A Goal Without a Plan Is Just a Dream

Starting, Running, and Leading a Business

Steve Main

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Published by Double Diamond Press
Reno, Nevada
stevemain.com

First edition, September 2026. Revised November 2026

Printed in the United States of America

ISBN 979-8-1740712-8-5 (paperback, 6 x 9 edition)
ISBN 978-0-9846664-1-6 (ebook)

10 9 8 7 6 5 4 3 2 1

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've been saying that sentence for years, 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's a second half to that sentence, and almost nobody says the second half.

The plan must also have a timeline, or it remains a dream.

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

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

You can't miss a deadline that was never set, and that's exactly why people don't set them.

A Month Is Not a Unit of Work

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, the second location open by August.

A timeline measured in months is a lie. That isn't because the number is wrong. It's because nobody does anything in a month. A month 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. He'll tell you about three or four days that stuck in his memory and he'll have nothing at all to say about the other twenty-seven. Those twenty-seven days were the month, and he 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's where businesses are lost, 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 don't mean one 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 isn't a management gimmick or a productivity trick. It's the bottom rung of a ladder that reaches a decade.

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

Ten Businesses

I've started more than ten businesses over the years. Some of them made money and some didn't. I've done budgets and sales projections

for every one of them, and my projections have never been right. I've been close, but never once perfect. That's the condition of the work, and the sooner you accept it the better your decisions become.

The one most of the stories in this book come from started in October of 1994, when I founded Main Corp Enterprises, Inc. in Nevada. I borrowed seventy-nine thousand dollars, spent twenty thousand of it to open a health club in Carson City, and left the rest sitting in reserve. That club opened in February of 1995, and the whole loan was repaid with interest before the end of that year. In that era the clubs operated under the name Nevada Fitness, and that's what I'll call them when I'm telling a story from that period.

By 2004 the company had grown to five clubs, in Sparks, Reno, Carson North, Carson South and Minden, with more than fifteen thousand members. Annual gross was over five million dollars, up from about four hundred thousand dollars in 1995. Monthly gross was over four hundred thousand dollars, up from about fifty thousand dollars a month when there was one club.

Today Parkway Athletic Club has locations in South Reno, Downtown Reno, Sparks, Carson City, Fernley and Fallon. My companies own and run the first four, and Fernley and Fallon are affiliated clubs. The business does ten to twelve million dollars a year now. For years Main Corp also licensed the Fitness For $10 brand to independent operators for a fee, which put Fitness For $10 clubs in other states and in Canada that I never set foot in. Those licenses have since ended. Running clubs and licensing a brand were two entirely different businesses under one parent company.

Almost every story in this book is a health club story, because that's where I've spent my life, but the method isn't a health club method. I've used the same three rungs on a consulting company, on a software

product, and on a licensing business that owns nothing but a name. The arithmetic didn't change when the product did.

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, but it will divide the same way.

Then Why Bother, If the Numbers Are Always Wrong

Somebody sharp is already asking the obvious question. If my projections have never been right across more than ten businesses, what is the ladder for? That's a fair question, and it gets a full answer in Chapter 1.

Two Mistakes, Before You Have Paid Me Any Attention

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

So here are two of my own mistakes.

The first is two ladies-only health clubs, one in Carson City and one in Reno, which I opened on a belief I never tested. I believed a significant number of women were intimidated by co-ed clubs and would prefer a ladies-only setting. That didn't turn out to be the case, and in 2004 I closed one and converted the other to co-ed.

The second is a general manager from Lake Tahoe, extremely experienced and highly recommended, who refused to use the

checklist system. He was terminated at four months, and the whole episode cost us roughly thirty thousand dollars.

Both of those get a full chapter later, and so do several more. You'll learn more from those two than you will from the five million dollars.

The Three Parts

Part One is Start It. Is there anybody out there who isn't already served? What does it cost to open the doors, and how much more than that should be sitting in the bank untouched? What do you charge, and how do you know? Who owns what, and what happens when the hard decision arrives? This is where the goal at the top of your ladder gets set, and where you find out whether it's obtainable or merely attractive.

Part Two is Run It. This is the numbers and the system, which are the same subject seen from two ends: contribution margin, break-even, fixed cost, cash flow, and what a dollar of your own money costs you. Then comes the operating system that carries all of it, the two-hour checklist, in Chapter 16. The arithmetic tells you what the rungs have to be, and the checklist is how anybody stands on one.

Part Three is Lead It. This is the people who climb the ladder with you. A leader is a person who has followers, not a person with a title. This is where I make the case that employees come first and that they know it, which is a position I hold more strongly than nearly anything else in this book, and which I know isn't universal.

How Every Chapter Is Built

Every topic in this book is an objective. If the ladder holds, then a chapter about pricing is an objective you either obtain or don't, so every chapter is built the same way.

At the top of each chapter you'll find one line stating the objective of that chapter, written as something countable so that you can tell whether you got it. Nobody has ever walked into a building and counted an understanding.

At the bottom you'll find the tasks that obtain it, five or six of them. Each one begins with a verb and is something a specific person finishes inside a bounded amount of time, and each has a column beside it saying how you verify that it happened. After that comes one thing to do now. 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.

About the Arithmetic

Some of this book is long division, and I'm not going to apologize for it.

Almost every business argument I've ever been in was really an argument about a number nobody at the table had computed. People argue about whether to open the sixth location, whether the struggling manager needs more time, and whether the discount is worth it. Those are arithmetic questions, not opinion questions, and arithmetic doesn't care how anyone at the table feels.

You don't need to be good at math. I'm 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'll tell you what I think. It might be wrong, but you'll know what I think.

What This Book Is Actually Offering

I can't give you the instinct. I believe some brilliant business people are born with a sense that others don't 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 isn't a pleasant word: discipline. Motivation is what a man has on the morning he decides to change his life, and it's 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 didn't.

I've reached most of the goals I set, and not because I'm clever or lucky. It's the same short list of tasks, done and then checked, for thirty years.

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. I'd read it before the others, because 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-term 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've thought about that exchange for twenty years, because the whole method is inside it. Almost every business plan I've ever read fails at exactly that point, the moment where the writer had to state something a person could count.

I'd word one line differently today. You can measure happiness, roughly, with a one-to-ten score, and Chapter 18 does it. What you can't measure is "increase happiness" with no whose, no how and no date.

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're going and when you'll 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 aren't smaller goals. They're 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's on a checklist, it's countable, and 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's the equation, and I mean it as arithmetic. The tense is doing work in every term: completed tasks, objectives obtained, a goal achieved. A task half done sits on the left side of that equation contributing nothing.

That's 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 isn't a goal, and neither is publishing a week of social media posts. 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's a task, and he has built a one-rung ladder that leans against nothing. He'll make the posts, he'll feel productive, and a year later he won't know why he's in the same place.

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

What Makes a Real Goal

There are four tests, and a goal has to pass all four.

Specific. That means a number, not "grow the business" or "improve service."

Measurable by somebody other than you. Hand the goal to a stranger. If that stranger can't walk into your building on the deadline you set and determine, without asking your opinion, whether you reached it, then it isn't a goal. It's a mood.

Obtainable, and still a challenge. Those two run against each other and both are required. An impossible goal doesn't motivate a staff. It teaches them that your numbers are decoration. An easy goal is worse, because you'll hit it and learn nothing.

Dated. Without the date it isn't a goal. It's a preference.

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

That goes for your business, for a manager and 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's 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

Rung	The statement	The arithmetic
Objective 5	Work six days a week: two new dues memberships daily, one paid-in-full every third day	
Task	Tour every walk-in guest	Every one. No exceptions.

The other four hundred dollars of each check is base pay, which is why the commission rung is smaller than the paycheck rung. That ladder also produced a commission rate and a price per membership, and I never stated either one. Do the division and it works out to roughly twenty-two percent commission. It also prices the memberships: about $115 brought in for each dues sale, over thirteen selling days a pay period, and about $460 for each paid-in-full, which is close to a year of dues. Those are approximations backed out of the ladder, not my old commission schedule.

The last rung is the one nobody argues with and almost nobody does: tour every walk-in guest. That means every one, and not just the promising ones. A representative who skips the guest in work boots because he doesn't look like a buyer has just decided, on his own authority, to lower the top of his own ladder.

That rung has a different name today. The tour is now a personal training consultation or a service presentation, because the selling itself changed, but the rung didn't go away.

Your bottom rung will be worded differently, something like estimate every job or 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 won't grant is that a decade can.

It's October of 1994. I've borrowed seventy-nine thousand dollars, spent twenty thousand of it, and I'm preselling memberships for one health club in Carson City, Nevada. It opens in February of 1995, and 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's more than twelve times where we're 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's five clubs grossing better than eighty thousand dollars a month each. So objective one is five clubs open and mature by year ten. I'm starting with one.

The company ended with over fifteen thousand members across those five clubs. Don't multiply that by thirty-nine dollars and expect to land on five million. Because not every member paid full dues, the real gross was well under that multiplication, and Chapter 4 shows why.

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

Three thousand isn't a number you reach and keep, because 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. Add about seventeen more a month to grow at the rate the ten-year goal required, and thirty-five plus seventeen is fifty-two memberships a month per club. That seventeen was the

operating target for a mature club. It isn't, by itself, the whole ten-year derivation, because the clubs opened at different times and not every member paid the full thirty-nine dollars. Seventeen a month for ten years is only about two thousand members, not three thousand, and most of the clubs had fewer than ten years. The rest came from faster early growth, starting with a presale like the one in Chapter 6. I never wrote that club-by-club bridge down, so read this ladder as the shape of the divisions, roughly, not a reconstruction of the decade. That was then. Today most of our clubs sell at least 150 memberships a month.

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

The ten-year goal, the five million dollars, the fifteen thousand members and the five buildings have just turned into two.

The rest of the divisions run the same way. Making two sales a day requires tours, and tours require booked appointments. It takes eight booked appointments to make two sales a day, because half of the people booked don't show up and half of those who do show up buy.

The standard I set was two appointments booked every two hours by every sales representative. With two or three representatives working a floor, that standard runs well above the requirement, and it's 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.

Working Backwards Is the Skill

The ladder doesn't care what you sell. Mine was buildings and members. Somebody else runs it in trucks, chairs, crews, routes, seats or bids.

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

There's an old line about a man who intends to build a tower, and the advice is that he sit down first and count the cost, to see whether he has enough to finish it. The warning isn't about going broke. It's about laying a foundation, running out, and having everyone who walks by see an unfinished thing. Count what the finished tower requires before you buy the first load of stone. Then go buy the stone.

Determining the Correct Tasks Is Critical

You can complete every task on the list, on time, done properly and confirmed by an honest person, and still miss the goal, because the tasks were the wrong tasks.

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

Ask a manager how many social media posts his people should put up this week and he'll say five. Why five? Because five sounds like a

serious week. It's a number a reasonable man would defend at a meeting and couldn't defend on paper.

Now derive one instead. Every business has a funnel whether or not anybody has written it down. Here is the funnel standard I used in my buildings.

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 planning ratios when the top of the funnel was a telephone. Nobody fills a health club with cold calls now. Today it's so many social media posts instead of so many calls.

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

Say I need three new members this week, and I mean need, not want, because the objective sitting above it says three.

Getting three people to join requires six people to actually show up. Getting six people to show up requires twelve booked appointments. Booking twelve appointments requires however many inquiries your own count says it takes. Generating that many inquiries requires however many posts your own count says it takes.

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

I haven't counted your funnel. 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 that four-step chain.

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

When My Tasks Were Right and My Objective Was Wrong

Now the expensive version, and it's mine.

I opened two ladies-only health clubs, which I describe in Chapters 24 and 25. The first was in Carson City, about half a mile from the first co-ed club we ever opened.

The task lists in those buildings were fine. They were the same lists that worked in the co-ed clubs.

They significantly underperformed compared to our four co-ed clubs, and it caused a cash flow problem. In 2004 I closed the Carson City club, converted the Reno one to co-ed, and moved the members and the dues base. The closing wasn't the mistake. The opening was.

The error wasn't in a task. It was in the fact that I never counted.

At the time, the industry figure was that about 13.6 percent of a population would ever join a health club, which is the count I work through in Chapter 2. Some fraction of that 13.6 percent is women who would specifically prefer a ladies-only building half a mile from a co-ed building they could already use. I never wrote that fraction down. I believed it was significant.

Belief isn't a rung on a ladder.

A number you never write down can't be wrong, and that's exactly the danger. An assumption that's 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, and correct everywhere else doesn't help. Correct execution of an incorrect task is the most expensive thing in business.

It doesn't look like failure while it's happening. Nobody is loafing and the reports come in complete. It looks like work until the cash flow says otherwise.

The test isn't whether your staff is busy. It's 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 aren't enough. They have to be in order.

If you don't determine the correct priorities for your daily tasks, you'll lose. It looks like a hard-working person doing the fourth most important thing at ten in the morning.

Nobody finishes the list, in any business I've run or seen. Something breaks, somebody calls in sick, or a customer has a problem at the counter.

So the real question is never whether the list gets finished. It's 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 the employee 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's 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 doesn't have to guess. He reads down the list and starts at the top.

An ordered list 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.

Safety, the law and a customer in real trouble come first, always. After that, 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 on. 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 can't be traced up the ladder to an objective usually doesn't belong on the list at all.

Done Is Not Verified

There's one more word in the equation, and the entire system turns on it: completed. A task that isn't 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 aren't complete. It has happened to me for more than thirty years and it'll 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, but 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.

That's why the general manager files a report every two hours, and it's why I read them. That report isn't surveillance or paperwork. It's 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've done budgets and sales projections for more than ten businesses I've started, and I've been close, and never once perfect. So what is the ladder for, if the numbers are always wrong?

The ladder isn't a prediction.

A plan is a map. It's a guideline for decision making and a way to stay focused. It isn't a fairy tale book. Football teams have playbooks and every play in there is drawn up to score a touchdown. That isn't how it happens.

The ladder is a structure for finding out you're 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, which is that 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's a rung where the actual number stopped matching the required number.

Those are four different failures with four different fixes. Too few posts indicate a management problem. Posts with no inquiries indicate a message problem. Appointments ending in no-shows indicate a confirmation problem. Tours with no sales indicate 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 down into two-hour tasks gives you a chance every two hours.

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'll make it up after lunch, and then not.

For me the answer is two hours. It's short enough that a bad one is recoverable inside the same day and long enough to finish something. It's the smallest block of time in which a business either produces or doesn't.

A man with a ten-year goal doesn't naturally feel that booking two appointments before eleven o'clock is the ten-year goal, but it is. When I look back at five clubs and fifteen thousand members and five million dollars, I can't 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 didn't.

And skipping one doesn't feel like anything. Skip one block a day for a year and it's about three hundred blocks, and three hundred blocks is more than two months of production for that club, gone. That's how decades get lost, in a nothing, repeated, and not in a catastrophe.

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

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

What that looks like when it's running in several buildings at once, and how the reports get read before lunch instead of after the month closes, is Chapter 16.

What you need first is the market evidence that supports the goal. Before you can set a number for a business, you have to know whether there's anybody left in your town to sell to.

Go count them. That's the next chapter.

The Tasks That Obtain It

Task	How you verify it
Write your longest-term 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, on the date you wrote down, 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-term goal in one sentence. Does it contain a number and a date? Could a stranger tell you on the date you wrote 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've 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, and almost none of them are going to buy what you sell. In my own industry the trade association put a number on how few.

Nobody is waiting for your business. No one in your town woke up this morning hoping you would finally open. They already have a place to go, or they aren't buying what you sell from anybody. Those are the only two groups. Your entire business has to come out of the second group, most of which is never going to buy, or you have to take it away from somebody in the first.

Thirteen Point Six Percent

Every category has a ceiling. Only some share of any population is going to buy what you sell, from anybody, at today's prices. It's usually a small fraction of the population, and if you don't know your fraction

you don't know your market, no matter how many people live in the county.

In 2004, when I did my expansion analysis, that number was thirteen point six percent. Out of any given population, nationwide, that's the share that would join a health club. It comes from IHRSA, the International Health, Racquet and Sportsclub Association, which is the trade association for our industry and which counts this for a living.

Eighty-six point four percent of the people in a market won't join a health club, from me, from 24 Hour Fitness, or from anybody. They wouldn't come in if we gave it to them free. They didn't 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 were never the market.

I'm picking on health clubs because that's my industry, but every industry has this number. You probably don't know yours, and there's probably an association or a trade publication that has already counted it. 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.

The number takes the population of your town, which feels enormous, and shrinks it to the actual pool. 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, or build one, and there are three ways.

The first is the trade association or trade publication, which is what I used.

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's 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 backwards from the census and your own competitor counts, and it works for anybody.

Take Washoe County. The clubs in the county claimed a combined total of 31,400 members. The county had 373,233 people.

31,400 ÷ 373,233 = 8.4%

Eight point four percent of everyone in the county was already in a health club, and the ceiling for the whole industry was 13.6 percent.

373,233 × 13.6% = 50,760, which is the whole pool.

31,400 ÷ 50,760 = 62%

On those counts, the county market was already sixty-two percent full.

That's a very different sentence from "Reno has two hundred thousand people." Sixty-two percent full says the easy part is over. The remaining thirty-eight percent are the people the industry has failed to reach for twenty years, and they'll be harder and more expensive to sign than anybody currently on a membership list. But the market isn't 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's one line of arithmetic and it will tell you what kind of fight you're walking into.

