume	(fixed costs + desired profit) ÷ unit contribution margin	How many to make what I want?
Special-order test	offered price > variable cost per unit	Take the discounted order?
Operating leverage	contribution margin ÷ operating income	How hard does profit swing?
Free cash flow	cash from operations − maintenance capital spending	How much money do I really have?
Weighted cost of capital	(debt share × after-tax debt cost) + (equity share × equity cost)	What is my lowest acceptable return?
Net present value	discounted cash in − cash out	Is this project worth the money?

Photocopy that table and put it in the drawer of the desk where you approve things.

Appendix B: The Checklist System

This is the template. Take it and change it.

One instruction before you read a line of it. **Do not adopt this appendix as written.** The specific tasks in a health club are not the specific tasks in a print shop or a dental office. What transfers is the shape. Daily, weekly and monthly lists for every position. A two-hour production cycle. One person whose job is to make sure the lists got done and reported. And a revision every month so the thing does not calcify into wallpaper.

Nothing in the shape requires a building, a front desk, or a membership. A three-truck plumbing company can run this out of a phone. So can an accounting office where every position sits at a desk, and so can a company where the whole staff works from home. What the system needs is four things. Named positions. Named tasks under each position. A fixed interval. And one person who reads the reports.

Here is the translation, and you should do it on paper before you read the sample lists. Wherever I say member, write the word your business uses for the person who pays you. Wherever I say club, write the word for the place or the crew where the work happens. Wherever I say general manager, write the name of whoever is responsible when that work goes wrong. If nobody's name fits that last one, you have found something more important than a checklist.

I am handing you a mix of documented fact and reconstruction, and you should know which is which.

What is documented is the architecture: the daily, weekly and monthly lists for every position, the two-hour cycle, the two favors, the two appointments, the general manager's report, the automatic projection reports it feeds, the monthly revision, the online site, and five of the fourteen training DVD topics. Those are the things I wrote down at the time and can put my name to without qualification. Chapter 16 is where I explain all of it and defend it. This appendix does not argue. It hands you the shape.

What is a reasonable reconstruction is the individual line items on the sample lists below. I do not have the 2004 checklists in front of me and I am not going to pretend that I do. What follows is what a front desk, a sales representative and a general manager list looked like in practice, rebuilt from the system I ran and the training we gave. Treat the line items as an illustration of the right grain size, not as an artifact.

What is current is the present-day version printed beside each sample list. We do not pressure sell anymore and we do not run on cold calls. The checklist survived both of those changes without a redesign. What it carries now is great service, a clean club, personal training presentations, and services done for members. The numbers on those items belong to the club that sets them, so I have left them for you to fill in.

The Architecture, As It Actually Ran

Nevada Fitness had daily, weekly and monthly checklists for every position in the company. The lists were online. Every staff member completed and recorded theirs every two hours.

The general manager of each club monitored all staff checklists in the building, submitted his or her own checklist to the online site every two hours, and filed the club’s report from the staff checklists. The general manager’s job was to make sure all checklists got completed and reported. The staff and general manager checklists guided the general manager’s decision making.

The regional managers and I could retrieve the general managers’ checklists online every two hours, from anywhere, and direct the general managers in their decisions. Chapter 16 works the arithmetic on what that interval buys. The short version is that it finds a problem up to one hundred fifty times faster than a month does.

The lists were on a staff-only web site. Members never saw any of it.

Decisions were made according to the priorities on the checklist. The list is a priority order, not a to-do list, which is the part most people copying this leave out.

All checklists were modified by a representative monthly. The stated reason was to keep pace with changes in the industry and to continue the learning process for the operator. Twelve rewrites a year, by design, not once when somebody complains.

Here is the blunt reason it exists, because somebody always asks and I would rather say it than have it discovered. Most people procrastinate. The two-hour updates are production requirements. If people are not directed what to do each hour of the day, they will do nothing. That is not an insult and I include myself in it. Chapter 16 answers the objection to that sentence in full, and it is a fair objection.

The Two Production Requirements

Every business has exactly two production requirements worth putting on a repeating clock. One is a small unexpected kindness to a customer you already have. The other is a booked appointment with a customer you do not have yet. Everything else on a checklist is maintenance. Those two are growth, and they are the two I would carry into any business.

Here is what they looked like in my clubs.

Every staff member does two favors for a member every two hours. A favor is going above and beyond what the member expects. A staff member walks up to a member and says thank you for your business, I would like to give you a free t-shirt, and hands over the t-shirt. That is one. Two of them, every two hours, by everybody in the building.

Every sales representative books two appointments to show the club every two hours. Not two conversations. Two appointments on a calendar.

Write your own version of both. A restaurant manager comps a dessert and says thank you for coming in on a Tuesday. A contractor calls a customer from six months ago to ask how the roof held up in the last storm. A dental office books two new patient consultations. The appointment does not have to be a tour. It has to be a time, a name, and a place on a calendar.

What those two requirements are now. We do not pressure sell anymore in the health club business. We still do the checklist, and the concept is still my foundation. We just use the checklists to accomplish different objectives that lead to the same goals. The kindness is a service done for a member. The booked appointment is a personal training presentation. Marketing is different now, so the prospecting number is social media posts instead of phone calls. On top of those sit the two things a day has to produce, which are great service and a clean club. Same two requirements. Different words on them.

That is the whole reason I am handing you a shape instead of a list. The tactics the shape was built to serve are gone and the shape is not.

Do the arithmetic on a ten-hour staffed shift, which is what our clubs ran. Five two-hour blocks. Ten favors per staff member per day. Ten appointments per representative per day. Two representatives in a building is twenty appointments a day, or six hundred a month out of one club. Multiply by the number of people on the floor and you can see why a club that ran the system and a club that did not were not in the same business. If your day is eight hours, it is four blocks and eight of each. Use the number of blocks your hours actually give you.

Three Sample Lists, And How To Read Them

The three lists below are the three positions every business has, whatever it calls them. The first person a customer deals with. The person who asks for the business. The person who is responsible when neither of the first two happens.

In a club those are the front desk, the sales representative and the general manager. In a restaurant they are the host, the manager who books the private parties, and the general manager. In a two-person contracting company one man holds all three, and he still needs all three lists, because the list is what keeps the second job from eating the first.

Read the lists for grain size, not for content. Notice that no item takes more than a few minutes, every item produces something you could point at, and the order is a priority order. Then write yours.

Each list below carries the 2004 items, which are the ones the stories in this book come out of. Under each one, marked separately, is what the same block carries today. Put your own numbers on the present-day items, because the number belongs to your business and not to mine.

Sample Daily Checklist: Front Desk

Reconstruction. The two-favors item is documented. The rest illustrates the grain size.

Every two hours: 1. Two favors for members. Write down the member’s name and what you did. 2. Greet every person entering by name where you know it. 3. Walk the floor once. Rack loose weights, wipe machines, restock towels. 4. Check the restrooms and the locker rooms. Note anything the maintenance person needs. 5. Log any member complaint, with the member’s name and what was said, whether or not it was resolved. 6. Report.

Once a day: 1. Open or close per the position sheet. 2. Reconcile the register against the point-of-sale totals. 3. Pass any billing or draft problem to data entry before the end of shift. 4. Confirm tomorrow’s appointments for the sales staff.

The same block today: 1. Two services done for a member, written down by name, in place of the two favors. 2. The floor walked and left clean. Racked, wiped, restocked, not noted for somebody else. 3. The restrooms and the locker rooms corrected on the spot where the person can correct them. 4. Everything else on the list above stays where it is.

Sample Daily Checklist: Sales Representative

Reconstruction, except the two-appointment requirement, which is documented.

Every two hours: 1. Two appointments booked to show the club. 2. Two favors for existing members. 3. Every walk-in gets a full tour. Log the name and the result. 4. Follow up on every prospect from the previous day who has not signed. 5. Report.

Once a day: 1. Ten calls to the corporate list. 2. Update the prospect log with next action and date for every open name. 3. Confirm tomorrow’s appointments personally, not by message.

Weekly: 1. Review the week’s appointment-to-sale conversion with the general manager. 2. Watch or rewatch one membership sales training DVD segment.

Monthly: 1. Sit with the general manager on the month’s numbers against target. 2. Review the revised checklist for the coming month.

The same block today: 1. Personal training presentations given, at the number the club sets, in place of the two appointments. 2. Two services done for a member, in place of the two favors. 3. Social media posts made, at the number the marketing plan sets, in place of the ten calls to the corporate list. 4. The tour, the prospect follow-up and the report do not change.

Sample Checklist: General Manager

Reconstruction, except the two-hour report and the responsibility for all staff checklists, which are documented.

Every two hours: 1. Pull every staff member's checklist in the building. 2. Confirm the favors and the appointments actually happened. Spot-check one. 3. Note any position that is behind and correct it now, not at the end of the day. 4. File the club report.

Once a day: 1. Walk the entire floor at open and at peak. 2. Review yesterday's new memberships, cancellations and gross. 3. Handle any complaint logged by the front desk that is still open. 4. Confirm the maintenance person's five hours were worked.

Weekly: 1. One-on-one with each sales representative on their conversion numbers. 2. Staff meeting. Read the mission statement out loud. Yes, out loud. 3. Training session using one of the DVDs. 4. Inventory check on the pro shop.

Monthly: 1. Full month against target on dues sold, new memberships and total gross. 2. Send the club's changes for next month's lists to the representative who rewrites them. 3. Performance conversation with every staff member.

The same block today: 1. Confirm the services and the presentations actually happened. Spot-check one. 2. Walk the club and confirm it is clean. Do not take a checked box for that one. 3. Pulling the checklists, correcting what is behind, and filing the report do not change.

What the Two-Hour Report Contains

Documented in part, reconstructed in part. The reporting cycle and the automatic projections are documented. The exact field list is my reconstruction of what those projections required as inputs.

The report is not a narrative. Nobody reads narratives every two hours. It is a set of counts, and the counts feed the projections automatically.