The Question Is Not How Big the Town Is

The pool isn't 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

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, Chapter 4, so here I'll just give you 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

Club	Members
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

On that arithmetic, nineteen thousand three hundred and sixty people in Washoe County fit the profile of a health club member and weren't in a health club. That's the market, on paper, not three hundred seventy-three thousand and not two hundred thousand.

That's the number I thought I had to sell to.

I Ran It Three Ways and Got Three Answers

I didn't 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. I still have all three spreadsheets.

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's the arithmetic above and it's 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. 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 don't 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've 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'll tell you what I now think that third number was.

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 aren't on that sheet.

Twenty-five thousand five hundred wasn't 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, including me. I'm catching it now, twenty years later, writing a book.

That's a number that would have gone into a presentation.

As for the 35,700, I can't now reconstruct what population base produced it. It's smaller than the county pool, which suggests I was drawing the boundary around Reno proper instead of all of Washoe County. That's a defensible boundary, but it's a different question and it gives a very different answer. And if 35,700 covered Reno alone while 31,400 still counted every club in the county, the subtraction

mixed two boundaries. Until both counts cover the same area, 4,300 is a warning, not a finished estimate.

What the Three Answers Actually Told Me

I'm not embarrassed by any of this, and here is why. Three worksheets gave three answers: 19,360, 4,300 and 25,500. Throw out the third one, because I've just shown you it was mislabeled. That leaves 19,360 and 4,300, and the 4,300 has the boundary problem I just described. So call it a range from 4,300 to 19,360, with the low end soft. Soft doesn't mean wrong. It means go count again.

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's well under the thousand the club needed, so 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, which is more than twice the ten percent capture rate I used in the larger Reno estimate.

That's what running it three ways is for. You aren't looking for the right answer. You're finding 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 haven't built a case. You've 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're 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's 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, and a specialist people fly in to see has almost no limit at all. You have to know yours before you can count anything, because the radius decides which population you're 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's a rule of thumb in my industry rather than a published number, and it matched everything I ever saw in Nevada.

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

Different boundaries may explain the gap between the two surviving estimates. 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's a bias in this chapter that nearly got me, and it's 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, my gut 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 wasn't 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 can't be conveniently unavailable.

The Ceiling Moved

Now I have to tell you something that undercuts half of what you just read.

The 13.6 percent number isn't 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 and told other operators to build theirs on it. I've used it in this chapter to walk you through 2004 because that's what I used at the time and the arithmetic has to match the decision I 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. It's an all-time high, and up 5.2 percent over the year before.

The ceiling nearly doubled. The two numbers weren't counted exactly the same way, since the new one includes studios and other fitness facilities, but I don't believe the counting explains a move that big.

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

373,233 × 26.1% = about 97,414 people

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

Compare that to the 50,760 I was working with. It's 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.

That doesn't 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 isn't a constant.

That number isn't a physical limit like the seating in a room. It's a description of how many people in a country currently want the thing you sell. That's 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 in your door and doesn't raise the ceiling itself. Then I spent twenty years helping raise the ceiling with price, and I didn't connect those two facts at the time. I don't believe the industry lifted 13.6 to 26 by building nicer clubs. I believe it lifted

it mostly by making the decision small enough that people who had never considered a gym would try one.

First, 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're sizing a market that existed when you learned it.

Second, watch the direction. A ceiling that's moving up means there are people arriving in your category every year who have never belonged to anybody. Those are the cheapest customers you'll 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 didn't do it for the ladies-only clubs.

I opened the two ladies-only clubs I describe in Chapters 24 and 25 because I believed a significant number of women were intimidated by co-ed clubs and would prefer a ladies-only setting. I never counted them. 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 clubs significantly underperformed the four co-ed clubs. The decision to open them 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 wouldn't have saved me by itself, but the discipline behind it would have. You don't get to assume a segment exists. You count it or you don't open.

I made a mistake when I decided to open a ladies-only club in the first place.

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 drive time 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.

Task	How you verify it
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 can’t 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 October of 1994 I borrowed seventy-nine thousand dollars to start our first health club in Carson City, Nevada, which opened in February of 1995. 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, signed no lease and hired nobody. 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's the part that sounds good, and it's the wrong part. The fifty-nine thousand is the lesson.

What the Other Fifty-Nine Thousand Was For

It was for being wrong. I don't mean a disaster like a fire, a lawsuit or a flood. I mean the ordinary condition of being a business owner, which is that the thing you carefully projected doesn't happen on the schedule you projected it on.

My projections have never once been right. Close is the best I've ever done. That doesn't mean my projections were bad, but 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 isn't idle money. It's 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

Here's how thin the estimates are, using my own numbers on my own company. 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, and dues of thirty-nine dollars a month. 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

Set that against fifty thousand dollars of monthly expenditure.

$49,000 − $50,000 = ($1,000)

That's not a significant monthly profit. It's a thousand dollars short, using my own two numbers from my own document.

I wrote both of those numbers and believed both of them, and the disagreement is only one thousand dollars wide, which is exactly why nobody catches this kind of thing.

Now imagine you're 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 don't usually die of catastrophe. They die of a small monthly gap that ran longer than the bank account. That's as true of a restaurant, a print shop or a two-truck plumbing company as it was of my clubs.

The two ladies-only clubs didn't blow up. 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 that I said a cash flow problem and not a profit problem. Those are different things, and Chapter 14 is entirely about the difference. The short version is that unprofitable is a condition you can survive for a while if you have money. Out of cash is a condition you can't 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

The two ladies-only clubs were a bad idea. But I've also watched good ideas die, and it's worth separating the two failures so you don't confuse them.

A bad idea fails because nobody wants it, and no amount of money fixes that. You can pour a reserve into a business the market has rejected and all you'll 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 in advance, and it isn't preventable at all once it's happening. Nobody lends to a business that's out of cash, and anybody who does will charge you accordingly.

That's what the fifty-nine thousand dollars was. It was the purchase of my own future options.

Here's the part I didn't 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 but the obligations didn't. The equipment leases on that building ran until March of 2005. The building lease ran until March of 2005 as well, and if we hadn't re-rented the space we would have paid rent on an empty building for every one of those months. We got lucky and leased out half the building quickly, and lucky is the correct word for it. So the club was closed and it was still spending money for the better part of a year.

Every promise you sign at the opening outlives the decision to stop. The lease doesn't care that you changed your mind, and the equipment company doesn't care that the club is dark. A reserve is for the tail at the back as well as the ramp at the front, and almost nobody plans for the tail, because at the moment you're opening you can't imagine closing.

What a Lender Is Actually Underwriting

People think a lender is evaluating their idea. A lender doesn't want a percentage of your idea and won't get one. A lender is underwriting one thing, which is getting paid back.

Everything in the packet is a proxy for that question. The question isn't "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? Don't say "working capital." Say 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 the strongest sentence in your request, 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 answer is usually everything, and pretending otherwise fools nobody who has done this before.

Your situation in your town with your credit isn't 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's the method, in five steps you can do in an afternoon.

Step one. Compute what it costs to open the doors. That's everything you spend before the first customer pays you: equipment, build-out, deposits, first and last months' rent, 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. That's 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. Do it because a projection has never once been right, and because the errors run in the direction of slow rather than fast. I've never in over ten businesses had revenue arrive earlier than I said it would.

Step five. Your reserve is roughly M × the doubled T, plus a cushion. That is every month of shortfall until revenue covers M, on the slow schedule, funded before you open. It assumes no revenue at all, which makes it a stress number rather than a forecast. That is the point.

Now check it against what I did. I spent twenty thousand dollars to open and held fifty-nine thousand in reserve. That reserve is just

about three times what it took to open the doors. Three to one isn't a formula I derived. It's what the number turned out to be, and I've never regretted the shape of it.

If you can't borrow enough to fund the reserve those five steps give you, on top of the opening cost itself, you have only two choices: lower the opening cost, or don't 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's the part that surprises people. I repaid seventy-nine thousand dollars plus interest in about a year, and I didn't 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. What I 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 consumed only if you need it. If you don't need it, you give it back, and the only cost was the interest.

There's a discipline in that, and it's harder than it sounds. Fifty-nine thousand dollars sitting in an account while you're running a young business is loud. There's always something to buy: better equipment, a second sign, a second truck, a television. The reserve is a fund for being wrong, not a fund for opportunities. 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 don't.

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. What it bought was 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, and it's 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 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 month after month by the same person who had decided to open them. I eventually said it out loud in 2004. We have given these two clubs plenty of time to grow. Plenty of time is a phrase you say when you never defined the time.

Write the kill number down the same day you write the loan request and put it in the same file. It's 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 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 you would close, and hand a copy to somebody who is not you.	That person can read your number 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 isn't for sale. You can't buy it, because the people who have it don't know they have it, and they'll hand it to you across a counter for free if you walk in and ask. I've 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's my method. It costs the price of gas and an afternoon, and in more than thirty years I've 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's the whole methodology, and I wrote it down in exactly those words in the research file.

That data 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, and checked against a second person. It's the actual count, or the count that the manager believes.

A manager showing a prospective member around a health club wants to tell you how many members he has, because it's a selling point. It says the place is busy, other people have made this decision, and you're not about to join something that's 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. The information isn't guarded. It's advertised.

Why Two People

I didn't ask one manager. I asked at least two managers or owners at every club, because 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 higher one and move on. A higher competitor count shrinks the market you think is left, and that is the direction you want the error to run.

The two numbers are far apart, and now you've learned something more valuable than the count. The business doesn't know its own customer base, which tells you about its data, its billing, its collections and its management. A competitor who can't 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.

Always get two sources. It's the cheapest verification in business.

What to Write Down

Don't go in with a notepad. Go in with your eyes, then get in the car afterward and write for ten minutes before you drive away. You'll lose half of it if you wait until you get home. Here's my list.

1. **The customer count**, from two people.
2. **The price sheet.** Get 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's every number they'll quote that isn't 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.** That's whatever they do to walk a stranger through the thing they sell. In a health club it's the tour, in a car lot it's the test drive, and in a kitchen remodel it's 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's their entire sales system and they'll 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 your weakness is.

Repeat it once a year, because all of this decays.

What a Price Tells You About a Cost Structure

A competitor's price is a confession, and 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 and eFit Financial. I used websites, phone calls, and posing as a club owner shopping for service. Here's what came back.

Service	Fee
Electronic fund transfers, drafts, billing, use of club software	1% of amount billed monthly
Add full database management,	up to 5% of amount billed

Service	Fee
data entry, cancellations, collections	monthly
Collections on delinquent accounts	as high as 40%

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

Then look at forty percent on collections. A company doesn't charge forty percent of a receivable unless collecting it is expensive and uncertain. That number is a warning, published by people who do this all day, that a real piece of a health club's billed revenue is at risk of never arriving. It didn't tell me the failure rate, and I would have had to ask for that. I didn't have to ask anyone for the warning. It was on a rate sheet.

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

One more piece of intelligence I got just by asking is that large health club chains don't 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. That one sentence from a competitor cut a whole segment out of a target market years later. I wasn't 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. The numbers you collect are true, but they don't mean what you think they mean. A competitor's customer count is a head count. It isn't 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, and that figure includes personal training, pro shop sales and new membership down payments, which aren't dues at all.

The difference 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 haven't been purged yet. Every one of those is a legitimate member, and 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's 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. Don't multiply a competitor's customer count by their advertised price and think you have their revenue. You have a ceiling, and the real number is well under it.

What the customer count is 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 nearly as good as a payer, because a person in somebody else's file, even a stale one, has already been sold once and isn't walking in your front door looking for a first club. It overstates the claimed pool a little, and that's the direction you want the error to run. Use the number for the question it can answer and don't 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. Here's my position, and it's 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.

These are my rules, and you may draw yours somewhere else.

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

I don't take anything, whether that's paperwork off a desk, lists, or anything else that wasn't handed to me. I don't record anybody.

I don't send an employee in to do something I wouldn't do standing there myself, and I don't ask an employee of theirs to violate a confidence or hurt their own employer.

Every piece of information on my research list is available to any member of the public who walks in the door. If you'd 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. From the same member counts I produced three different answers for the size of the unserved market, and one of the three was labeled "Available Members" when it was just the sum of my competitors' memberships.

Nobody fails at competitive research because they couldn't get the numbers. They fail at what they do with them afterward.

Second, there's a whole category of things this method can't tell you, and I didn't appreciate that at the time.

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

That mattered, because more than ten health club competitors closed their doors during our run in Northern Nevada. Every competitor from Carson City to Minden was eliminated except one. Some of those clubs were dying while I was standing in their lobbies taking notes on their equipment, and I couldn't 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's the best free information available to you and it's better than anything you could buy, but it isn't omniscience. Get the numbers yourself, verify them twice, write down which question each number can answer, and then do the arithmetic slowly.

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 circle with the address of each one.	A stranger could drive to every 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? I mean their building, not their website.

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.

There's no correct price sitting out in the market waiting for you to find it. People talk about pricing like it's a rock under a log, where you lift enough logs, run enough spreadsheets, and there it is. 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.

I've set the price on more than ten businesses, and I've never once found a price. I've 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, and whether I wanted to be full at nine in the morning or full at six at night.

Nobody can rank all thirty in order of importance, but 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

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 customer standing in front of you at five thirty in the afternoon isn't thinking about your equipment lease, your insurance, or the fact that you personally guaranteed the note. He's thinking about whether your price is a good trade for what he's holding.

Cost tells you what price you can't 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 widens your pool. For years, the industry figure was that about 13.6 percent of a population would ever join a health club. By 2025 it was 26.1 percent, and Chapter 2 explains what happened. For most of my career I said price decides which slice of that ceiling walks in your door and does not raise the ceiling itself. I no longer believe the second half of that sentence.

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.

What I didn't understand at the time is what happens when you do that across a whole industry for twenty years. You don't 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 weren't shopping was the price. That's how a ceiling moves, and I believe it's a big part of why the number nearly doubled.

Low price is also a weapon, which people forget. When you're the cheapest thing in a town, every competitor above you has to explain themselves to their own customers. Since Nevada Fitness entered Northern Nevada, more than ten competitors have closed their doors. One of them was 24 Hour Fitness in Carson City. That didn't happen because we had nicer carpet.

The disadvantages are real. A low price makes volume mandatory. If your model needs a thousand customers and you get seven hundred, a

higher price would have let you survive the miss, and a low price won't. A low price also cuts your margin for error on everything else, because every dollar of waste is a bigger share of what you keep. 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 real advantages. Perceived value follows price. When a price is high the customer expects quality, and a portion of the time he'll 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're 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 isn't profit. It's 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're paying people to buy from you. Plenty of businesses do this and don't know they're 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 is. A lawn service has it in monthly accounts, and a dentist has it in the patients who come back twice a year.

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, 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, and it's 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, 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's the snowball. It rolls downhill and gets bigger and you didn't have to push it again.

The paid-in-full members are the shovel, not the snowball. They're 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'd starve before the base got big enough. Why not ten out of ten paid in full? Because in year three you'd own nothing. You'd wake up every January with the same empty building and have to sell it all again.

Your ratio won't be seven to three, and your two kinds of money won't be called dues and paid in full. A shop has walk-in sales and house accounts. A software company has subscriptions and setup fees. Name your two, count last month's sales into the two columns, and find out what ratio you've been running without choosing it.

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 on raw counts we lost half as many. I never had the club sizes behind the seventy, so that isn't proof of twice the retention. And thirty-five 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, and you should.

The Five Pricing Objectives

Before you set a number, decide what the number is for. There are five common pricing objectives. I've used three of them and refused two.

Pricing objective	What it means	Verdict
Penetration	Price low to take market share, keep less of the value for yourself	Adopted
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 objective	What it means	Verdict
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's an entry strategy and it's the right one when you're new and unknown. We used it in Carson City in 1995 and we've 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.

There's 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's 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's not a matter of whether you'll make money but how much, and you're free to price to a target. Be careful with this one. Most businesses aren't 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 hasn't yet been persuaded that there's any real difference between you and the next guy. That customer is more common than owners want to admit. If he can't tell you apart, he'll decide on price and location. So you get close on price, beat them on what's 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 didn't want it. With the consulting price above I had already decided the customer gets the lion's share, and you can't skim and promise a big return at the same time.

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 a fit, not a moral position.

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 didn't get passed down to the customer's customers. Nothing about our price made his profit margin fluctuate.

Two of the five didn't 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 didn't stay at twenty-two dollars. By 2004 our monthly dues were thirty-nine dollars, a seventy-seven percent increase over about nine years. 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 isn't growing or isn't telling you everything.

Second, low price gets you volume and volume gets you saturation, and saturation is a real ceiling. Our profit in one club was about four thousand dollars a month. Across five clubs it averaged about thirty thousand a month combined. It had been fifty thousand a month, and it came down because of competition and market saturation. Saturation limits new sales, and a low-price strategy accelerates you toward that ceiling faster than a high-price strategy does.

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.

I'd still do it the same way. But I'd tell a new owner to write down, before opening day, the exact number of customers the low price needs before it pays, and the date by which he has to have them, and then check it every month. Most owners never write that number down, and then they can't tell the difference between a bad month and a broken model.

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've competed against clubs that did all

three, and they're gone. Charge what you decide to charge, say it out loud, and let people decide.

Price is a decision, and you're 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 one customer and write your up-front charge beside it.	The acquisition figure traces to last 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 sales.	The two counts match a report anybody can pull from your sales records.
Write the number of customers your current price needs before it pays, 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 for? Write down which of the five objectives you're using. If you can't name one, you haven't 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. It had no equipment, no front desk and no carpet worth mentioning. I had borrowed seventy-nine thousand dollars that year and spent twenty thousand of it, and I intended to keep the other fifty-nine thousand in reserve. The club would open in February of 1995.

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

The number isn't the lesson. The lesson is what a presale is. Most people think a presale is a way to raise money before opening, and it is. But its real job is to answer the only question that matters, while you can still change your mind: will anyone buy this?

A presale is taking money for something that doesn't exist yet. A caterer takes a deposit on a wedding two years out. A machine shop takes half down before it cuts any metal. 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 isn't really about health clubs. If you can describe what you're 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've 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've counted populations, pulled penetration rates, and walked into competitors and asked two different managers how many members they had. All of that is estimating. A presale is measuring. Research tells you how many people in your town are likely to want what you sell. A presale tells you how many will hand you money for it before it exists, and that's worth more.

When I studied the Reno market I worked the same question three ways and got three different answers, which I take apart in Chapter 2. That's what estimating looks like when you're being truthful about it.

A presale doesn't have a range. It has a count. Either two thousand people signed or they didn't.

If you're 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, and take them the simple way, as though every one of the two thousand went on dues. 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. The real mix ran closer to the seven-to-three split in Chapter 5, which moves some money from the second line into the first without changing the point.

The first number is cash before opening. It's the money that buys the equipment you haven't bought yet, pays the first months of rent, and

covers the payroll of the people selling. A presale run properly can fund a large part of the build-out of the very thing being presold.

The second number is more important. Most new businesses open at zero and climb. A presold club opens at forty-four thousand dollars a month and climbs from there. In a business with high fixed costs, that's the difference between a company that survives its first winter and one that doesn't.

Against that, remember the loan. 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

This part matters more than the money. You're selling something that doesn't exist. That isn't automatically wrong. Every builder who takes a deposit and every author with a preorder is doing it. It becomes wrong at a specific line.

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, but it's the difference between a business and a story. Here are the rules I've followed 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're planning to buy it if presales go well, don't put it on the flyer. The customer can't 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. If a presale member's dues were scheduled to start and the doors weren't open, the dues didn't

start. That's the only honest way to hold money for a thing that doesn't 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's being paid to take a risk on you. A presale price that's 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 isn't revenue. It's an obligation you've been paid to fulfill. If the money goes into a truck, or an owner's draw, or payroll for anybody who isn't building or selling the thing, 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.** Do it every time, without a conversation. A person who cancels a presale and gets a fast refund tells six people you're straight. A person who has to fight you tells sixty.

If you'd be embarrassed to have the customer read your own project schedule, you're not presale-ready. You're fundraising.

The Mechanics

Here's how to run one.

Step one. Lock down the thing you cannot change later. For most businesses that's the address. You can't presell a location you might get, because 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 wouldn't have moved the club. I would have refunded the presale payments. If your business isn't tied to an address, then the thing you can't change is the delivery date, or the specification, or the

person who will 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, and 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. (Ten percent is the number I used in Carson City in 1994. The 13.6 percent the rest of this book runs on is the number I had later, and it's the better one.) 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's the number that has to be on the wall.

Step three. Sell from a temporary space. A folding table in the empty building or a card table in a strip mall suite will do. It doesn't need to be nice. It needs to be at the address, because the address is what you're selling.

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

Step five. Track it daily, not weekly. A presale that's going to fail shows you in the first ten days, and 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's the most valuable one in the list. Decide, in writing, what number by what date means you don't open. Then hand that piece of paper to somebody who isn't you. Chapter 23 is about why. The short version is that 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 the rule about giving the money back, and don't take the first dollar.

Who Actually Sells It

Presales fail here more often than they fail on price. A presale doesn't sell itself and it doesn't sell off a screen. Social media can put a person in front of you, but it can't sign anybody. There's 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 makes the presale the most demanding selling environment your business will ever have, and it happens before you've hired anyone good.

I sold in that Carson City presale myself, every day, and so did the small handful of people I had. Two rules came out of that and I've used them ever since.

The first is that the owner sells during a presale, and doesn't just supervise. You're the only person who can describe the thing that doesn't exist yet without lying, because you're 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's your build-out plan changing, and it won't 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 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 haven't collected yet, you're borrowing against a customer who hasn't 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, that they'll buy at your price, and that your location is acceptable to enough of them. It doesn't tell you they'll stay.

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 doesn't show up for a year, and by then you've 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 and our Reno club had eight hundred. Same company, same system, same brand, same sales training, same market, and one of them is six times the other. Both of them opened.

And there's a harder one. A presale proves demand for a price. It doesn't 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 (Chapter 25 is the whole decision). People will sign up for a thing at a good price without that meaning the thing should exist. A presale is a strong test of demand and a weak test of judgment.

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 produced by a specific town, a specific year, and a specific price.

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

A presale 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.
Add the up-front payments	Both figures are on one page

Task	How you verify it
across all presale agreements to get your opening cash. Separately, add the monthly dues on the recurring agreements to get your opening recurring revenue.	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? I don't mean who runs it. And 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's cheapest and easiest today. Then five years later they're sitting in a room with a partner, holding a decision that's obviously correct for the company and obviously bad for one of the people at the table, and there's no mechanism to handle it. So the decision doesn't get made, and 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.

The Boxes You Can Put a Business In

I'm 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'll get sold the one he's fastest at.

Sole proprietorship. You and the business are the same thing. It's simple and cheap, and everything you own is on the table. That's fine for a man who mows lawns alone. It isn't fine for anything the public walks into, whether that's 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 don't want to be the ones 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'm the Chairman of the Board. A corporation costs more to maintain, and for me it was a clean place to hold a brand, a license, or a subsidiary. An LLC can do that job too. Pick the box for the job.

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

Here's the practical rule I'd give a person starting today. You don't 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

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 wasn't 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.

What made it hard was that the two ladies-only clubs had one owner who wasn't an owner of the co-ed clubs.

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 didn't own a piece of. He wasn't being difficult and he wasn't wrong. His interests simply didn't line up with the company's, and that wasn't 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.

How I Weighted It

I ran the decision on five criteria and I weighted them on a scale of one to ten.

Criterion	Weight
Maintain current market share	7
Increase future market share	10
Lower overhead	7
Increase profit	10
Ethics	9

Ethics carried a nine, higher than lower overhead and higher than maintaining current market share. Only the two growth criteria outranked it, and only by one point.

I put it there on purpose. When you have an owner who can't win under the correct decision, ethics isn't a footnote to the analysis. It's one of the largest numbers in it. If ethics had carried a three, the ranking wouldn't have moved. Combining still wins by ninety-one points and selling the Carson club out from under him still finishes last. What the nine bought wasn't the answer. It was the obligation to build the transition around the man who was going to lose.

The four alternatives scored out at 357, 272, 228 and 235. Combining the two clubs into a co-ed club in Reno won by 85 points. I'll walk through that whole matrix later in this book, because the method is worth a chapter of its own.

What I want you to see here is what we did for the owner who was going to lose. We didn't buy him out at a discount because he had no way to stop us, and we didn't 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 on the dollar. 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, and a fifth co-ed location that all members can use raises the value of every membership we sell.

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, and I checked that before I moved, not after.

We completed the transition on August 15, 2004. We had two cancellations.

The Rule I Took From It

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

It's 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 doesn't get made, or it gets made and you've created an enemy who knows everything about your business.

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's a loan or a revenue share, not equity.
2. **Write the exit before you need it.** That means 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'll 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.** I mean who decides, not who is consulted. I consulted Bruce Gimple and John Gutierrez on the ladies club transition and they both changed my timing. That's consultation working exactly as it should. It isn't the same as authority.
4. **Say the hard thing to the losing partner first, and in person.** Do it before the memo and 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 that when you have the power and the other person doesn't, what you do says who you are.

Two Businesses, One Parent

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

Main Corp **owns Parkway Athletic Club**. There are six Parkway locations. My companies own and run four of them, in South Reno, Downtown Reno at Saint Mary's, Sparks and Carson City. Fernley and Fallon are affiliated clubs. In the four we own, 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.

For years Main Corp also licensed the Fitness For $10 brand to independent operators for a fee, which put Fitness For $10 clubs in other states and in Canada that I didn't operate. Somebody else signed that lease and hired that staff. They paid us for the brand and the system. Those licenses have since ended, but the fork below still applies to any business.

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. The two roads look similar from a distance, but they aren't the same business at all, and the arithmetic will show you why.

Main Corp didn't drop the Fitness For $10 name when our Northern Nevada clubs became Parkway Athletic Club. Today they're two separate lines of business running under one corporate roof, and they have opposite risk profiles.

Operating a club. Take our own unit model. A ten-thousand-square-foot satellite club needs about one thousand members. At thirty-nine dollars a month that is 1,000 × $39 = $39,000 of dues. Add the low estimate of ten thousand dollars a month from new memberships, personal training and pro shop, and you're at about $49,000 of gross. Monthly expenditures on that model run forty-five to fifty thousand dollars. So at exactly one thousand members you're somewhere between a small profit and a small loss, and every dollar of upside comes from member one thousand and one and up.

Licensing the brand. I'll borrow the fee structure I designed for our consulting venture as the illustration, because a license fee works the same way: 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 can't 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, with separate books, separate reporting, and separate people accountable. A parent company can hold both. A single set of books can't tell you which one is working.

The Third Layer Nobody Sees

Two of the Parkway clubs my companies own don't sit directly under Main Corp. The Carson City club and the Sparks club run through a separate entity, Carson City Fitness. I'm 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 a Parkway Athletic Club. What's there is a brand owned by one company, an operation run through a second, a general partner interest held through a third, and a building owned by the second.

Every layer is doing a job. The brand sits in the parent because a brand is the thing you license, and you can't 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 isn't 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'd rather that risk stop at a company than at my house.

For every entity you own, you should be able to say in one sentence what job it's doing. If you can't, you either don't need it or you don't understand it, and both of those are expensive.

Every one of those boxes also 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. Don't build this structure on day one. Build it the day the job appears.

I Built the Misaligned Owner Myself

First, I set up ownership of the ladies-only clubs in a way that created that misaligned owner. Nobody did that to me. 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's 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'd better be able to explain it in one sentence to the person receiving it. If your ownership structure needs a diagram, your people won't trust it, and a structure your people don't trust doesn't align anything.

Ownership isn't paperwork. It's 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 makes 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 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.

That's been true for more than thirty years.

If you've decided from that that planning is a waste of time, you've drawn exactly the wrong conclusion.

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's not how it happens, but nobody throws the playbook away because the plays don't all end in the end zone. The playbook is what lets eleven men move at the same time in the same direction, and it's what lets the coach know, at the end of the drive, which play failed and why.

A map doesn't promise you'll 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, not just 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 to the general manager in Carson City 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 didn't 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 didn't 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 failed to communicate, and 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.

In your head the plan is perfect, because you've already filled in every gap without noticing. Hand it to somebody who owes you nothing and watch what happens.

Who The Plan Is For

The plan isn't a sales document. Marketing plans are not shown to customers. The plan is a guideline for the company, and it's for the staff members who are implementing the strategies. If your plan is written to impress a banker or a partner, it'll be full of adjectives and short on numbers, and your general manager won't be able to do anything with it on a Tuesday morning. Write it for the person who has to execute it.

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's the part that makes the rest of it true.
2. **The strategy.** What you're 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've 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	Which competitors' customers are we trying to win?
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's 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 can't explain the company to a stranger in an elevator.

Turning a Plan into a Testable Claim

Here's 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, and 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.

Those two lines are falsifiable. There's a number that would kill each one. What they're missing is a date. Chapter 1 says a goal without a date is a preference, and I wrote both of these without one. Yours should say by when.

We collected competitor member counts by shopping every health club in Washoe County and asking at least two managers or owners how many members their club had. On the county arithmetic, that put the unserved pool at 19,360 people. If a new club obtained only ten

percent of the available market, that is 0.10 × 19,360 = 1,936 members.

H1: 1,936 > 1,000. True on paper.

Then the money. Our dues were thirty-nine dollars a month, so 1,936 × $39 = $75,504 in monthly dues income. The lowest monthly figure for any club in the history of the company for new memberships, personal training and pro shop combined is well over ten thousand dollars. Add the low estimate and the monthly gross is at least $75,504 + $10,000 = $85,504. Against monthly expenditures of forty-five thousand dollars, that is $85,504 − $45,000 = $40,504.

H2: $85,504 − $45,000 > 0. True on paper.

Both projections cleared their thresholds with a lot of room. If H1 had come out at 1,050 against a threshold of 1,000, I wouldn't have called it proven. I'd have called it a coin flip with a lease attached.

Your two lines won't say members. They'll say covers per night, or billable hours, or trucks on the road, or units out the door. Write the claim, put a symbol on the quantity, put a threshold number beside it, and then go find out. A plan that can't be proven wrong can't be proven right either.

The Honest Part About My Own Numbers

Now I'll show you where my own analysis disagrees with itself.

First. That pool of 19,360 was one of three answers I got. I worked the available Reno market three separate ways and came out at 19,360, at 4,300, and at 25,500, as I walked through in Chapter 2. What matters for a plan is what the spread does to the hypothesis.

H1 survives comfortably under the number I used, and under the larger one too, though the larger one is the mislabeled competitor count from Chapter 2 and should never have been on the page as a demand estimate. 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. That pass had its own boundary problem, which is exactly why you settle the circle before you count anything.

I don't 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. Failing to declare which one you're standing on isn't.

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, five thousand dollars apart, on the same page for the same club.

At $85,504 of gross it doesn't change the answer. At a thousand members it changes everything. A thousand members at thirty-nine dollars is $39,000, plus the ten-thousand-dollar low estimate is $49,000. Against forty-five thousand of expenses that is a four-thousand-dollar profit. Against fifty thousand it is a one-thousand-dollar loss. That's on gross dues. Take billing out first, as Chapter 13 does, and it's about twenty-eight hundred dollars of profit against about twenty-two hundred of loss. It's the same club and the same month with the opposite conclusion, and the entire difference is an assumption I never nailed down. I take that apart properly in a later chapter on fixed cost.

A pro forma is only as good as the assumption you're least sure of.

What Makes an Objective Real

I've read a lot of business plans and most of the objectives in them aren't 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. Until you say what you'll count, there's nothing to count, so nobody can ever be held to them and nothing happens.

Then there's the other failure, which is the objective that's measurable and worthless. The same plan said the company wanted to spend five million dollars. That is a silly objective. Anyone can do that.

An objective has to be a challenge, yet obtainable, and you must be able to know whether you have obtained it.

Here's 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's countable. You just add up the income. And it has a deadline, which most objectives are missing.

Run every objective you have through five tests.

1. **Is it a number?** If there's no number, it's 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'll hit it by doing what you did last year, it's a forecast, not an objective.
5. **Is it obtainable?** If it's impossible, your staff will know it in week three and stop trying. An objective that's too hard and one that's too easy are equally irrelevant.

Here's 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 × $50,000 × 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, and 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.

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'll spend a whole chapter on that

near the end of this book. It belongs in the plan now because you'll build a bad exit if you build it in the month you need it.

Instinct, and Where It Fits

One more thing, and it's a strange thing for a man with an MBA to write. I believe 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. This sense is hard to teach and hard to learn.

I've met both kinds. So a fair question is why bother with the plan at all, if the good ones just know. The answer is that instinct tells you what to do and the plan tells you whether it worked.

Instinct is fast, it's often right, and it's completely unaccountable. It can't be handed to a general manager in South Reno. It can't be checked in March against what you believed in January. It can't 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 can't quietly move it afterward, and believe me, you'll 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	The line is in the plan and a

Task	How you verify it
as a hypothesis with a symbol and a threshold number.	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 using the less favorable 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, and 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's culture. It's what the company does in the week when doing the right thing costs money, not what's on the wall. And the person who sets it is the first person you hire, not you.

Everybody Copies The First One

Here's why the first hire matters more than the tenth. You're one person. You can't 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 and the third learns it from the second. By the time you have twelve

people, nobody is copying you anymore. They're copying a copy of a copy of the first person you hired.

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, and most people in a group will conform to the leader's expectations. That works for you and 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? It isn't experience. I've 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 can't 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's what no list solves. I can't 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 isn't a training failure. It's a person deciding it doesn't matter. Your business has its own version of that floor, 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?** The question isn't whether they agree with the task but whether they'll do it. A candidate who wants to improve your process in week one has improved nothing, because there's 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's a hard truth about this industry and there's 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 won't find it on your own.

Notice that none of the three is a skill. Skills I can teach. These three I can't.

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 aren't there?

You can answer that before you hire. Write down the five things you do in that position and how you do them. Then pay your finalist for one shift and watch that person work the list. You aren't measuring speed. You're 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 didn't lose one corner. You published a policy. 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

The first hire is the most important one you'll ever make, and it's the one you're least qualified to make. You've never managed anybody in this business, because the business hasn't 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're hiring in a hurry, because you're out of hours, and hiring cheap, because you're 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've paid both bills and they aren't close.

A Mission Statement Nobody Can Recite Is Decoration

Every company I've ever seen has a mission statement, and almost none of the employees can say it. That isn't the employees' fault. It's the fault of whoever wrote a hundred and forty words when twenty would do.

Here's a test you can run this afternoon, even though you won't 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. Don't 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. A mission statement that can't be recited can't be used at two o'clock on a busy Saturday, and that's 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, ahead of best equipped, most advanced or lowest priced. That's a word an eighteen-year-old at a front desk can act on within four seconds of reading it.

For every body is two words on purpose. The person who feels intimidated about walking in is the person we most want to walk in.