Whatever you sell, the report has six categories and only six. What was sold. What recurring money was added. What was lost, with the reason. What money came in outside the main line. Who is behind. What is broken. A dental office, a body shop and a staffing agency can all fill those six in under two minutes. The fields in the table below are my six, written in club language.

Field	What it captures
Appointments booked this block	By representative
Tours given this block	By representative
Memberships sold this block	Count and dollar value
New monthly dues sold	The residual, which is the number that compounds
Favors completed this block	By staff member
Cancellations taken	Count and stated reason
Personal training sold	Count and dollar value
Pro shop and other gross	Dollars
Total gross for the day so far	All categories
Positions behind on checklist	Named, with the correction applied
Anything broken	Named, with who was told

If you are running the present-day list, the appointments row becomes presentations given, the favors row becomes services done, and marketing posts get a row of their own. The six categories do not change. That is the point of building a report out of categories instead of out of this year’s tactics.

From those inputs the system generated projection reports on its own for new monthly dues sold, new monthly membership sales, and total daily gross in all categories. That automation is the part that makes the whole thing survivable. A general manager who has to build a report every two hours will quit in a month. A general manager who has to file counts every two hours will do it for years.

What the Regional Manager Does With It

Reads it, and acts inside the same day.

That is the entire answer, and it is the reason the system is worth its cost. Bruce Gimple was our Regional Manager and John Gutierrez was our Regional Customer Service Manager. In 2004 the three of us could pull any of the five clubs' reports at any hour. A club that had booked zero appointments by ten in the morning got a phone call at ten fifteen. A club showing four cancellations in one block got a phone call about the reason field.

The regional manager also catches the pattern a general manager cannot see from inside one building. Five clubs reporting the same weak block on the same weekday is not five problems. It is one problem, and it is usually a staffing schedule.

If you run one location, or one crew, that reader is you. The job does not disappear because the company is small. It just does not get a title. Somebody has to read the counts the same day they are filed, and somebody has to pick up the phone at ten fifteen. If nobody does, you have a filing system rather than a management system.

The Fourteen Training DVDs

We made fourteen different training DVDs. Each topic featured an expert, or the person most qualified to train in that area. The argument for filmed training is in Chapter 16 and it has nothing to do with saving money.

Five of the fourteen topics are documented:

1. Data entry
2. Collections
3. Customer service
4. Personal training sales
5. Membership sales

The DVDs also trained all staff members on how to plan and complete the tasks on their individual daily, weekly and monthly checklists. That is documented too. My own recollection, which is not a document, is that the training covered what a favor is and how to do one, and how to ask for an appointment.

We also set up a video telephone system so consultants could give instruction to members twice a day. That was 2004 technology. Whatever the equivalent is on your desk now will do the same job better.

I am not going to invent the other nine for you, and I would not want you to use mine if I could remember them. Here is the better instruction. **The remaining topics are the ones your business has to name for itself.**

Do it this way. List every task in your company that, done badly, costs you real money. Now sort that list by how often a new person has to do the task in the first thirty days. The top of that sorted list is your filming schedule, and the person who films each one is not the manager. It is whoever in your company is genuinely the best at it, even if that person has no title at all.

Before You Copy Any of This

One warning, and it is the one I would give first if you only read a page of this appendix.

Do not use these lists to micromanage. It stifles a staff member's creative juices, and people need some freedom to create.

Every list above says **what** has to happen. Not one of them says **how** the person does it. Two favors every two hours is the requirement. What the favor is belongs to the employee, and the best ones I ever heard about were things I would never have thought to write down.

Keep the list short enough that there is room above it. If yours gets longer every month and nothing ever comes off, or if items start describing manner rather than action, you have crossed from clarity into a cage. Chapter 16 has the three warning signs in full.

And leave real time unassigned. Every employee needs some of their day to use their own skills and abilities to make the company better. The monthly rewrite above only works if somebody had an hour in which to notice the better way. Fill every hour with your tasks and there is nothing left to rewrite from.

The Rule Under All of It

A checklist is not surveillance. A checklist is clarity.

The most disrespectful thing you can do to an employee is hand them a vision and no instructions and then be disappointed in them. I have watched a highly experienced, highly recommended general manager refuse this system and cut a club’s new sales in half in the time it takes to repaint a lobby. That story is Chapter 22 and it cost about thirty thousand dollars.

Write down what everyone is supposed to do in the next two hours. Then check.

Then leave them alone and find out what they do with the rest of it.

Appendix C: The Two Surveys

Here are both instruments. Copy them.

I designed these myself in 2004 and ran them across all five clubs. The entire cost of the project was paper. I say that in Chapter 18 and I am saying it again here because the single most common reason a small business does not measure satisfaction is that somebody quoted them a price for it. Nobody needs to quote you a price for this. It is twelve statements and a photocopier.

Neither instrument is about fitness. The first one asks a customer whether you are doing the job. The second one asks an employee about the person they report to. Every business on earth has both of those questions sitting unanswered, and most owners guess at them for a whole career.

Two rules govern the design and everything else follows from them.

The customer survey is short because a long one is an inconvenience to the customer. Five statements. That is deliberate. Whoever your customer is, you are asking for a favor while they are on their way somewhere. A member standing at my front desk with a gym bag will answer five things. He will not answer twenty, and if you make him try, the twenty answers you get back will be worse than the five you would have gotten. The same is true of a diner waiting on a check and a homeowner standing in a driveway next to a work truck.

The staff survey runs upward and it is anonymous. Each staff member evaluates their supervisor, not the other way around. Anonymous is not a courtesy. It is the mechanism. Take the anonymity away and staff members write things they think their supervisor wants to hear, and then you have paid for paper to be told you are doing great.

Instrument One: The Customer Survey

This is mine, word for word, as my members answered it. Rate each statement on a scale of one to ten. Ten is the best and one is the worst.

1. *The club is clean.*
2. *The staff is friendly.*

3. *The staff handles problems promptly.*
4. *The staff helps me with my fitness goals.*
5. *I am satisfied with the club.*

That is the whole thing, and it is word for word what Chapter 18 prints.

Now translate it, because only one of those five statements is about fitness at all. Here is what each slot is doing.

Slot	What it measures	Mine said
1	The condition of whatever the customer sees or receives	The club is clean
2	How your people treat them	The staff is friendly
3	What happens when something goes wrong	The staff handles problems promptly
4	Whether you deliver the one thing they hired you for	The staff helps me with my fitness goals
5	The overall verdict, and it must be last	I am satisfied with the club

Slot four is the only one you have to write from scratch. A dental office writes something about comfort during treatment. A roofing contractor writes something about the crew finishing when they said they would. A restaurant writes something about the food. Everything else you can use as it sits, with your business name in place of “the club.”

One honest note on the wording. In my own records these last two statements appear two ways, once as “the staff helps me with my fitness goals” and “I am satisfied with the club,” and once as “the staff helps with my fitness goals” and “I am satisfied with Nevada Fitness.” They are the same questions with the company name swapped in and a word dropped. I am printing the version above because it is the one that generalizes. If you are wondering whether a difference that small matters, it does not, but you should still write your five statements once and then never change a word of them again. The moment you reword a statement, this year’s score stops being comparable to last year’s, and comparability is most of the value.

Instrument Two: The Staff Survey

Each staff member rates their own supervisor. Anonymous. Rate each statement on a scale of one to ten. Ten is the best and one is the worst.

1. *The supervisor uses a positive inspiring approach in helping staff members grow and improve.*
2. *The supervisor is effective in communicating the business goals, objectives and vision.*
3. *The supervisor is well respected.*
4. *The supervisor manages people well.*
5. *The supervisor is fair and impartial.*
6. *The supervisor is well organized.*
7. *I am happy in my job.*

Now the honest part, before somebody notices it for me.

I proposed ten statements for the staff evaluation. Seven are what we recorded and reported. I do not have a good record of which three were dropped or why, and I would rather tell you that than pretend the plan and the execution matched. They usually do not. I am not going to invent three statements twenty years later and present them as though they were part of the original instrument.

If it bothers you, here is what I would tell you to do with the gap. Do not fill it with three more statements about the supervisor. Seven is already enough on that subject. If you want to add anything, add statements about the things your particular business lives on, and add them the same way these are written. Flat. Declarative. Rateable one to ten. No compound sentences, because a staff member cannot rate “my supervisor is fair and communicates well” when the answer to one half is nine and the other half is four.

Notice what the seventh statement is doing, by the way. Six statements about the supervisor and then “I am happy in my job.” That last one is the control. When statements one through six come back high and statement seven comes back low, you have learned something you could not have learned any other way, which is that the problem is not the manager.

How to Run Them

1. **Customers: about three hundred per location.** That is what we did. Three hundred members in each of five clubs. If you run one location, three hundred is still the right order of magnitude for a business of a few thousand customers. If you serve two hundred customers a year, survey all of them. Otherwise do not survey everybody. You do not need to and the response quality drops.
2. **Staff: everybody, and truly anonymous.** No names, no handwriting anybody recognizes, no handing it back to the person being rated. If a supervisor has three subordinates, be careful, because three responses are not anonymous no matter what you write on the form. In a small team, collect the forms centrally and report only the averages.
3. **Average the scores.** Statement by statement, manager by manager, location by location. That is all the arithmetic there is.
4. **Check the median against the average.** When we ran ours, the answers ranged across the full scale from one to ten, and the median was within half a point of the average on every statement. That check matters. If your median and your average are far apart, one loud group is dragging the number and the average is telling you a story that is not true of most of your customers. Go look at the distribution before you act on anything.
5. **Run it again.** We tested reliability by running it and running it again and comparing. A single survey is a snapshot. Two surveys six months apart is a measurement.

What Ours Came Back As

I am printing this so you have something to compare against, not because your numbers should look like mine.

	Clean	Friendly	Prompt	Helpful	Satisfied
All-club average	**6.74**	**8.64**	**8.16**	**8.53**	**8.69**

Five areas surveyed and exactly one weakness. Cleanliness, at 6.74, sitting almost two full points under everything else.