Go beyond the expectations of our members is the operational half. It's an instruction, not an attitude, and it turns directly into a task, which I'll 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's 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 and concern for employees.

It's a good list. Here's my own statement held up against it.

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 the nine are missing. I left them out on purpose and I'd 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'll admit something about my own forty-one words. The part our people 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.* That's twenty-two words, and it's the part that got memorized because it's 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'd write the twenty-two words and stop.

So use the nine components as a checklist, not 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 writing it. The staff should be part of the drafting. Have each manager and their department write one, then merge them. People support what they helped build, and when you read six drafts from six departments, you find out what your company thinks it's doing, which is worth more than the finished sentence.

Two Favors Every Two Hours

Now, "go beyond the expectations of our members" is a fine phrase, but on its own it does nothing at all. 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.

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 against three thousand members is roughly one unexpected good thing per member per month, produced by a task on a list rather than by inspiration.

Now run that arithmetic in your own business. 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. Then multiply it out against your customer count the way I just did, and see whether the promise on your wall is physically possible.

I'm introducing it here and not explaining the whole system yet. The daily, weekly and monthly lists for every position, the general manager's report every two hours, and why the lists get rewritten every month are all in Chapter 16. Right now I only want one thing understood. Your culture is a set of tasks with a clock on them, or it's a decoration.

Not Telling Somebody What to Do Is Not Respect

I've written elsewhere in this book that most people, left undirected, will do nothing, and I've 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 isn't respect. It's abandonment with a friendly face. Then, at review time, you sit them down and grade them on standards they were never given. I've 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 isn't surveillance. It's the answer to a question every honest employee is quietly asking: what does a good day look like here, and how will I know if I had one?

I haven't always hired well. I've hired experience over fit and paid for it in real dollars. I've promoted people because they were loyal and available rather than because they were right for the seat. The system doesn't 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.

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've 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's the opposite. It's the most demanding sentence in this book, and everything in Part Two rests on it.

Here's what I mean. A man can take a shovel behind the Sparks club and dig a hole all day, until his hands bleed. At six o'clock he has a hole. Nobody will pay him for it and nobody wants it. 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 weren't on it at nine.

The amount of effort didn't change. The production did. The value of labor is equal to what it produces, not what it costs you or how tired it made somebody. That's 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 don't.

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's why people say things like "the money just disappeared." Money doesn't disappear. It goes somewhere, and it went somewhere because somebody worked or somebody didn't.

A dollar is stored labor. 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're 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 you buying somebody's hours and hoping those hours produce more than they cost. Rent is you buying the hours somebody spent building a building. Your bank balance 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

You know the story of the seventy-nine thousand dollars I borrowed in 1994 to open the first club in Carson City. Here I want you to see what happened at that bank.

That seventy-nine thousand dollars wasn't 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. Strip out the paperwork and that's what a loan is.

I've thought about that every time I've signed a note since. 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 won't 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 company get something they would pay for?

It has to be something a stranger would open a wallet for, not something you like or something that felt productive.

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 don't care what you sell. Run them on a delivery route, a dental practice or a print shop and they behave the same way.

Here's 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, one of the two favors we required 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 ran in a month.

Now run it on a different hour. A manager reorganizes the supply closet at three in the afternoon on a Tuesday. There's nothing wrong with an organized closet, but no member paid for it, and tomorrow isn't different.

Here's 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 of contribution, the Chapter 11 number, and hands it over again the next month, and the month after that. I don't have that year's actual close rate written down and I won't invent one for you. The funnel in Chapter 1 was a standard, not a measurement. 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 doesn't 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, and neither produced a thing a customer would pay for.

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

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

The checklists still run today, but what sits on them has changed. The two hours now go to a personal training presentation, a service done for a member who is already in the building, and the condition of the floor.

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.

Both sides were arguing about the wrong thing. Labor and management were both 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. 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. That's 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. When we set up WebFit, employees of the operating company were owners of it, and the deal was blunt: if an employee received five thousand dollars from WebFit, his Nevada Fitness paycheck was reduced by twenty-five hundred for that month. Half of what he earned by producing came off the fixed payroll. 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'll 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 didn't manufacture my ability to work. I didn't 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 doesn't 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 isn't greed and profit isn't a dirty word. It's a return on something I was handed, and I owe somebody an accounting for it. I'll come back to that in

Chapter 27 and I won't 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 wasn't, because I had put those people in a building serving a market that didn't exist in the size I thought it did.

That's what "hard work has no value" costs when you say it honestly. It doesn't only apply to the man with the shovel. It applies to the owner who pointed the shovel.

An owner's job isn't 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	The sentence is on the page, and

Task	How you verify it
one thing a customer received because of that hour.	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, then by the conversations you hold in an hour, 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 can't, 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 can't answer the second question, which means they're guessing at the first one. They know their sales and their bank balance. They watch both go up and down and assume the two are connected in some reliable way. They aren't.

I've watched businesses grow their way straight into the ground, with sales up, profit down and the owner confused. It happens because the owner is tracking the top line, and the top line doesn't tell you what you keep.

One number does. It's called contribution margin, and once you have it you can answer a whole shelf of questions you've 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's profit. That leftover is the contribution margin. It contributes, which is where the name comes from.

There are two ways to say it. **Per unit**, it's the price minus everything that varies with selling one more. **In total**, it's 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 keep.

The Nutcracker Company

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

In my managerial accounting coursework I spent a term working a company called Drosselmeier Corporation. It makes Christmas nutcrackers. The plant can produce twenty-four hundred units a year. It sells two thousand.

- 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. This isn't the statement your accountant hands you. It's 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)

Drosselmeier Corporation, 2,000 units	Total	Per unit
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. 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's just gross profit with extra steps. It isn't, 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 fixed things, 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's 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**

It's the same company, the same year and the 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 went up ten percent. Operating income went 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 can't do that with gross margin or with last year's net income. You need the ratio.

The Same Math, Wearing a Health Club Uniform

Now let's 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. The building is already there, the heat is already on, the front desk is already staffed, and 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 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.

One thing has to be in the open before you build anything on this. In 2004 I didn't 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 document. There's a little more in there. Towels get washed. Hot water gets used. A busier 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 wouldn't argue with you. I'd argue very hard with anybody who told me it was sixty.

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 wasn't worth thirty-seven eighty-three. He was worth thirty-seven eighty-three times however many months he stayed, and we lost about half as many members a month as the industry figure I was using.

Run that on whatever you sell. If your product repeats (a service plan, a lawn contract, a standing order, a maintenance agreement), then one sale is a payment that keeps arriving until somebody stops it.

That ratio is why every sales rep in our company had to book two appointments to show the club every two hours. When ninety-seven cents of the next dollar is yours, the only rational thing to do with an hour is go get another dollar.

The method and the hour haven't changed, but what we put in the hour has, and so has the margin. Today that two-hour block goes to a personal training presentation and to doing something for a member who is already in the building, and the marketing that fills the block is a post rather than a call. A training presentation sells a product with a real trainer cost, so run the ratio again for what you're selling now.

When Growth Actively Hurts

There's one case that ought to be impossible and isn't rare at all: a negative contribution margin. The price is below the variable cost, and every single sale makes the business worse.

You'd 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, decide they have to be close to that, and never work out what one more sale costs them. For me that meant the billing, the collections, the towels and the wear. For a caterer it's the food, the labor and the fuel.

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'll 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'll

conclude the problem is theft or accounting. The problem is that he's 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

Take two businesses, both doing a million dollars. One keeps sixty cents on the new dollar and the other keeps fifteen. They shouldn't be run by the same playbook, and if you run them the same way one of them will fail.

Here's the arithmetic. 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 moves.

The fifteen percent owner can't get there on volume, or at least he can't 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's a second difference, and it's 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 doesn't fall by fifteen percent. It falls from three dollars to zero. He's done, and he'll 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 wasn't. 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.

Personal training sits somewhere in between, and I won't quote you a number I can't support. I don't 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'm 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's 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 isn't automatically good. It's good in exact proportion to your contribution margin, and if you don't know your contribution margin, you don't 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 order, a seat, a job.	The definition is on the page, and whoever keeps your books agrees it is 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.

It was the same company, the same brand, the same equipment lines, the same checklists and the same training. One building was packed at six o'clock on a Tuesday and the other 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'll 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 aren't the same answer, and everything below is how you know which one you are.

The Formula That Answers "How Many"

Chapter 11 gave you contribution margin. Here's 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. That pile doesn't 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 operating profit. Debt principal belongs in a separate cash calculation.

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

Those two formulas will answer more real questions in your business than any other arithmetic in this book, and they don't care what the unit is. It can be a nutcracker, a membership, a haircut, a paving job or a night in a room.

Working It on the Nutcracker Company

Go back to Drosselmeier, with fixed costs of 90,000 and a 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.

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 can produce 2,400 units a year.

The arithmetic gave a clean, correct, confident answer of 2,500, and the building can't 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 didn't know it had. It can buy equipment, hire more people, pay for better training, or some combination. 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's 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's what happens when you run the numbers. You get a better question instead of an answer.

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 can produce 2,400 a year. 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	Some fixed operating expenses cannot be reduced quickly.

Route to 45,000	What it takes	The new problem it creates
		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 route ends at 45,000, and none 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'll deal with that spread in the next chapter. I treat that whole figure as fixed, because the one variable cost I can document, billing, already came out in the thirty-seven eighty-three. If billing is already inside that total, I'm counting it twice, and each break-even below drops by about thirty members, to roughly 900 and

1,030. A thousand still sits inside the bracket. Treat these as illustrative figures from my unit model, not a reconciled ledger.

Dues aren't 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 of gross. Because the forty-five to fifty thousand is total spending, what it cost to earn that ten thousand is already inside the pile, so I credit it at gross. That ten thousand covers part of the pile before a single dues member is counted, and I'm ignoring the few percent of billing on it.

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**

For years I told anybody who asked that a ten-thousand-square-foot satellite club needs one thousand members. That wasn't a calculation. It 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.

On these illustrative figures, the formula says 926 on the good assumption and 1,058 on the bad one, and one thousand sits right in the middle. I didn't know that when I said it. I'm glad the arithmetic agreed with me, but I didn't do 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.

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 becomes a list. In 2004 that list said book two appointments to show the club. Today it says give a personal training presentation and do something for a member who's already in the building, and the marketing that feeds it is a post instead of a call.

The Order You Should Take at a Loss

Every operator eventually gets this situation. Somebody offers to buy a batch from you at a price you'd never advertise.

Drosselmeier gets an order for 300 additional units at 90 each. That is 27,000 of additional gross.

Don't build a whole new income statement to answer it. Multiply the gross by the contribution margin ratio.

27,000 × .60 = **16,200**

That's 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, the salaried people and the insurance are 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.

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's wrong, and here's 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 didn't lose anything. You made forty-two hundred dollars you wouldn't otherwise have made.

On a special order with room in the plant, the first question is whether the price beats your variable cost per unit, plus anything the order costs that you would not otherwise spend, like a special setup or extra freight. 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 easy money while you have spare capacity.

Drosselmeier had room. Two thousand plus three hundred is 2,300, and the plant can produce 2,400 a year.

Change one thing. Suppose they were already running at 2,400.

Now those three hundred units can't 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)**

That's twelve thousand dollars gone on an order that felt like found money. A full plant can still take an order, but only when what the order brings in beats everything it pushes out.

And that's only the number you can see. The customer whose order you bumped has now learned that you aren't reliable. 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 didn't exist before, and the club's fixed costs don't 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 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 isn't the square footage. It's 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. Find the thing that runs out first, because that's what a discount is really spending.

When a full-price member can't get a machine, he doesn't 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 the national figure of about seventy I was using. Whatever the exact rates were, I believe 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's the same kind of mistake Drosselmeier would make with its twelve thousand dollars. It just takes months to show up instead of showing up on the invoice.

The Shape of Your Costs, and What It Sets Up

Two businesses can sell the same thing at the same price, earn the same profit in the same month, and still be nothing alike. One of them 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 hard.

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.

Which one you are isn't a preference. It's a set of promises you already signed, and that's Chapter 13.

I Never Ran This Before I Opened a Club

I never ran a formal break-even calculation before opening a health club, not once in ten years.

I ran "a satellite club needs a thousand members," which I got from watching clubs succeed and fail. I acted, and years later I checked.

But the break-even math wouldn't have saved me from my worst decision. When I opened a ladies-only club, my error wasn't 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 isn't 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's 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're standing on. Find out what that pile of fixed costs is made of before you trust anything it produced. That's 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 floor under any special-order price, good only while you have spare capacity and the order carries no extra costs of its own.	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? I mean units and not dollars of sales, because units are what your people can 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 isn't a cost. It's a promise.

Accountants put it in the expense column and that's fine for accounting, but it hides what happened. 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 doesn't contain a single clause about how your sales are going.

Variable costs show up when business shows up. Sell nothing and you buy nothing. Fixed costs arrive on the first of the month in January when the building is packed and on the first of the month in August when the parking lot is empty. They don't know the difference and they don't care.

I closed our Carson City ladies-only club on the fifteenth of August, 2004. We moved the equipment to Reno, transferred the members and placed the staff in other clubs.

My rent obligation on that empty building could run through March of 2005, and the equipment leases on machines that were no longer in that building ran to March of 2005 too.

That was seven months of worst-case exposure on a business that had stopped existing. I escaped roughly half of the rent because we found a tenant for half the space. The closing worked. That's just what a fixed

cost is. Somebody in 2001 or 2002 signed a lease, and in 2004 that signature was still collecting.

The Promise Comes Before the Production

What makes this dangerous is that you make the promise first. The production comes later, if it comes.

We hired a general manager from Lake Tahoe for our Carson North club. He required a higher starting base salary because of his experience, and we agreed to that number before he ever set foot in the building. New sales were cut in half from the time he took over, and the salary didn't adjust. It couldn't, because it was a promise.

I'll tell that story properly in Chapter 22, and Chapter 23 is about how we kept paying for it. That episode cost us about thirty thousand dollars, part of it lost profit and part of it money spent on the club. What belongs here is the sequence. We committed to a fixed cost on the strength of a résumé, which is a projection. The projection was wrong, and the promise wasn't.

Every fixed cost in your business has that shape. You promised on the strength of a number you hadn't 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 doesn't hold together.

Here's what I wrote 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."*

That's 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. It was the same club, the same paper and the same author, with two different numbers on the line that matters most.

The Reno satellite club, projected 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**

That's five thousand dollars a month, or 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.

That's one hundred and thirty-two members, about fourteen percent more selling, all of it created by a discrepancy in a document I wrote myself.

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 isn't there to be right. It's there to tell you which promises you can afford to make.

Operating Leverage, in One Sentence

The concept this whole chapter is built on 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's operating leverage. Businesses with high fixed costs make more money going up and lose more going down, with no middle setting.

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, and utilities on a building that has to be lit and heated whether four people are in it or four hundred. On the other side is 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. That's ten percent more members and 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. It's the same ten percent and the same one hundred and thirty-four percent swing, pointed at your head.

Those are the illustrative unit figures from the last chapter, at forty-five thousand. If billing is already inside that total, each profit runs a little over a thousand dollars better and the swing shrinks to about a hundred percent. It's still a swing.

What It Actually Did to My Company

I don't 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? I believe most of it came from fixed costs being spread, though the clubs also grossed more apiece, and two snapshots from different years cannot split it exactly. 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's operating leverage working for you, and it's the 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.

That's twenty thousand dollars a month, or two hundred and forty thousand dollars a year, gone.

I want to flag the next piece of arithmetic before I do it, because I'm 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 didn't lay off half the company or 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.

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're 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 won't follow the system, and you're eating the whole margin. There's no fat in a seven-cent business.

That's why the checklists matter. It's 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

There are five things, and they're all boring, which is why most people skip them.

1. Know your fixed number to the dollar. Add up every promise you've made that arrives whether or not you sell anything. That means rent, salaries, insurance, loan payments, leases, and 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 and the equipment leases ran to March of 2005. That's 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. Don't run it at plan or at ninety-five percent of plan. Run it ten percent down, because that's a normal bad year, not a catastrophe. If the deal only works at plan, it's a bet and not a deal.

4. Turn fixed into variable wherever somebody will let you. Take percentage rent instead of flat rent, commission instead of base, contract instead of salary. You'll usually pay more in the good years for that, and what you're buying is the bad year.

5. Keep a reserve, and don't touch it. That fifty-nine-thousand-dollar reserve from Chapter 3 sat untouched for a year and let me keep every promise I'd made while the first club proved itself. I wouldn't have gotten the chance to pay the loan off in 1995 if I'd spent the reserve on a nicer sign.

There's an old and very plain idea that a man should count the cost before he starts building, so that he doesn't lay a foundation and then stand there unable to finish it. I don't know a better description of what a fixed cost commitment is. You're laying a foundation, and 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 let you see both.

What I haven't told you is which one was right, because I don't know. I never opened that particular sixth club in Reno 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's how it happens. It isn't fraud or incompetence. It's 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 didn't match.

If I had built the club and the real number had come in at fifty-two thousand dollars a month, 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 didn't know existed.

So do this. Take your pro forma, find the line you're least sure of, and move it fifteen percent in the direction you'd hate. Then look at the answer. That answer, not the one in the plan, is the promise you're about to make.

Make the next promise at a number you could still keep in a bad year, because the good year doesn't 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 with sales down twenty percent.	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 will move 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 and 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 co-ed 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's how I wrote the problem down at the time. "The two ladies-only health clubs have significantly underperformed 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 doesn't say the clubs lost money. It says they caused a cash flow problem.

Those 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 isn't 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 forced the timing was the bank balance and not the mistake.

The Sentence That Saves Businesses

A profitable company can run out of money and close.

That isn't a paradox and it isn't rare. It's 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 let you spend at nine in the morning. The two numbers are related, but they aren't 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 don't stop until you can name the line that separated them.

There are five places they separate. Learn these five and you'll never be surprised again.

Where the Two Numbers Come Apart

One. Receivables. You booked the sale but you haven't 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. When a member signs up on monthly dues at thirty-nine dollars, we draft the account and the money moves. We aren't mailing invoices and hoping. If you run a business that invoices, you have a whole category of problem I mostly don't 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 haven't yet touched.

Nike is a big company but the arithmetic is the same. In fiscal 2003 the change in their accounts receivable ate one hundred thirty-six million three hundred thousand dollars of cash. That's real money that never showed up as an expense anywhere.

Two. Inventory. Everything sitting on a shelf is a dollar you already spent that hasn't turned back into a dollar. It isn't an expense until it sells. Until then it's your money, wearing a different hat, in a box.

For us that is the pro shop. The forty thousand pounds of free weights per location feel like the same idea, but they're not for sale, so they belong under the next heading.

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 won't see it that way. It spreads 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's a press, for a contractor it's a truck, for a dentist it's a chair.

Four. Debt principal. This 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.

The interest on a loan shows up on your income statement and the principal doesn't. Principal isn't an expense. It's 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 when you started while your accountant congratulates you.

I lived on the other side of this in 1995 when I paid off the entire seventy-nine-thousand-dollar startup loan before year-end. 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's the reason the two numbers aren't simply "profit minus surprises."

Depreciation is a real expense on the income statement that didn't move a nickel this month. It's 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's my definition. Free cash flow, the way I use it, is cash after maintenance capital spending: the money left over after you've paid to keep the business the size it already is.

That means 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 aren't growth. They're rent on staying the same size. Pay for them before you call anything free.

Cash from operations, minus what you spent on equipment and buildings just to stay the same size, equals free cash flow. Spending to grow is a separate decision, made out of the free cash flow rather than before it. Most published free cash flow figures subtract all capital spending, growth included, which is what I do with Nike below. And loan principal still has to be paid out of what is left.

Running It On A Club

Now do it on something you can walk through.

When we studied a sixth Nevada Fitness in Reno, I built the unit on a ten-thousand-square-foot satellite club. One thousand members were needed to make it worth doing. Dues were thirty-nine dollars a month. At ten percent of the 19,360 from Chapter 2, that is 1,936 members, and with the other club income added I projected the gross at no less than $85,504 a month in Chapter 8.

Against that, my own documents say monthly expenditures are fifty thousand dollars in one place and forty-five thousand in another. Chapter 13 takes that apart. Call the projected surplus somewhere between thirty-five and forty thousand a month, on paper, before anybody reconciles profit to cash, 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. Find the annual cost of keeping your equipment as good as it was on opening day. I'm not going to invent that number for you, because it's on an invoice in your file cabinet and not in mine. Get it, divide it by twelve and put it in the table.

What is left is free cash flow. It's still not money you can spend. Loan principal and anything else you owe come out of it first. What is left

after that is what's 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, unless they're already inside your expenditure total. Count them once.

The Same Company, Both Directions

Now watch a company a thousand times my size do the same thing. I don't want you to memorize a rule about which number is bigger, because 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.

Now let me show you the 2004 column with the pieces in it, because this is the reconciliation every owner should be able to run on his own business.

Line	Amount (millions)
Net income	945.6

Line	Amount (millions)
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**

Add the column. It comes to 1,514.4. Nothing mystical happened between the two ends of that table. Five kinds of ordinary business activity happened.

I'll give you one note on those numbers. Nike's 2003 annual report lists fiscal 2003 cash from operations at 917.4 million. The 2004 annual report, looking back at the same year, lists it at 922.0, and notes that some prior-year amounts were reclassified. 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'll find the same thing in your own books, and when you do, don't assume somebody is lying. Assume somebody classified something differently and go find out which.

Now run free cash flow for fiscal 2004. Cash from operations of 1,514.4 million, minus 213.9 million of capital spending, leaves 1,300.5 million. Nike does not report how much of that spending was standing still and how much was growth, so I subtracted all of it. That makes the answer conservative.

That subtraction is the whole art of it. You're 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.

I originally wanted to make the change immediately. John and Bruce each asked for more time, for reasons I go through later in the book, so I delayed two weeks. The transition was completed on August 15, 2004.

We had two cancellations from the whole transition. We normally lose many more members than that in the same window with nothing going on. We leased half of the Carson building quickly, which cut the worst case on rent. The equipment leases were on a clock that ran out in March of 2005. We lowered overhead more than we expected, and the lower overhead improved profit. The target was ten to twenty percent positive cash flow each month at the Reno location by March of 2005.

The meeting only picked the date. What limited cancellations to two was a sales staff with two weeks of listed, reported work in front of them, in buildings where the general manager filed a report every two hours. A decision sets the calendar, and the next two hours are what carry it out.

We also didn't perform as expected in new sales. That was troubling. Our calculation of increased market share had a discrepancy in it.

So the cash side of that decision beat my forecast and the sales side missed it. If I only tell you the first half, I've written a brochure instead of a book.

Your cash position changes while you aren't looking, and counting it once a quarter isn't attention. Because the two ladies-only clubs had a partner who wasn't in the co-ed clubs (Chapter 7), I had to track every dollar between those entities to the penny.

I Framed a Symptom as the Problem

There's one more thing I got wrong. I framed the problem as the timing of the change, and the timing was a symptom, which is the subject of Chapter 24. Cash flow is what dragged me back to the real problem, because a cash problem won't 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. If	Each line carries a dollar amount, and the lines add up to the gap.

Task	How you verify it
something is left over, name it. It may be payables or other working-capital or financing items.	
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, after maintenance spending only.	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've 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's putting his own cash into the business feels thrifty, and the owner who's borrowing feels exposed.

That's backwards. Debt has a rate printed on it, and 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's the test. If you took the same money and put it somewhere else, what would it earn? That's what your money costs you to leave in this business. It's a real number, you're paying it every month, and it doesn't get smaller because it isn't on your income statement.

What I Actually Did in 1994

Take that same 1994 startup loan from Chapter 3—twenty thousand spent on Carson City and fifty-nine thousand held in reserve. Earlier I used it as a lesson about not running out of cash. Here it's a lesson about the price of money.

I paid interest on the entire seventy-nine thousand dollars, not just the twenty thousand I used. That reserve wasn't free insurance. It had

a printed rate on it and I paid that rate every month for the privilege of not needing it. I'd do it again, because the alternative price of running out of cash in year one is one hundred percent of the business.

That's what a cost of capital decision feels like. It isn't a formula. It's you deciding what you're 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's a standard way to price the money in a business. It has letters in it. I'm 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 in the closest thing to a sure thing, which is long government paper. Hold it to maturity and you get paid. Sell it early and the price can move against you. When I ran these numbers on Nike in 2005, that rate was 4.6 percent. If a business can't 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's the price of the equity in that business. It's 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 people forget this, interest is deductible. At a 35 percent tax rate, and assuming you can deduct all of the interest, 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 matters.

I have to be straight with you here. My spreadsheet printed 7.10 percent. When I run that same blend by hand off those same six inputs, I get something different.

(0.146 × 5.2%) + (0.854 × 8.24%) = 0.759% + 7.037% = **7.80%**

Those are my two numbers about the same company and they're seven tenths of a point apart. I'm showing you both instead of picking the pretty one. Somewhere in that sheet a cell is pointed at the wrong place, and I didn't catch it at the time.

I'm 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's off by seven tenths of a point, then you should never take one on faith, including mine. Do it on paper. It's six inputs and a few lines of arithmetic, and it takes ninety seconds.

Your Bar Is Yours

Don’t go write 7.8 percent on a wall. That number belongs to a shoe company in 2005.

I’ve 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. That’s seven to eight percent for a shoe company and ten point four for a project, 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’s one sentence. If a project can’t beat the cost of the money, don’t do the project.

That arithmetic buys you a door with a height on it, not a valuation.

Substitute your own project for mine and the sentence doesn’t change, whether it’s a second location, a second truck or a bigger oven.

Here’s 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 is the wrong bar, and it’s my own handwriting. It only asks whether the club makes money. It doesn’t 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 and got three answers on the available market, from four thousand three hundred to twenty-five thousand five hundred, and one of the three was mislabeled. I was careful about the numerator. I was lazy about the hurdle.

Here's what that laziness looks like on a Tuesday. A hurdle rate is a number you set once a year, and the two-hour report tells you whether you're going to clear it. I couldn't say whether that club would beat ten percent because nobody in the company was reporting against a bar. We reported activity, but not against a number the money had to beat.

Say your money costs you ten percent all in. A project that returns eight percent isn't a small win. It's 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, or an oven, a van, a chair or a press in somebody else's. The new equipment has to beat keeping the old equipment. Count what the new machine costs, what it would earn or save over the old one, what the old one would sell for today, and how long each one has left. If that difference doesn't clear your hurdle rate, don't replace it yet. Safety is the exception. A machine that's unsafe gets replaced. 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 right answer was still no.

The project was a new product line. 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's 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	891,795
3	2,000,000	1,281,315
4	2,600,000	1,435,957
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. Write the memo, get it approved, break ground.

No.

Look at what you're holding. It's six million dollars of present value with six thousand nine hundred fifty-five dollars of margin sitting on top of it. That's 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 doesn't exist yet.

- The eight-hundred-thousand-dollar salvage assumption alone is worth $380,890 in today's money. That's 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 sets 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, before any discounting, 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 isn't an opportunity. It's a coin flip with a spreadsheet stapled to it.

The honest move is to say so out loud. Don't say "the model says yes." The model says the model can't 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 won't clear the bar. Over ten businesses and more than thirty years, not one of my forecasts ever came in exactly as written.

That's the real value of running the cost of capital. It doesn't usually tell you yes. It tells you when yes is too thin to trust.

I Never Checked My Own Cost of Capital by Hand

I got two things wrong in this chapter, and I've 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 isn't a test at all. It's a hope with an inequality sign on it.

One more thing. Money that costs nothing doesn't 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. When a decision involves a partner whose ownership differs across units, you aren't just pricing your own money. Knowing the

price of a dollar 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-term government bond 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, if your interest is fully deductible, 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, and make it a number, not a feeling. It's six inputs and a few lines of arithmetic, 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. But 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 doesn't.

So two questions are still open, and this chapter answers both. How long is the block? And how do you know that the task inside it happened?

The second question is the one that matters, and almost nobody asks it. The equation this book is built on isn't tasks equal objectives equal goal. It's completed tasks equal objectives obtained equal goal achieved. Completed means confirmed by somebody who wasn't the person doing the work.

When there was one club in Carson City, the monthly gross was about fifty thousand dollars. By 2004 we had five clubs, more than fifteen thousand members, over four hundred thousand dollars a month, and better than five million dollars a year.

I didn't get from one club to five with a vision. I had the same vision the whole time. A vision is a sentence. A business is a set of tasks that somebody has to 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. That system is the most valuable thing I own and I'm going to hand it to you in one chapter.

Daily, Weekly, and Monthly, for Every Position

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: front desk, sales representative, personal trainer, maintenance, assistant manager, general manager and regional manager. There's no seat in the building where the answer to "what is my job today" is a shrug or a personality.

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's the one this chapter is really about.

Weekly is upkeep: follow-up on the customers you haven't heard from, equipment inspection, scheduling. These are the things that won't 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's the same as having none. The thing in your head isn't available to the newest person you hired at six in the morning.

Decisions are made according to the priorities on the checklist, so the list is a priority order, not a to-do list. When two things want the same twenty minutes, the list already decided. That's worth more than the

tasks themselves, because the 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's the whole mechanism in the plainest words I have.

Nevada Fitness has developed a series of tasks that need to be done every two hours by all staff members. These checklists are all online. The general manager of each club files the report every two hours from the checklists of all staff members in his or her club, and the manager's job is to make sure all checklists get completed and reported.

General managers submit their own checklists to the online site every two hours. The regional managers and I retrieve those checklists every two hours and direct the general managers in their decisions.

Read that chain 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
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

Level	What they do every two hours
	hour

Four levels and the whole loop closes in two hours.

That chain is easy to read as reporting, but it's the verification step in the equation.

Look at the second row again. The general manager doesn't do the tasks. He confirms that they were done. That row 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 don't 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. We saw the actual checklists, filed that morning, by name, not a summary.

What that buys is arithmetic. Say a club is staffed for ten hours a day. That's five two-hour blocks. Find out about a problem at month close and three hundred staffed hours of production have already happened and can't 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 generates projection reports automatically 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.

Owners and management know exactly what kind of production and service occurs every two hours in every location they run, and they correct a lack of production immediately.

Immediately is the word I want to defend. Most owners believe they run their business daily. They don't. They run it at whatever interval they receive information, and for most small businesses that interval is a month.

What Is Actually On the List

A checklist full of vague instructions isn't a checklist. It's 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.

Item one. Every person you pay owes something to a customer inside every block.

That means everybody, not just the people whose job title says sales or service.

Here's our version from 2004. Every staff member had to complete two member favors every two hours—say, walking up to a member, thanking him for his business, and handing him a free T-shirt.

It's small and 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 or a receptionist at a dental practice can each 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.

It's a number, not an adjective: two of something a stranger has to agree to.

Here's our version from 2004. A sales rep had to make two appointments every two hours to show the club. That's the number. It isn't "prospect actively" or "focus on new business." It's two, before eleven o'clock, and two more before one.

For a contractor that's two estimates on the calendar. For a print shop it's two quotes out the door. Pick the thing that has to happen before money can happen, and require a number of it. Two is what our funnel produced. Yours comes out of the ladder in Chapter 1.

Now compare that to a sales rep who is told to do his best. His best isn't a number, so it can't be missed, so it can't be coached, so it won't be repeated. At the end of the month you'll have a conversation about attitude. Attitude conversations are what managers have when they've forgotten to set a number.

The lowest month any Nevada Fitness club ever had, in new memberships, personal training and pro shop sales combined, was well over ten thousand dollars. That floor was built out of required activity rather than hoped-for effort.

Here's roughly the shape of a two-hour block for four seats in my company.

Position	Every two hours
Front desk	Two favors. Walk the floor once. Check-ins reconciled. Phone messages cleared.

Position	Every two hours
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’s on purpose. There’s exactly one item every person in the building owes, from the newest part-timer to the man who runs the club, and it’s the one that touches a member.

What Is on the List Now

That was the list in 2004. It isn’t the list today, and the difference is the best argument I can make for the system.

We don’t pressure sell anymore in the health club business.

We still do the checklist. The concept is still my foundation. We just use the checklists to accomplish different objectives that lead to the same goals: what to do in a day to provide great service, and what to do in a day to keep the club clean. Now we emphasize doing personal training presentations and doing services for people.

Marketing is different now too. It’s so many social media posts instead of so many calls. The company doesn’t run on cold calls anymore.

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

Everything in the right column is new. Everything holding the two columns up is the same: the same three time frames, the same two-hour block, the same report, filed by the same position and read by the same people. Every item still carries a number, and every item is still confirmed by somebody who didn't do the work.

That's the point I want you to take out of this chapter, and I didn't see it coming when I built the thing. A method that outlives the tactics it was built to serve is a method worth having.

Anybody can build a routine around what's selling this year. The test is what the routine does when this year ends. Ours held, and the business does ten to twelve million dollars a year now, running on the same list.

So don't copy my items. Copy the shape. Write down the objectives your business 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 doesn't 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 can't run blocks when nobody is in the same building.

He has it 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 three 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.

The Checklists Change Every Month

Here's the piece that most people who copy this system leave out, and it's what keeps it alive.

Each general manager sends the club's changes to the representative who revises the checklists monthly. The system changes monthly, in order to keep pace with the changes in the industry and to continue the learning process for the operator.

That's 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's 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's in all five buildings at once.

That's how the list survived the changes I described a few pages ago without anybody tearing the system down.

Fourteen DVDs, So the Best Person Trains Everybody

Now the second half of the machine, the half most owners have never considered.

The checklist tells a person what to do. It doesn't 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's the entire idea. The best closer in the company trains every salesperson in the company, every time, in every building, and not just once at a meeting somebody missed.

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.

As I said in Chapter 9, staff have to be trained to run their tasks and treat members the way the owner would.

You can't hit that standard 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's the strongest objection there is. My answer starts with the least flattering thing I've 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've had that read back to me in a tone, but it doesn't 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's 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 clarity, not surveillance. 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.

The same goes for the report, which is what people are really objecting to. The report isn't there to catch anybody. It's 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 isn't an accusation. It's what you do because memory isn't evidence.

A football team has a playbook. Every play is drawn up and every man knows where he is supposed to be on it. Nobody thinks a playbook insults a quarterback. The playbook is what makes the eleven of them a team instead of eleven people running.

And here's what I've watched happen for more than thirty years. Employees under this system are calmer, not more anxious. They don't have to read my face across the room. They can read the list.

In Habakkuk, the prophet is told to write the vision and make it plain on tablets, so that he may run who reads it. It has to be written *plain*, and the reason given is speed, not tidiness. A person can only move fast on something they can read fast. If your people can't read your vision, don't blame them for walking. Get back to your list and make it plainer, because that's the 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 whose club's new sales were cut in half in the time it took him to repaint a lobby.

Where the Checklist Does Damage

Now the part where the objection is right. I've 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 doesn't leave them any.