Here is why I keep telling that story. **Nobody had complained about it.** Not one member had walked up to a front desk and said this place is dirty. We were running about thirty-five cancellations a month per club against a national average of about seventy, and the lowest thing our members rated was the one thing not one of them had ever said out loud to us.

The staff survey did the same thing in the other direction. Our Regional Manager averaged 8.66 across the seven statements, the second highest of the eight managers rated. He scored 9.3 or better on five of them. He scored 5.6 on “well organized,” which was the lowest single score in the entire company. Nobody had ever told him that either.

That is what these instruments are for. Not for the things people complain about. You already know those.

The Rule This Appendix Exists to Enforce

We hired a maintenance person in every club to clean five hours a day, on top of the cleaning companies that were already coming in nightly. That decision cost real money every month and it came directly out of a 6.74.

Which brings me to the only sentence in this appendix I would underline.

A survey you do not act on is worse than no survey.

Not equal to. Worse. Running one and doing nothing teaches every customer and every employee who filled it out that you asked and did not care, and you will not get an honest answer out of those people again for years. You have spent your credibility to buy a number and then thrown the number away.

So before you photocopy anything, answer this. If the results come back and one area is two points below the rest, are you willing to spend money on it in the next thirty days?

If the answer is no, do not run the survey. Save the paper.

Appendix D: Questions for Thought and Reflection

Each chapter ends with one thing to do now. These are all five from every chapter, including the one the chapter ended on. They are here rather than in the chapters so that a person reading straight through is not stopped five times a chapter, and so that a person who wants to sit down and work can find all of them in one place. Take them a chapter at a time. Write the answers down. An answer you only thought about is the same as no answer, which is the argument of the whole book.

Chapter 1: Task, Objective, Goal

1. Write your longest goal in one sentence. Does it contain a number and a date? Could a stranger tell you a year from now whether you reached it?
2. Take that goal and do the divisions out loud. What does it require this year, this month, this week, today, and in the next two hours?
3. Look at the number your ladder produced at the bottom. Is your current standard set at that number, or above it? What happens to your month when three days go badly?
4. Take the most important repeating task in your company and ask where its number came from. Was it derived from a funnel, or did somebody decide it sounded like a good day’s work?
5. How do you currently know that a task was completed rather than reported? Name the person who confirms it, and make sure it is not the person who did it.

Chapter 2: Nobody Is Waiting for Your Business

1. What percentage of the population in your market will ever buy your category of product from anyone? Do you know the number, or are you guessing? Who publishes it?
2. Draw the circle. How far will your customer travel to reach you, in minutes rather than miles? What population is actually inside that circle?
3. List every competitor inside that circle and write down how many customers each one has. If you cannot fill in a single number, what does that say about how ready you are to open?

4. Subtract. What is left? Is what is left bigger than the number of customers you need to survive, and by how many times?
5. Name one segment of your market you believe exists because it feels true. What would it cost you to count it before you bet on it?

Chapter 3: The Seventy-Nine Thousand Dollars

1. What does it cost you to open the doors, to the dollar? What does it cost you to exist for one month with zero customers?
2. How many months of that monthly number do you have in the bank right now? Say the number out loud.
3. Your revenue projection: what happens to your business if it is correct but arrives four months late? Does the business survive that, or just the plan?
4. If you have already borrowed, how much of what you borrowed did you spend on things you could have waited on? Would you make the same call today?
5. Write down, today, the loss and the date at which you would stop. Who else has a copy?

Chapter 4: Shop Them Yourself

1. When did you last physically walk into a competitor’s place of business? Not their website. Their building.
2. Name your three closest competitors. How many customers does each one have? If you do not know, what would it take to find out this week?
3. Pull your main competitor’s price list and read it as a confession. Where is the price high relative to the work involved, and where is it low? What does that tell you about where their money is made?
4. What is your own average revenue per customer, versus your advertised price? How far apart are those two numbers, and would an outsider guessing from your price sheet be wrong about you?
5. Where is your line on posing as a customer? Write it down before you need it, not after.

Chapter 5: Price Is a Decision, Not a Discovery

1. What is your price actually for? Write down which of the five objectives you are using, and if you cannot name one, you have not made a decision yet.
2. What does it cost you to acquire one customer, and is your up-front charge above that number or below it?
3. What is your ratio of recurring revenue to one-time revenue, and did you choose that ratio or did it just happen to you?
4. How much revenue walks out your door every month before you sell anything, and does your sales staff know that number by heart?
5. At what number of customers does your current price stop working, and what is the date by which you must hit it?

Chapter 6: Two Thousand Members Before the Doors Opened

1. Before you spend money on the thing you are building, what is the smallest test that would prove a stranger will pay for it?
2. What exactly have you committed to deliver, and are you selling anything beyond that list?
3. What is your target number, where did it come from, and is it written somewhere your whole team can see it every day?
4. What number by what date would mean you should not open, and who besides you has the authority to call it?
5. If every deposit holder asked for a refund tomorrow, could you give it back today?