I've 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 weren't 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's the line.

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. It might be carrying somebody's bag out to the car, or remembering that a member's daughter had a game on Friday and asking how it went, or 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, and I couldn't have. I found out about most of them later, from members, at the front desk.

The checklist is a floor, not a ceiling. It's the minimum that has to happen before anybody goes home. 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. I said that a person who isn't directed will do nothing. Now I'm 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. An open hour in a day that has a written floor is different. The list already said what mattered, the person already did it, and what's left over is a trained man with time on his hands and a standard in his head.

It took me too long to learn this. Every employee needs some free time to use their own skills and abilities to make the company better. You can't monopolize a person's whole day with your tasks.

Think about that as an owner. Every hour I assign is an hour spent on something I already thought of. I'm not the smartest person in any of my buildings, and on most subjects I'm not close. The trainer knows things about how members quit that I'll 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 aren't coming back, and nobody has ever asked him.

None of that reaches me if every hour of their day already belongs to me.

I'm not going to hand you a percentage, because I don't have one I can defend. What I can tell you is that a schedule with no slack in it produces exactly what you specified and nothing else, and what you specified is a year old.

And a second thing happens in that time, which I didn't expect. People who are given some of their day back use part of it on the customer, because they had the room and they wanted to, not because a list told them to.

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 aren't 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.

Go back to the monthly rewrite. Somebody at the Sparks club figures out a better way to hand off a tour, and next month it's on the list in

every building. That's a staff member's idea becoming company standard in thirty days.

That door is the only way the list gets better. I didn't 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 doesn't just cost you a few unhappy employees. It costs you every improvement your people would have found and didn't bother to mention.

The monthly rewrite only works if somebody had an hour in which to notice the better way. Fill every hour with my tasks and the rewrite has nothing to rewrite from.

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 isn't software. The price is that somebody at the top has to 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'll begin filing a report that isn't true. He isn't a liar. He's a busy man who has correctly determined that nobody is reading.

At that point you've 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's

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. Are you going to read them?

If the answer is no, don't 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 aren't prepared to spend that, your system will calcify and you'll have a beautiful monument to how you ran the business two years ago.

The third cost is that the machine is indifferent to what you put on it. It'll verify a wrong task just as faithfully as a right one, and it'll 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 didn't work. When I show this to somebody now it looks like a designed thing. It was accumulated, not designed. Don't 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 doesn't want to hear it is only half a system.

Two hours is my interval, not a law. It 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'm not going to tell you it's 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 isn't an interval. It's an autopsy.

You don't build a business in a decision or in a year. You build it in the smallest block of time in which a person either produces something or doesn't. 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's the one step in the equation that turns a claim into a fact.

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.

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.

Task	How you verify it
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 has 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 named person filing every block, and read every report the same day it is filed.	You are holding one filed report for 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 do differently if the number moved?

Most owners can't answer the third one, which means the first two don't matter.

The last chapter gave you the machine, the two-hour checklist system. That system will run whatever you put on it, and it doesn't care 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'd already been running clubs for years. Most of that material is written for factories, in a vocabulary designed to keep people out. I'm going to hand you the four pieces of it that changed how I run a business and leave the vocabulary in the box.

A Complaint Is Not a Problem

"The service is slow."

That's a complaint. You've heard some version of it every week you've been in business. You can't fund it, you can't assign it, you can't tell when it's finished, and you can't tell whether the person saying it is right.

Here's a ladder for turning a complaint into something you can put money against. Each rung adds one thing. I'll walk it on a restaurant, because that's where I first saw it done.

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's a fact instead of a mood, with one number from the customer and one from the process. Notice that the four minutes came from asking customers what they expect, not from management.

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.

With one sentence you just cut the project in half. This is a ninety-minute problem, not an all-day one.

Rung three. Add the extent, in dollars.

We are losing an average of 24 customers per day. Average revenue per customer is $16. Annual lost revenue is $140,160.

Show the arithmetic, because the arithmetic is the 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 the four the customer expects, we could keep all of those customers.

Three rules go with that ladder, and every one of them is about what you leave *out*.

No cause. Don't write "the service is slow because we are short-staffed." You don't know that yet. The minute you put a cause in the problem statement, everybody stops looking.

No solution. Don't write "we need another server." That's an answer, and you haven't done the work to earn it.

No blame. Don't 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.

Our clubs averaged about thirty-five cancellations a month. The national figure I used was about seventy, so we were running at half the industry count, and I was proud of that number for years. A count isn't a rate, and I never had the club sizes behind the seventy, so the pride ran ahead of the proof.

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'd never collect over the following year. Run it for all twelve months the way the restaurant did and the annual number is $982,800 of future dues walking out in one year. If we'd performed at the national figure of seventy a month instead, one month would be $163,800 and the annual number would be $1,965,600.

I just made an assumption there, that the average canceling member would have stayed another twelve months. Your number is different, so 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. It's 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 don't rebook.

Measuring the Wrong Thing Is Worse Than Not Measuring

I have a story about this, and it cost me something like thirty thousand dollars. It's in Chapter 22. The short version is that we hired a general manager who asked for televisions, paint, desks and chairs while new sales were cut in half, and for four months we let the thing we could see outrank the thing that mattered.

The lesson isn't "watch your numbers." It's 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'd think.

Too Scattered, Or Aimed Wrong

Now the second piece, which is the one I wish somebody had explained to me in 1995.

A process can be wrong in two completely different ways. The two problems look identical on a complaint form and need opposite fixes.

Here's 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.

That's dead center of the target. If you only look at the average, that process is perfect. It wasn't. The spread of the results was such that the process produced a range 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's 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's failure by scatter. Now picture the mirror image. The spread is tight, but the average sits at nine minutes instead of seven, so every order is consistently near the edge. That's failure by aim.

Those are two different diseases. Bad aim is a setting, and you move it. The process itself is fine, it's just pointed at the wrong place. Change the step, cut a form, move the target, and it's done in a week.

Bad scatter is a system, and there's no knob. If your results are all over the map, it's 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, as long as you can answer one question.

Is the thing my customers wait on slow on average, or is it wildly inconsistent?

Every business has one of those, whether it's a table, a callback, a quote or a repair. In my clubs it was the front desk, so I'll 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 don't 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 won't.

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's the system doing what the system does. Chewing out that employee is noise, not management, and the staff learns that results are random and punishment isn't.

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.

A process can be perfectly stable and still be no good. Stable only means predictable, and predictable garbage is still garbage.

From What They Say To What You Build

The third piece is about translation, and it's the shortest.

Customers don't 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're useless as instructions.

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, and the teller is efficient. Then they laid their training options across those three and scored how strongly each 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'll 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 can't draw the line, take it off the list.

Now go back to the man from Lake Tahoe and his televisions, paint, desks and chairs. Draw me the line from any one of those to "the staff handles problems promptly." You can't. That's why granting those requests didn't work, and I should have known it in the first meeting rather than the fourth month.

Balanced, So Nobody Can Cheat

The last piece exists because of a specific kind of dishonesty that isn't really dishonesty.

Give a manager one number and he'll move it. He'll move it by wrecking something you aren't looking at, he won't think of it as cheating, and he'll 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, and learning and growth. 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,

Perspective	What we watched
	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 track the financial row.

A general manager wants his profit line up this quarter, so 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, customers stop coming back, and the recurring revenue base falls, and that base is the financial number that mattered all along. He won on the number you were watching by breaking the three you weren't.

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. Your objectives aren't real if you can't count them. "Increase happiness" isn't an objective until you say whose happiness, how you'll measure it, and by when. Chapter 18 does that with a one-to-ten score. An objective must be a challenge, it must be obtainable, and you have to be able to know whether you got there. It's like counting. You'll know when and if you get there.

There's 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's 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 haven't fooled a customer. You've fooled the one man who can't 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'd go fix that thing. Then we finally surveyed our members properly, and of the five areas we asked about, exactly one came back a weakness. It was cleanliness, at 6.74 out of ten against scores in the mid-eights everywhere else, and it was the thing almost nobody had complained about out loud.

This chapter isn't so you can build a dashboard. It's 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's worth your Tuesday.

Which brings us to the obvious question. If you're going to measure what your customers and your staff think, how do you ask them, and how do you make sure they tell you the truth? That's the next chapter.

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.

Task	How you verify it
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, and 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.

We had five clubs, three hundred members surveyed in each, and every manager in the company rated by the people who worked for him. The budget was fifteen hundred sheets of paper for the member side, with no consulting firm, no focus group and no vendor.

The main reason small businesses don’t know what their customers think is that they believe finding out is expensive. It isn’t. 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 couldn’t improve either one because I didn’t know which part of the experience was weak.

I thought I knew. I’d run those clubs for ten years, and I fixed the complaints I heard at the desk.

That's the trap, and almost every owner I've ever met is sitting in it. Complaints aren't a sample. They're 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 have.

Five Questions for Customers

I asked 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'll hear only from the people who love you and the people who are furious, and both are useless as a picture of the middle.

Everything was rated one to ten, ten being the best, with numbers and no comment boxes. You can't average a paragraph, and you can't 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's deliberate. Ask only number five and you learn whether people like you and nothing about why. Ask only the first four and you can't tell which of them drives the whole thing.

Your four won't be mine. Fitness goals mean nothing to a customer at a print shop. Write four things you control and could change on Monday, and make the fifth one the overall question. That structure is the part worth copying.

That came to fifteen hundred members and seven thousand five hundred ratings.

Survey Up

The staff side is where I'd push you hardest. It's the piece almost nobody does and the piece that changed how I ran the company.

We didn't ask supervisors to rate their employees. Everybody does that already and it tells you very little you didn't 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.

An evaluation with a name on it is a job-preservation exercise, and every person filling it out knows what the safe answer is. You'll get eights and nines across the board, you'll feel good, and you'll have learned nothing except that your people aren't fools.

I proposed ten statements for the staff evaluation. We recorded and reported seven. I don't have a good record of which three were dropped or why, and I'd rather tell you that than pretend the plan and the execution matched. They usually don't.

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 isn't like the other six, and it's 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, which isn't the same as whether he's well liked.

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

Club	Clean	Friendly	Prompt	Helpful	Satisfied
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 weren't 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 me no handful of furious or delighted members was dragging a column around. It doesn't prove the members who answered spoke for all the rest. We ran the survey a second time, as a check on the survey itself, and the results were similar.

Friendly, helpful and satisfied land in the mid-eights in every club. Prompt does too, everywhere except Reno, and I'll come back to Reno. There isn't a bad building in the company on those four. And then there's 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**

That's nearly two full points out of ten, in all five buildings.

In ten years, cleanliness wasn't 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 every one of those fixes was in a category we were already good at.

Members don't 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's the 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. The Reno club scored 7.17 on handling problems promptly, against a company average of 8.16 and 8.64 at Carson South. That was one club with 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 isn't a decision. Here's the decision.

We hired a maintenance person in each club to clean five hours a day. That's in addition to the cleaning companies that already cleaned every club nightly.

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's real payroll, added permanently, on top of a contract we already had, to fix a problem not one member had put in writing. Our clubs averaged about thirty-five cancellations a month against the national figure of about seventy I was using, and dues were thirty-nine dollars a month. Every cancellation we prevented was thirty-nine dollars that kept arriving, and it kept arriving the next month too. That's dues, not profit. Chapter 19 prices the payroll against what a kept member leaves you.

Run the same comparison in your own business. Put the cost of the fix on one side and the value of the customers you'd keep on the other. If the second number is bigger, the fix isn't an expense.

I can't prove the maintenance hire moved retention, because I didn't run that test cleanly. 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.

The Score I Did Not Want to See

Now the uncomfortable one. Here's the manager table, in full, exactly as it came back.

Statement	Reg. Mgr	Reg. Service	Reg. Maint	Sparks GM	Reno GM	Cars on N GM	Cars on S GM	Minden GM
Positive	8.1	8.5	7.8	8.3	8.4	8.6	9.1	8.2

Statement	Reg. Mgr	Reg. Service	Reg. Maint	Sparks GM	Reno GM	Carson N GM	Carson S GM	Minden GM
approach								
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 organized	**5.6**	8.6	7.4	7.0	7.5	6.8	8.0	8.5
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's 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.

Then there's well organized, at 5.6. That's the lowest single score in the entire company, 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 isn't a man his people dislike. One column from one survey isn't proof, but a gap that size was more than enough to go find out about. It looked like a specific, isolated, very large hole in a very good manager, reported anonymously by the people who work under him.

The other man in that table is the Regional Maintenance Manager. He's the weakest overall at a 7.17 average, and he's 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's a convergence I didn't go looking for. The two surveys were 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.

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. Both are about the unglamorous, repeating work nobody thanks you for. We were a company full of well-liked, fair, respected people who weren't tidy, in the building or on paper.

That's a finding about me, not about them. I set the culture and I hire for what I value, and I'd 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's comfortable and because nobody will ever know you took it.

The second wrong answer is to fire him, because some owners think that's what decisiveness looks like.

You don't 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 don't know how to hire a man whose staff respects him, considers him fair, and is happy working for him, and I've tried.

The right answer is much less dramatic than either of the wrong ones. You stop pretending you didn't 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 isn't a mystery. He spends his time on what he's 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'll get done. He doesn't have to become a different man to stop costing you money.
3. **You measure it again next year.** If the number moves, the fix probably worked. If it doesn't, you have a second data point and a much harder conversation, and you've earned the right to have it.

That's 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's 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'll tell you the one thing nobody in the building will say to your face. Take the wound, fix the thing, get back to work.

I Never Surveyed Myself

Three things.

I never surveyed myself. There are eight managers in that table, and not one of them is me. Every manager in that company was rated by the people under him except the one man whose habits set the standard for all of it. I didn't leave myself off on purpose, and that's the point. It never occurred to me, and it took me years to see it.

I designed the instrument my company was going to be graded by. I wrote every statement on both instruments, and a man who writes his own test has some influence over the result. A 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 can't prove the outcome. We hired the maintenance people and I believe it helped. I didn't 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'd push back on him hard.

Now the discipline. Don't run a survey you aren't prepared to act on.

A survey you ignore is worse than no survey. 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 didn't just waste paper. You taught fifteen hundred customers and every employee you have that being asked for your opinion here doesn't mean anything. The next time you ask, they'll tell you it's fine, because they know it doesn't matter.

So before you print the first sheet, decide what you'll 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 didn't ask.

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

Task	How you verify it
	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'd 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 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 how many of your commitments to them you have kept.

What is leadership? What does it look like on a Tuesday afternoon? And who decides whether you have any?

It isn't you. That's the answer to the third question, and it's the only place this chapter can start.

A leader is someone who has followers. That's the definition. It's not a job description, a personality, or a line on a business card. Turn around and look. If people are behind you, you're leading. If nobody is there, you're 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've 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. Nobody filed paperwork. The followers simply moved.

Here's 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, meaning the questions people really ask and not the ones they're supposed to ask. If they walk past a supervisor to get to a twenty-two-year-old with no title, you've just found out who is leading that afternoon.

That's information, not a crisis, and what you do with it is a decision. The mistake owners make is to treat the gap between title and followership as insubordination. It's a report, and it's more accurate than anything you'll get in writing.

The Pen

The clearest picture I have of how leadership moves through a company is a picture of me behaving badly, or rather of what would happen if I did. Here's the line I've 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.

Now watch the mechanics. At the time we had five clubs: Sparks, Reno, Carson North, Carson South and Minden. Above the clubs were the regional managers. Below each general manager were the staffs, and across all five buildings we had over fifteen thousand members.

The regional manager doesn't throw anything. He's embarrassed for me. But he has a call with two of the general managers inside the hour,

and he's short with them, because he's 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'd describe as throwing a pen. Every one of them passed along the temperature.

Our whole operating system ran on a two-hour reporting cycle. It took two hours to move a number and forty-five minutes to move a mood.

That's the ratio you're working against. Information travels at the speed of your system. Behavior travels faster, because behavior doesn't 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 didn't make that up and neither did the person I learned it from. But there's a piece of it people miss, and the pen is what taught it to me.

They don't 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 aren't stupid, and when a claim and the evidence disagree, everybody in the building believes the evidence.

Being a leader has taught me a lot, and the first thing is don't throw things.

I'm half joking and half not. Take the pen out and put anything you like in its place. It could be sighing when a manager asks a question, checking your phone while somebody is telling you about a problem, or 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.

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, the department and the keys. Turn around and look, and there was nobody behind him.

Now put the member survey beside it. That same year fifteen hundred members rated five things about the clubs. Clean came back at 6.74 out of ten, against the mid-eights on everything else, and it was the only weakness they found.

The weakest-led department in the company produced the only thing our members marked us down for.

Here's what it cost, and it's permanent payroll. We put a maintenance person in every club to clean five hours a day, on top of the nightly cleaning company.

5 hours × 5 clubs × 30 days = **750 hours a month** of new payroll

Dues were thirty-nine dollars a month, so a member who stays a year brings in 39 × 12 = $468. That is revenue, not profit, so price the

hours too. At an illustrative ten dollars an hour all in, 750 hours is $7,500 a month, or $90,000 a year. At about $454 a year of contribution per member, 37.83 × 12, the cleaning has to keep roughly two hundred members a year who would otherwise have walked. With members telling us clean was our only weakness, I would run it again tomorrow.

But be clear about what I bought. I bought cleaning. I didn't 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's 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's respect.

Or you can produce followers with vision. That's slower. You have to say where you're going, say it more than once, and then go there yourself while people watch to see whether you will.

The difference doesn't 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.