Chapter 7: Who Owns What

1. Does any partner in your business own a piece of one part instead of a piece of the whole, and what happens to that person when that part underperforms?
2. If you had to close or sell one unit tomorrow, does anything in writing tell you who decides and how the losing party is made whole?
3. Which of your business lines carries financial risk and which carries reputational risk, and are they reported separately?
4. Who in your company is consulted, and who actually decides? Can everyone on your leadership team answer that the same way?

5. When was the last time you read your own operating agreement, and would it survive the worst month you can imagine?

Chapter 8: The Plan Is a Map, Not a Fairy Tale

1. Take your three most important objectives. Do all three have a number and a date? Cross out any that do not, and see what is left.
2. What is the single assumption your business plan most depends on, and how many different ways have you worked it?
3. Write your main business claim as a hypothesis with a symbol and a threshold. What result would prove you wrong?
4. Who outside your company has read your plan and told you what they did not understand?
5. When did you last update the plan, and does the version your staff is working from match the one in your head?

Chapter 9: Your First Hire Is Your Whole Culture

1. Ask your newest employee to recite your mission statement without help. What did they say, and what does that tell you about the one you wrote?
2. Can your mission be turned into a specific task that a specific person does at a specific time today? If not, what is it for?
3. What did your company do in its last genuinely hard week, and what did your staff learn about you from it?
4. Which behaviors in your business trace directly back to your very first hire, good ones and bad ones alike? Name one thing you let go by once and can no longer get rid of.
5. Does every person on your payroll know what a good day looks like in their job, stated as a number?

Chapter 10: Money Is Labor Stored

1. Pick one employee and one eight-hour shift last week. Can you name the specific thing a customer received because of that shift? If you cannot, whose fault is that?
2. What percentage of your payroll is paid for presence, and what percentage is tied to something you can count?

3. Where is your business currently digging a hole behind the building? Name the task, not the person.
4. If the money in your account is stored labor, whose labor is it, and what do you owe them?
5. What would change on Monday if every person in your company knew exactly what they were supposed to produce in the next two hours?

Chapter 11: The Only Number That Tells You Whether Growth Helps

1. What is one “unit” in your business? A month of service, an order, a seat, a job? Write it down before you do anything else.
2. When you sell one more of that unit, exactly what costs go up? List them. Then check whether each one truly goes up, or whether you are counting a fixed cost twice.
3. What is your contribution margin ratio? If you have more than one product, which is your highest and which is your lowest?
4. Are you pushing volume on your lowest-margin product because it is the easiest thing to sell?
5. If your sales went up ten percent next month, how much more would you keep? Answer with a number, not a feeling.

Chapter 12: Break-Even, and the Order You Should Take at a Loss

1. What is your break-even, in units, this month? Not in dollars of sales. In units, because units are what your people can actually go get.
2. If you wanted an extra two thousand dollars of profit next month, how many more units is that? Does everyone who could go sell them know that number?
3. What is your real capacity, and how would you know you were near it? Name the physical thing that runs out first.
4. Look at the last discount you gave. Did it fill a seat that was empty, or did it move a customer who was already paying you more?
5. If one of your major variable costs went up ten percent tomorrow, how many more units would you have to sell just to stay even?

Chapter 13: Fixed Cost Is a Promise You Already Made

1. Write down every fixed obligation in your business on one page, with the amount and the date it ends. How long did that take, and why have you never done it?
2. What percentage of your total monthly cost is fixed? Is your business built to survive a slow quarter, or only to enjoy a fast one?
3. Run your own numbers with sales down ten percent. Are you still profitable? At what point do you stop being profitable?
4. Which line in your projection are you least sure of? Move it fifteen percent the wrong way and look again.
5. What is your reserve, in months of fixed cost? If the answer is zero, what would you have to stop doing to make it two?

Chapter 14: Profit Is Not Cash

1. Do you know, without calling anyone, what your bank balance will be thirty days from today? What about ninety?
2. Last month you made a profit. Where did the cash go? Name the five lines: receivables, inventory, equipment, principal, and depreciation added back.
3. What does it cost you every year, in real checks, simply to keep your business the same size it is today? If you cannot answer that, you do not know your free cash flow.
4. Is there a part of your business right now that you are calling unprofitable when it is really a cash flow problem? Would you act on a different timetable if you called it what it is?
5. Whose money is in your business besides yours, and what would they say about how closely you are watching it?

Chapter 15: What a Dollar Costs

1. What number would you have to be offered, guaranteed, to sell your business tomorrow and put the cash somewhere else? That number tells you what your equity costs you every year.
2. Write down your hurdle rate. Not a feeling. Five inputs and two multiplications, on paper, this week. What did you get?

3. Look at your last three capital purchases. Did any of them have to clear a stated rate before you approved them, or did they only have to be “a good idea”?
4. Is there something in your business right now earning six percent while your money costs you ten? What would you do with the proceeds if you sold it?
5. When your next project’s numbers come out barely positive, who in your company is allowed to say “this is a coin flip” without it hurting their career?