Notice that the word is *hostile*, not *gone*. They don't 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're weak is the day the ledger gets settled. I've watched it happen in other companies and it isn't 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, or a partner with a different interest gets a vote. Something moves, and on that day you find out what you built.

There's another version of this that's subtler and more common than outright fear.

If a leader goes left but expects her followers to go right, that is pushing, not leading.

That's the failure of most management I've seen. It isn't cruelty, it's direction. You're asking people to go somewhere you aren't going. You can push people a long way if you're strong enough, but every foot of it costs you something, and the moment you stop pushing they stop moving.

The Four Things That Earn Respect

I'm going to give you four things, and the operational version of each one, because a virtue you can't schedule is a decoration.

One. Be open and honest.

That means honest when the number is bad, not just when it's convenient. Tell your people the truth about the business, including the parts that scare you, at a level of detail they can use.

The operational version: when something goes wrong in your company, how does your staff find out? If they hear it from you, you're open. If they hear it in the parking lot two weeks later and you never mentioned it, you're 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*. It doesn't say usually. Your staff doesn't score this one as a percentage. They score it as a streak, and it resets at zero. Count your percentage anyway, below, so you can see the pattern before they do.

The operational version: keep a written list of every commitment you made to an employee this month. I mean to an employee, not to a customer or a bank. 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's not the number you think it is.

Three. Take responsibility for your actions.

We'll come back to this one in a minute, because it has a wrinkle most people get wrong.

Four. Do not ask others for more than you would do yourself.

The operational version is simple and physical. Is there any task in your business you've decided is beneath you? Name it. Then go do it on a Saturday, in front of people, without announcing that you're doing it to make a point.

I'll tell you what I think about this one, and it may be too blunt. If you won't clean a bathroom in your own building, you haven't 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 haven't earned it.

Those four things are the whole list. There's 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, which is the single most useful distinction in this chapter. Fault and responsibility aren't the same.

Here's 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, and I mean genuinely rude, not a misunderstanding. She leaves and she doesn't come back.

Whose fault is that? It's entirely his. He's an adult, he chose his words, nobody instructed him to speak that way, and if it happens twice he shouldn't work there anymore.

Whose responsibility is it? It's yours, completely, with no share of it going anywhere else.

Those two answers don't compete. Most owners think they do, so they spend their energy establishing the first one. They want it on the record that they didn't tell him to say it. Nothing about the business has changed and the customer is still gone.

Fault answers the question *who did it*. Responsibility answers the question *who will fix it*. Only one of those two questions has a future tense in it.

Once you accept that, the follow-up questions 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, and none of them is his fault.

I'll give you a real one out of my own history. I opened two ladies-only health clubs on a belief about the market that didn't turn out to be true. I eventually closed one and converted the other.

Whose fault was it that those two buildings underperformed our four co-ed clubs for years? It wasn't the general managers' or 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, and 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. I don't get to point at a sales report.

Here's the part that surprised me. Taking that on publicly didn't 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's 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 don't 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's not a religious add-on to business ownership. It's the job.

What This Costs

Everything above is expensive in exactly one currency, and it isn't money. It's 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. Some mornings I've 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's nothing noble about it. It's maintenance, the same as unlocking the door.

The second cost is speed. Fear is faster. Explaining where you're 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, and it doesn't get more efficient with practice.

With that time you're buying the version of your company that still functions on the day you aren't the strongest person in the room.

I don't know when your day is coming, but I know it's on the calendar. So build for it now, while it's cheap.

The Tasks That Obtain It

Task	How you verify it
Stand where your people work at four in the afternoon and write down the name of the person they actually take a problem to.	The name is on paper, and it either matches a title on your org chart or it does not.
List every commitment you	The list exists and a manager

Task	How you verify it
made to an employee in the last thirty days, one line each, with the date you made it.	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 one customer's twelve-month contribution, what he pays minus what he costs you to serve, next to the annual payroll it would take to fix your weakest department, and count how many customers a year that department has to keep for the payroll to pay for itself.	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, ahead of customers. The second half of that sentence is the half that does the work, so here's 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've said that in rooms full of business owners and watched the temperature drop. Every book, every seminar and 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 don't believe it, and I haven't 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.

That didn't 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 be fair up front. The Marriott gives exceptional service. I've done a tremendous amount of business with that company since, by choice, with my own money. They're very good at what they do. This is

a story about one rule inside a good company, and that's why it's worth telling.

Here was the rule at the spa. Employees weren't allowed to let customers into the aerobics room during a class if they weren't participating in the class.

That's a sensible rule. A person wandering through, standing in the doorway or cutting across the floor disrupts a class that other paying guests came for. It's a safety issue and a courtesy issue.

I watched employees enforce that rule, and every time I saw it done, it was done politely. That 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.

Sometimes the customer complained. When that happened, the customer was given free massages, free overnight stays, whatever it took. And often the employee was written up for not following the customer-is-always-right rule.

The employee followed the written rule and was polite, and she 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 didn't 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

That write-up cost more than one employee's morale. Morale is what the manager thought he was spending, and he thought it was a fair price for a smooth afternoon. What he really did was teach a class.

Every employee in that building heard about it before the end of the week. Staff talk in the break room and in the parking lot, and a story about somebody getting written up for doing the right thing travels farther and faster than any memo ever written.

And the lesson everyone took from it was correct. Don't enforce the rule. Enforcing it has a downside for you and no upside. Look the other way, let the man walk into the class, and if twenty people in that class are annoyed, they're annoyed at the man and not at you.

So now watch the chain. I wrote this out once for somebody who didn't 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.

One rule bent to satisfy one customer leaves 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 don't think the manager who signed that write-up would have signed it if somebody had handed him that arithmetic first. He wasn't a bad man. He was following a rule he'd been given, and the rule was stupid. I'll spend the whole next chapter on why.

Backflips and Trucks

Here's our rule. It's 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 isn't soft. "Employees come first" gets heard as an excuse, and it's the opposite of one. We required our staff to do two favors for a member every two hours, and today it's two services. A favor is going above and beyond what the member expects, and it's a task on a checklist with a clock on it. In 2004 our sales reps had to book two appointments to show the club every two hours. Today that block is a personal training presentation, as Appendix B shows. That's production, and it's measured.

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's 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.

Rewarded, not just tolerated or defended, and in front of people.

Here's what happens if you don't do it that 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's what surprises owners. You think you're only losing enforcement, but you're losing compliance too. An employee who has learned that the rules don't survive a determined customer has

learned that the rules aren't real, and a rule that isn't real binds nobody, including the person you told to enforce it.

The Word "Politely" Is Doing All the Work

I have to slow down on one word, or this chapter becomes an excuse for rudeness.

The employee is rewarded if she **politely** holds the customer to the rules.

That's the only condition, and it isn't a small one.

A little crow is always necessary. That's part of every job where a customer can reach you, and anybody who can't eat a little of it shouldn't be in one. Somebody is going to be unfair to you today and you're going to say "I understand. Let me see what I can do" and mean it. But there is such a thing as too much. Boundaries must be set.

So the standard for an employee is a warm face, a level voice, no argument, and a rule that doesn't move. If she does that, she's right, and my job is to make sure she never has to wonder whether I'm going to hold that position when the customer asks for me by name.

If she does it with a sneer, that's a different conversation and a real one. She was right about the rule and wrong about the job.

The distinction isn't hard. Companies don't make it because "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

Here's how you run employees-first, in five things. You can put every one of them 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've abandoned. If the answer is no, the no should have been written before either of them got out of bed. Then she isn't refusing him. She's 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. 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 brings in 39 × 12 = $468 of dues, about $454 after billing. So if a twenty-dollar concession keeps a member who was truly wronged, that's a very good trade, and I don't want an employee spending twenty minutes and a phone call to find that out.

Now the other side of the same arithmetic. 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 exact number matters less than the shape of it. A concession is cheap. A repealed rule isn't, 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's the highest-return thing on this list, because it's the direct answer to the Marriott write-up. Somebody is going to teach a class in your company this week. Make sure it's 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 aren't angry. If the customer was owed something, the customer gets it from you, the same day. The customer doesn't need to see the correction. If the mistake is a safety or legal problem, fix it on the spot. Your other employees are all watching from about fifteen feet away. If you reverse her in public, they'll 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's 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. It's 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 I got it wrong for a long time by simply not asking.

Employees-first doesn't mean giving your people what *you* would want. It means finding out what *they* want and taking it seriously.

There's a line in Colossians telling masters to give their servants what is just and equal. That's a two-thousand-year-old employment

instruction, and it doesn't say *generous*. It says *just and equal*, which is a harder standard, because it means finding out what the thing is 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 didn't 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, but only one of them lands. If you hand him the plaque and take the birthday, he'll thank you politely and know exactly what you are.

Employees Come First Is Not Employees Can Do Anything

Now the failure mode. I've 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'll say the hard version, because I've written it before and I won't walk it back. Most people procrastinate. If they are not told what to do each hour of the day, they will do nothing. The two-hour updates are production requirements. That isn't contempt, and I include myself.

Directed doesn't 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.

Put the two sentences together and you have the doctrine. I will protect you from a customer. I will not protect you from the checklist.

The checklist system from Chapter 16 is what keeps employees-first from turning into a country club. Two favors every two hours. Two appointments every two hours in 2004, two presentations today. 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.

I don't do this because I'm generous. I've never claimed to be generous. I do it because it produces. An employee who knows she's backed will enforce your standards when you're two hundred miles away, and there's no supervisory system on earth that can replace that. I'd 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.

Task	How you verify it
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 an unsigned form rating their supervisor, marked with the supervisor's name and nothing that identifies the employee, and average the scores yourself.	The completed forms identify the supervisor but not the employee, 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’d been running health clubs for a while and had heard that sentence more times than I could count. But 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 didn’t have an answer, because there is no answer. I didn’t do it to be clever, although I’ll admit I enjoyed it more than I should have.

In about eight seconds he had stated a rule and then broken it, and he didn't notice either one. He said the customer is always right. Then a customer told him the price and he said no.

He didn't believe the thing he said, and he never had. He said it the way people say "how are you" in a hallway, as a noise that means *I am friendly*.

I've thought about that man for twenty years, because he wasn't unusual. Ask a hundred business owners if the customer is always right and ninety of them will say yes without blinking. Not one of them means it, and every one of them has employees who have to live inside a rule the owner doesn't believe.

This is only the beginning of the problems with the customer-is-always-right philosophy.

The Stupidest Rule a Business Can Make

I'm going to say this in the strongest form I have, and then 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's a logical fact, and I'd challenge anybody to get around it.

A rule is a statement that something isn't 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 aren't participating, deliveries at the back door, shirts required.

Now add one more rule to the list: the customer is always right. 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. You wrote a rule that automatically wins against all the others, so every other rule on your list has just been repealed.

Which Right Customer Is Right?

Here's the harder version, and it finishes the argument. Two customers want opposite things.

That isn't a rare case. It's the loud table and the quiet table in a restaurant. It's 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, where eleven customers in the class complain about one customer who is disrupting it.

Which right customer is right?

There's no answer inside the rule. The disruptive man is a customer, so he's right. The eleven people complaining about him are customers, so they're right. The rule gives 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 favors in practice. It's the loudest one, not the majority. The eleven will complain to the instructor once, and that's as far as most of them will take it. They'll finish the class, say nothing more, and quit in March, and you'll never connect the two events. The one loud man will find a manager in ninety seconds.

So the rule doesn't mean *the customer is always right*. It means *the customer who complains is always right*, and that's the sentence your business is running on.

Every day, in every business that has more than one customer, somebody has to choose between customers. The choosing is the job.

A rule that says every customer is right takes the job away and leaves you the consequences.

The Other Side of the Ledger

Now I owe you the other half, because I've 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 couldn't help me with my reception problems. They didn't 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, one after another, over two months.

I was paying Dish Network one hundred and twenty dollars a month. That didn't seem to get their attention.

I asked for a one-month credit for the two months this problem went on. 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 switched to DirecTV, at the same 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's only the part he could 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.

We had televisions running in five health clubs. I don't know what fifty commercial receivers would have billed at, and neither did he. That's the 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's all I, the customer, was asking for, and it wasn't unreasonable.

J & S Digital Satellite

Now the company that did it right. Notice exactly what they did, because it isn't 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's what earned them everything. They addressed the Dish Network receiver issues. Those problems weren't their fault. J & S didn't make the receivers, didn't 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 didn't have to do.

J & S will have me as a customer for life.

Now put the two companies side by side.

	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. What they did was give me more of *their own effort* than the contract required.

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 weren't paid to carry. It comes out of your capacity and you decide how much of it to spend. It's the two favors every two hours. It's 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 comes out of your standards, and unlike hours, you don't 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's right when he isn't.

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's the replacement, in three parts.

1. Customers get great service, defined as tasks.

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. What matters is that they're countable. Service defined as a task gets done. Service defined as a value gets discussed.

2. The rules are short, written, and every employee can name them.

If you can't list your rules on one page, your staff aren't enforcing rules. They're 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 isn't "because we said so." It's "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 handles requests 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?

As Chapter 20 showed, a member who stays a year brings in $468 of dues. Run the same multiplication on whatever your customer pays you and however long they stay. 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 risking $1,440 of revenue to save $120, and he'll be praised for it, because the $120 shows up on a report and the $1,440 never will.

That's 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'm done.

The first one is in the heading. I'm the man who flipped a quarter on a counter over a yogurt topping. I've asked for a credit, been told no, and taken my business elsewhere over one hundred and twenty dollars, which some people would say isn't proportionate. I know what it feels like to be on the other side of the counter thinking that being the customer is itself an argument.

It isn't an argument, and it wasn't one 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. Those are two separate facts.

The second admission is more useful. I am not saying a business should try to serve all customers at all costs.

There are customers whose business you shouldn't want. It's a very small number, and you'll know them within about four minutes: the customer who abuses your staff, and the customer who wants a rule broken every visit and gets louder each time. In my clubs that customer brought in $468 a year, and by degrading the experience for even one percent of a three-thousand-member building he put $14,040 of other people's dues at risk. Run that comparison in your own numbers before you decide he's worth keeping.

You're allowed to let that person go, politely, with a refund if one is owed, and without a lecture. It's one of the most profitable things you'll 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 does a customer bring in over twelve months, and how much of that do you keep after the cost of serving him? Write both numbers down. Does the person authorized to say no to a credit know them?

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's the least likely to be worth the money.

I paid about thirty thousand dollars to learn that. Here's 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.

Read that paragraph again, because I wrote it at the time, in those words, and every sentence in it is a mistake. They're all true statements, and every one of them is the wrong thing to be thinking about.

Look at what's in there: excitement, experience, a recommendation, professionalism, and a salary premium justified by the experience.

Now look at what isn't in there. There's no number. There's nothing about what this club needed to produce, at what level, by what date.

There's no statement of the problem this man was being hired to solve, and not one word about whether he would run our system.

I hired an adjective. I hired *professionalism*, which isn't a measurement, which nobody can be held to, and which I couldn't have proven or disproven on any Tuesday of his employment.

Bruce Gimple, our regional manager, made the decision to hire this candidate. I'm 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'll come back to that at the end.

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. Under our checklist system, the general manager files the club's report every two hours from the checklists of all staff members in his club. That isn't paperwork around the job. That is the job.

He wouldn't do it. He had run a club before, at Tahoe, with his own methods, and he'd been hired at a premium 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.

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 came out about thirty thousand dollars worse than if this escalation had never happened, some of it profit we never made and some of it money spent on the club.

The Sentence I Wrote Afterward

When I sat down to work out what had happened, I wrote this, and it's the most useful thing I've 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. 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's my failure, not his. It happened before he ever walked in the door, when I wrote a job description with an adjective in it instead of a number.

There's a name for what upper management did over the following four months. It's a well-documented, extremely expensive thing that smart people do, and it has the whole next chapter to itself. This chapter is about the hire.

The Arithmetic

Let me rebuild the thirty thousand dollars, because it's worth seeing where a number like that comes from. I'm 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** of damage.

Now put that next to what our company was 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 that hire cost us over those four months was about the size of one full month of the entire company's profit, across all five clubs.

Here's the other way to get there. The lowest dollar amount for any Nevada Fitness club in the history of the company, for monthly income in new memberships, personal training and pro shop sales, is well over ten thousand dollars. New memberships are the largest piece of that ten thousand. Cut them in half and you're giving up something in the neighborhood of four thousand dollars a month, before you count the dues those new members would have paid month after month for as long as they remained members.

$4,000 × 4 months = $16,000 of sales we didn't make, and that's only the front end. Add the dues those members would have kept paying and the salary premium we paid over what a normal general manager

cost us, and that's the lost-profit side. Then there are the televisions, the paint, the desks, the chairs and the additional equipment. None of it was what the club needed. We bought it to give him a chance, and that money would have done far more spent somewhere else. It was money spent badly, not profit lost, so I keep it on its own side. Put the two sides together and thirty thousand dollars looks like about the right size for what the hire cost us. I can't split it between the two sides to the dollar, so read it as the scale of the mistake, not an audited figure.

One more number should bother you. **New sales were cut in half in month one.** We terminated in month four. We had the information on day thirty and 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 isn't 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're listening for one thing. Does the sentence "at Lake Tahoe we did it differently" appear? It isn't disqualifying by itself. Good people

have good ideas and I want them. What matters is what comes next. If it's "so I would want to understand why yours works before I change anything," hire him. If it's "so I would want some latitude," you have your answer, and it's 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 fourteen training DVDs on subjects from data entry to collections to membership sales, each one featuring the person in the company most qualified to teach it, so that the best person trains everybody instead of the nearest person. I can teach a good person our sales process in a month. You can teach yours in a month too, whatever it is.