Chapter 16: Two Hours at a Time

1. Write down what the newest person in your company is supposed to accomplish in the next two hours. Could that person write the same list without your help?
2. At what interval do you actually find out that something has gone wrong in your business? Not when you would like to. When you do. How many hours of production go by before you know?
3. Who trains your new hires right now? Is that your best person at that job, or your most available person? What would it take to record the best one doing it right, one time?
4. Pick the single most important repeating task in your business. Is it stated as a number, with a clock on it, or as an attitude?
5. If you installed a reporting system tomorrow, would you personally read the reports every day for the next year? If the honest answer is no, what three things will you read instead?

Chapter 17: Measure What Moves

1. Take the loudest complaint in your business this month and walk it up all four rungs. Standard and actual. When and where. Dollars per year. The goal. Can you finish it, or do you not have the data?
2. Pick one thing your customers wait for. Is it slow on average, or is it inconsistent? Do you have thirty measurements that would let you tell the difference?
3. Last time an employee had a bad result, did you find out whether it was a bad day or a bad system before you talked to them?

4. Write down the four or five numbers your best manager is judged on. Which one could they move next quarter by damaging something you are not measuring?
5. Of everything currently on your team’s task list, how many items can you trace back to something a customer actually said they wanted? What are you going to do about the rest?

Chapter 18: Ask, Don’t Assume

1. What are the five things you would ask your customers to rate one to ten? Write them down right now. Is the fifth one the overall question, and are the first four things you could actually change?
2. Who in your company has never been rated by the people who work for them, and why not? Is your name on that list?
3. What is the last complaint you acted on, and do you have any evidence that the thing complained about is one of your actual weaknesses?
4. If your best manager came back with the lowest score in the company on one statement, do you know today what you would do about it? Would you say the number to him out loud?
5. Before you print the survey, answer this: what result would cost you money to fix, and are you willing to spend it? If not, what is the survey for?

Chapter 19: A Leader Is Someone Who Has Followers

1. In your business, where do the questions actually go at four in the afternoon when something breaks? Is that the same person whose title says it should be?
2. Write down every commitment you made to an employee in the last thirty days, and mark which ones you closed. What is your percentage, and what would your staff guess it is?
3. Think of the last thing that went wrong with a customer. Separate it honestly into fault and responsibility. What is on your side of that line that you have never addressed?
4. If your power in this company shifted tomorrow, which of your people would stay because they believe in where you are going, and which would settle a score?

5. What is the one task in your business you consider beneath you, and when was the last time you did it in front of somebody?

Chapter 20: Employees Come First, and They Know It

1. The last time one of your employees enforced a rule and a customer complained, who won? What did the rest of your staff learn from watching?
2. Does every person on your payroll know, in dollars, how much they may give a customer without asking permission? If not, what are they doing right now when it comes up?
3. Name a rule in your business that your employees quietly do not enforce anymore. Why did they stop, and what did it cost you to find out this way?
4. What do your best employees actually want from you? Do you know, or are you guessing from your own preferences?
5. If you back your people, what are they required to produce in return, stated as a number on a clock? If there is no such number, you have not built employees-first. You have built a nice place to work.

Chapter 21: The Customer Is Not Always Right

1. Does the phrase “the customer is always right” appear anywhere in your business, on a sign, in a handbook, or in the way a manager talks? What rule does it currently override?
2. Name a situation this month where two of your customers wanted opposite things. Who decided, on what basis, and did the loud one win?
3. What is a customer worth to you over twelve months? Write the number down. Does the person authorized to say no to a credit know that number?
4. What is the last thing your business did for a customer that it was not obligated to do at all? If nothing comes to mind, you are not producing service, you are only avoiding complaints.
5. Is there a customer in your business right now whose business you should not want? What is stopping you from letting them go?

Chapter 22: The Man from Lake Tahoe

1. Write the job description for your next hire. Does it contain a number, a level and a date, or does it contain adjectives? Cross out every adjective and see what is left.
2. In your last interview, did you put your actual system on the table and ask the candidate what they thought of it? What would you have done if they had asked for latitude?
3. What are the two numbers your newest manager exists to move? Do they know those two numbers, and did they know them before their first day?
4. Think of the last spending request you approved from an underperforming manager. If your best performer had asked for the same thing at his numbers, would you have said yes?
5. How long did it take you to act on the last piece of bad news your reporting system gave you? Not to see it. To act on it.

Chapter 23: Why Smart People Keep Paying for a Bad Decision

1. Name one thing in your business right now that you would not start today if it were sitting in front of you fresh. What is it costing you every month you keep it?
2. For your last major decision, who approved it and who is scheduled to review it? If those are the same person, what will you change?
3. Write the kill number for your newest project in one sentence, containing a figure and a date. If you cannot, do you actually know what success looks like?
4. The last time somebody behind on their numbers asked you for money, would you have approved that same request from somebody ahead of theirs?
5. What is the longest a failing decision could run in your company before you would find out about it? Is that number hours, weeks, or a quarter?

Chapter 24: Decide Like It Matters

1. Write down the problem you are working on right now. Then ask what would be different if it were solved. Did you write a problem or a symptom?

2. List the criteria for your next real decision and weight each one from one to ten. What does that weight table say about you that you did not intend to say?
3. Is “do nothing” on your list of alternatives, and did you actually score it? If not, you have left off the option you are most likely to choose.
4. Take your last big decision and ask honestly whether you had already made it before you analyzed it. How would you know?
5. Who in your company is closest to the customer and closest to the work, and when did you last let one of them change your timing?

Chapter 25: Know When to Kill It

1. Is there a unit, a product, or a line in your business that you would not start today? Say out loud what you believed when you started it, and whether that belief is still true.
2. For the newest thing you have started, what is the number and the month at which you will admit it did not work? If you cannot answer, you have not set a deadline, you have set a hope.
3. If you closed your weakest location tomorrow, where would the recurring revenue go? Would it follow you, or would it evaporate?
4. If you had to shut something down next month, could you name where every employee was going before you announced it?
5. In your last shutdown or cutback, how much of the savings did you actually get, and how much of the new revenue you promised yourself ever showed up?

Chapter 26: Grow, Stop, or Sell

1. What is the total addressable market for your business, as an actual number of customers? If you cannot produce that figure, you do not know whether you are growing or just taking turns.
2. If you opened one more location tomorrow, how many of its customers would have bought from you anyway? What is that worth per month, and what new fixed cost are you paying to house them?
3. Is your average revenue per location going up or down? When did you last look at that instead of the total?

4. If a buyer walked in on Monday, which of the five things they are buying could you hand over without a scramble? Which one would take you two years?
5. Which of the three doors are you actually in right now, and when did you last choose it on purpose rather than by habit?

Chapter 27: Whose Business Is It?

1. What is your number? Not your goal. The monthly figure at which you would say the word "enough" out loud and mean it. Have you ever written it down?
2. In the last three years, how much did your income go up, and how much did your standard of living go up? Which number is bigger?
3. Name one decision in your business you are currently unable to make cleanly because of what it would cost you personally.
4. If everything you are managing was handed to you rather than generated by you, what is your accounting going to sound like?
5. What is the one thing that, if you did it every two hours for the next year, would change your business more than anything you are currently planning?

About the Author

Steve Main is the founding partner and chairman of the board of Main Corp Enterprises, Inc., the Nevada company he founded in October of 1994.

He started it with borrowed money. Seventy-nine thousand dollars, of which he spent twenty thousand to open a health club in Carson City and left the rest sitting in reserve where he could not get at it. He repaid the entire loan with interest before the end of the following year. He has told the story in every book he has written and he tells it the same way every time, because the lesson is not the twenty thousand. It is the fifty-nine thousand that never got spent.

He sold memberships from a table in the unfinished building through the fall of 1994, and the club opened in February of 1995 with two thousand members. By 2004 the company had grown to five clubs, Sparks, Reno, Carson North, Carson South and Minden, after the two ladies-only clubs were consolidated in August of that year. More than fifteen thousand members. An annual gross over five million dollars. Monthly gross over four hundred thousand dollars, up from about fifty thousand dollars a month when there was one building and one payroll.

Today Main Corp operates Parkway Athletic Club, six clubs across South Reno, Downtown Reno, Sparks, Carson City, Fernley and Fallon. Main Corp also owns the Fitness For $10 brand and licenses it to independent operators for a fee. That is why there are Fitness For $10 clubs in Arizona, Florida, Minnesota, Nevada and Canada that he has never set foot in. Two brands, one parent company, two entirely different businesses.

He has started more than ten businesses over the years, and he will tell you plainly that his projections have never once been right on any of them.

He earned his undergraduate degree at California State University, Chico, finishing in 1986. His first job out of college was in a Marriott spa. There he watched employees get written up for politely enforcing a rule. That is where he formed the conviction about employees he has argued for ever since, and it is the most contested chapter in this book. He returned to school nearly twenty years later and took an MBA from American Intercontinental University in 2005, while running five health clubs. He holds a Six Sigma Green Belt through Villanova.

He is the author of four previous books.

He also hosts *Vitality and Wellness*, a health and fitness channel for adults over fifty. That is a natural place for a man who has spent more than thirty years watching what actually gets people into a building and back again the following Tuesday.

He lives in Nevada. He owns one residence, on purpose.

Other Works by Steve Main

Steve Main is the sole author of all four of the following books.

Total Health Club Management. The operating manual for the health club business, written from inside it. Market entry, pricing, presale, staffing and the day-to-day mechanics of running a club that makes money. It is the most technical of the four, and it is where the pattern of ending every chapter with questions for the reader’s own business began.

A God-Made Millionaire. What money actually is, and how a person of faith should think about acquiring it. This is the book where he lays out that money is labor stored, that the value of labor is what it produces, and that a man ought to live below his means and not raise his standard of living in proportion to his income.

Managing and Growing God’s Resources. The stewardship book. The content point, the budget formula, and the categories a person’s money divides into once he has decided the money is not ultimately his. If Chapter 27 of A Goal Without a Plan Is Just a Dream interested you, this is the long version of it.

Leadership. Short, direct, and built on one definition: a leader is a person who has followers. Everything else in it follows from that sentence, including his four requirements for earning respect and his distinction between fault and responsibility.

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Every one of these is reachable from stevemain.com. If you are reading this years from now and one of the addresses above has moved, start there.