I can't teach a man to run a system he has already decided he's above.

3. Buy experience only in the thing you actually need.

Experience is specific, and it's only worth a premium when it's experience at the exact problem you have.

Our problem at Carson North was new sales. His experience was in running a nicer building. Those aren't 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 aren't about the same thing, you're paying for something you

don’t need. That holds whether you’re 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 sit down and count the cost first, so that he did not lay a foundation and then run out of money with everyone watching. It’s a practical warning, and it’s exactly right about a premium. We counted the salary, and that was the only cost we counted. We never counted four months of a club running at half, or what a general manager who won’t use your system teaches the four managers watching him.

Count that cost first. Then go build the tower, because the passage isn’t 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’s containment, and it’s a procedure. Write it before the person starts, because you won’t write it afterward.

A goal without a plan is just a dream. A new manager without a written ninety-day plan 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 can't fill that in, you don't know why you're hiring, and you should stop.

2. Days one through thirty, they run the system exactly as written. No changes. That means thirty days of the system as it exists, without their ideas or yours, so that when the numbers move you know what moved them. A manager who can't 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. It's a page with two numbers, not a conversation about how it's going.

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've 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. The reasoning is in the next chapter, but put the rule in now, because it's free and it would have saved me most of the thirty thousand dollars.

The One Question

A struggling manager is going to ask you for money. It won't sound like an excuse. It'll sound reasonable, it'll be about the customer experience, and it'll 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?

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 doesn't 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 isn't a thing you can purchase from a furniture company.

There's 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 and no claim that had failed. 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've said so in writing before, and I'm saying it again here only because I know who signed it. I'm 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 could read the two-hour reports from Carson North any day I wanted, and cut in half isn't a subtle number. I didn't object either.

I said in Chapter 16 that our checklist system is clarity, not surveillance, and that its real defense is that it makes a bad hire visible fast. This chapter is my proof, and it's also the limit of my claim. The system did what I said it does. New sales were cut in half and the report told us so within weeks.

The system wasn't the problem. We were. A number on a screen can't make you look at it.

I've been asked whether the man from Lake Tahoe was a bad manager. I don't think he was. I think he was probably a good manager of a club that wasn't 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's 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 sales in half, work out what that does to its monthly profit, multiply the drop 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.
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? I mean you, not somebody else.

Nobody throws good money after bad, at least not the way it feels from the inside. No owner has ever sat at a desk and thought, this is bad money and I'm going to throw it after worse money. What he thinks is that he's very close, that the last piece is missing and he can see it from here, and 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. It's the most expensive bias in business and it's aimed directly at people who are good at their jobs.

Max Bazerman of Harvard Business School spent his career studying how managers actually 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.

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's an org chart more than it's a bias. Fix the org chart and you fix most of the bias.

Four Months and Thirty Thousand Dollars

I'll use the Carson North hire briefly here, because the full story and the hiring lessons are in Chapter 22. What I need from it is the shape of the escalation.

Bruce Gimple made the hire. Every one of us in upper management, including me, knew that man's credentials and every one of us was in a position to approve more money later. That last part matters more than the hire.

The new general manager resisted following the Nevada Fitness checklist system, and new sales halved. Then came the requests.

He said the club needed new televisions, paint, desks and chairs for the sales staff. We granted it. One month later, sales were still at an all-time low. He asked for additional equipment in order to increase sales. We granted it again. He was terminated at four months. Between lost profit and money spent on the club, that hire cost us about thirty thousand dollars. Chapter 22 has the arithmetic.

Now look at the sequence. Decision one was the hire. Decisions two and three were spending approvals, made after we had evidence. We didn't 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 averages about seventy-five hundred a month, but it didn't arrive that way. The televisions, paint, desks and chairs went out early, while we were still giving him a chance, so stopping later wouldn't have gotten that money back. The

lost sales and the salary premium ran month by month, and that hole gets deeper as the sales pipeline empties. Killing the decision at sixty days instead of one hundred twenty would have saved two months of those, and maybe the extra equipment. A straight line says fifteen thousand. I can't prove the real number to the dollar, but nothing new had to be learned to save it. Everything we needed to know was visible in month two.

What escalation costs you isn't the original mistake. It's 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. "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 were visible from the parking lot, and both were 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.

The number that mattered was on the report and the number was cut in half, and a number on a page can't compete with a freshly painted wall you're 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’s nonsense. We had spent money, therefore we should spend more money. But nobody experiences it as that sentence. What you feel is that we’re already in for a lot, so let’s not waste it.

The money is gone in every branch of the decision. It can’t tell you anything about which branch to take, because it’s 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 keep paying the premium	You pay only what a replacement costs
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 control. That’s the entire mathematics of a sunk cost, and I’ve watched intelligent men argue with it for a full quarter.

Why It Gets Worse The Better You Are

If escalation only happened to careless people, you could hire your way out of it. It doesn't. It's 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've been right that many times in a row, "give it another month" isn't arrogance. It's 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 hasn't 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 isn't a financial cost, and it moves more money than most financial costs do.

None of those three are character flaws, and that's why the fix isn't moral.

The Fix Is a Procedure

You can't decide to be less biased. I've 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 don't decide to be better. Decide earlier, decide it in writing, and hand the review to somebody else.

Here is the template, on one page. I call it a decision charter, and 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.

That's eight lines and fifteen minutes. Now let me fill it in for the hire that cost us about 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

Line	What it should have said
	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 and I only approved it. That is not clean independence. The clean version is somebody who was not in the room, and if you have one, use him.
What happens if we hit the kill number	We end it and place the club under the Carson South general manager until we rehire.

I didn't 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, and 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" isn't a kill criterion. It's a phrase people say to end meetings. New sales below the trailing average at day sixty is a kill criterion, because on day sixty it's either true or it isn't, and no amount of talking changes which.

2. Put the review date on the calendar before the first dollar moves. I mean a date on a calendar with a person invited, not a reminder in your head. 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 really reviewing himself, and he already knows the verdict he can live with. In our company the closest we came was the regional manager reviewing my decisions and me reviewing his, and as the table admits, I had approved his hire. Use somebody who neither sponsored nor approved the decision. If nobody like that exists, write down the reviewer's involvement and get an outside challenge where you can. It doesn't require an outside board. It requires a rule.

4. Judge every follow-on request against the plan, not against last month. This one is subtle and it's 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 instead. Then ask the question I now ask about every spending request from a unit that's behind.

Would I approve this request from a manager who was hitting his numbers?

If the answer is no, you're funding an excuse instead of a business case, and you're 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 the desks, the chairs and the equipment, because we would never have bought them for a manager who was hitting his numbers, and it would have put the real conversation on the table months sooner.

Where This Meets the Two-Hour System

You already have the machine for this if you've been reading straight through. The two-hour reports let regional managers and me correct a club before lunch instead of after the month closed. That isn't surveillance and it isn't about distrust. It's 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.

A restaurant can count covers by shift and 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?

In Carson North the manager wouldn't work the checklist himself, so every conversation about him became a conversation about impressions, and impressions were exactly the thing his spending was improving. A man who won't 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 don't want to make myself the hero of the ladies-club decision I'll show you in the next chapter, because I got a piece of it right for the wrong reason. When I closed the Carson ladies club and converted the Reno one, I wrote, "We have given these two clubs plenty of time to grow." That instinct to stop was right, and it let me act while acting was still cheap. But I never wrote down how much time was plenty. There's no date in that sentence and no number in it, so I have no procedure to hand to a manager, and I can't repeat it reliably and neither can you.

Getting it right by judgment isn't a system. It's a good day.

I also want to be plain about who approved the escalation in Carson North. Bruce made the hire, but I was in upper management, I knew the man's credentials, and I was in a position to stop the second request and the third. I didn't. Writing "all upper management was in a position to escalate the commitment" in a memo is a very tidy way of saying I was in the room and I said yes.

Escalation doesn't look like a fool doubling down. It looks like 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 can’t, do you 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? I mean how, not what you decided. 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 can't, and I include the good ones. They can tell you the answer and the reasons, but the reasons were assembled after the answer, the way you clean the house after you decide company is coming. That isn't dishonest, but it isn't a method, and a thing that isn't a method can't be taught to a manager, handed to a partner, or checked.

I'm 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 aren't complicated, and that's 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.

I've used those six lines 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. The example below is mine because it's 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, approximately one half mile from the first co-ed health club we opened in February of 1995. We had a second ladies-only club 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'll give you the outcome now so you aren't 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 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."*

Hold on to that, because later in this chapter I'll 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're trying to accomplish. They aren't the options. They're 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, our rent obligation could last until March of 2005. That's a bounded worst case, and knowing the boundary is what let me score this criterion instead of worrying 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. The memo didn't say ten to twenty percent of what, and it should have. A criterion needs its denominator. The harder half of the same criterion was this. 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. There was also a structural problem. The two ladies-only clubs had one owner who was not an owner of the co-ed clubs. The terms 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 didn't own a piece of. You handle that 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
Increase Profit	10
Ethics	9

Now read that table as a portrait of the man who wrote it, because that's what a weight table is.

I weighted the future over the present. 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 and 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. 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 doesn't get scored. It doesn't get on the page.

The nine didn't measure right and wrong. It measured how hard each option was on people who didn't 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.

The last two were the one-club options, dealing with Carson alone or keeping Reno alone, and both were scored and both lost. 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 happens to most problems. If you leave it off the page, you haven't eliminated it. You've just stopped measuring the thing you're 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.

That's twenty judgments. Every one of them is mine and every one of them is arguable, which is 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. The real product of this method isn't the answer. It's 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.

Highest number wins. Combine the two ladies clubs into a co-ed club in Reno, at 357.

Why the Winner Won

Don't 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, future market share and profit, produced eighty of the eighty-five points. Everything else was noise, and two of the five columns ran against the winner.

This wasn't a broad victory. It was a decision that rested on exactly two beliefs. If either one of those beliefs was wrong, half the margin goes with it, and if both were wrong the lead shrinks to five points, which is no lead at all. That's 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. "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. Let me tell you what that 9 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, and 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 isn't ethics. It's a timing preference wearing an ethics jersey.

A club that's bleeding cash isn't a safe harbor for the people in it. It's 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.

Look at "sell Carson" the same way. It was also a 9 on ethics, and it finished 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 co-ed club to somebody who would then compete with us using our own former

members. It was a clean exit and a terrible strategy. The model caught it, and my gut, I'll admit, had thought selling sounded tidy.

The Problem Is Not the Symptom

After the transition was done I wrote myself an evaluation. It was for me, not for a class, though it ended up in one. 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 isn't a problem. It's a variable of a solution to a problem I hadn't written down yet.

That's dangerous because 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've run health clubs since 1994 and those are the four things I think about in my sleep. Experience covered for a broken first step. Don't count on that. Your managers don't 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.

The Two Weeks

There is one more thing in this decision that the matrix never saw. 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. We had two cancellations from the entire transition, and we normally lose many more members than that in an ordinary two weeks. I don't 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 or 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 isn't an argument against the model. It's an argument for showing it to somebody before you execute it. The matrix told me *what* to do and 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 isn't.

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's 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. It doesn't hold up.

Look at the order of events. I originally chose to make this change immediately, then I built the model, and the model agreed with me.

That isn't proof the model was wrong. 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'm not exempt from that. Being good at something is 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'll know that it agreed, rather than telling yourself later that you had no opinion going in. 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're running a ceremony, not a decision process. Somewhere in a real business there is a decision where the arithmetic says the thing you didn't want, and if you've never met it, you're 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	The page is dated and the

Task	How you verify it
back of that page and leave it face down until the totals are added.	answer is still there when you turn it over.
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 didn’t 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, the one from the last chapter, approximately one half mile from the first co-ed health club we opened in February of 1995. 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, and I've never found one that tells you how to end one properly. That's strange, because 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. I'm going to say unit, and a unit isn't only a building. It's the second location, the product line you added four years ago, the department, the service, the truck, the territory, or the shift you opened and have been feeding ever since. A restaurant killing its catering side and a shop dropping the brand it stocks least go through the same seven steps. My unit happened to have showers in it.

And if you run one location, don't skip this. The single most common version of this decision in a small business isn't closing the doors. It's

admitting that one of the things you sell has never made money and never will.

I Was Wrong

Before the mechanics, here is the mistake, 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."*

I had a theory about a customer and the theory was wrong. Nobody sold it to me, no partner pushed it, and no consultant talked me into it. I believed it, I signed the lease, I bought the equipment, and I was wrong.

I won't dress that up, and I'd 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 don't know. I can't 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 didn't. Both of ours underperformed significantly against our four co-ed clubs.

You don't 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.

That second sentence is the rule of this chapter. What's right about it is that it's 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 didn't sit there for another three years quietly eating the profit of the other four.

What's 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 does, the members do, and you do, because your name is on the sign and half the town knows you opened it. A deadline written in that condition 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, but it's a farmer's line, and every farmer knows that leaving a failed crop in the ground doesn't make it grow. It only costs you the season you could have used

for something else. There's a season for planting and a season for pulling it out, and the skill is in knowing which season you're in.

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.

They didn't get a refund or 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 and our biggest club in Sparks.

That isn't generosity. It's the cheapest possible way to protect the single most valuable thing in the whole transaction, and I'll 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. On the day you take something away, the customer should end up with more than he had on the day before. Before you move a single contract, read the contract and your state's rules on closures, transfers and refunds. More buildings do not replace a customer's rights.

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, the treadmills or 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. It's the same locked door and two completely different financial events.

Find the equivalent in your business before you close anything. It's the recurring thing: the service contracts, the subscriptions, the standing orders, the accounts. Whatever it is, it doesn't have to die with the location, and it will if you don't 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's a hard reason for that. 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'm paying for should be under members.

That's the general rule. Look at every asset in the unit you're closing and ask whether you're still paying for it. Anything you're still paying for has to be earning somewhere else by the end of the week, whether it's a leased oven, a financed truck or a copier on contract. The payment doesn't 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 isn't a logistical achievement. It goes in this list at number four because it wasn't really about those four or five people.

Every employee in the other five clubs was watching how we treated the employees of the club we shut down. Whatever we did there became the answer to a question nobody was going to ask out loud, which is what happens to me if my club is next.

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, and that's the reason I could make the decision at all.

The equipment leases and the rent exposure both ran to March 2005. So the most those two fixed obligations could cost me, in the scenario where absolutely nothing went right, was seven months that I could add up on one page. Moving and the other closing costs came on top

of that. I could tell my partners that number, and 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. Roughly half the rent exposure evaporated, 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. John Gutierrez and Bruce Gimple talked me into waiting a couple of weeks, John for the sake of the members and Bruce for the sales staff and the marketing. Chapter 24 tells the full version of that conversation and what it taught me about the limits of a decision model. 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. I was proposing to move the dues base out of two clubs he owned a piece of and into a company he didn't own a piece of. There is a version of that transaction that would have amounted to theft, however well a lawyer papered it, 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, and the transition was structured so that his ownership shared in it.

Chapter 7 is about setting ownership up so this kind of decision is still possible later. The day you have to close a unit is the day you find out whether you set it up well, and it's 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, about half of it gone early
Profit	Improved by the lower overhead
New sales	**Did not perform as expected**

We had two cancellations. Our clubs ran about thirty-five cancellations a month each in ordinary business, so 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's 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.

Here is the number that makes it concrete. Dues ran thirty-nine dollars a month, so every member who didn't 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's very nearly the entire annual profit of my first club, which made about four thousand dollars a month, or forty-eight thousand a year.

I didn't have a hundred cancellations. I had two.

The Part That Did Not Work

Here it is 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.

The belief was that if we broadened a ladies club to co-ed, added men to the addressable market and won corporate deals with a co-ed club in Reno, new sales would climb. They didn't climb the way I said they would.

Everything under my control worked. The members stayed, the people were placed, the equipment earned and the building got re-leased. The overhead came down more than forecast, and the lower overhead improved profit. That's a defensive success and it's 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's largely a matter of discipline. Growth is an addition problem and the market gets a vote. I confused those two things in my projections.

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

Three things.

I would write the kill number on the day the club opened, not in the month I closed it. Then "we have given these two clubs plenty of time to grow" would be a fact instead of a judgment I happened to get right.

I would separate the two forecasts and hold them to different standards. Overhead reduction I would forecast tightly, because I can point at leases with end dates. Sales increases I would forecast at the low end and be pleased to be wrong.

And I would stop telling myself that a good ending fixes a bad beginning. It doesn't. It limits the damage, which is worth a great deal. 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 isn't coming back.

Decide the date while you can still be objective about it, and close the unit 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's the last decision in this book, and it's 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.
Read their contracts and your state's closure and transfer rules, then 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,	Each line has an end date from a lease or contract and a

Task	How you verify it
and write beside each one where it will earn instead.	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 can’t answer, you haven’t set a deadline. You’ve 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 thousand.

More is not a strategy.

Every business eventually arrives at a place where the thing that got it here won't get it any further, and at that place there are three doors: grow, stop or sell. Most owners never notice the second and third doors exist, because growth is the only one that gets applauded, so they walk through the first one out of habit and find out later that it was a decision.

When I say location in this chapter, 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 or a territory. 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 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 one table.

	Monthly gross	Monthly profit
One club, early	about $50,000	about **$4,000**
Five clubs	over $400,000	**about $30,000** average
Five clubs, at the peak		**$50,000**

We went from about fifty thousand dollars a month in gross to over four hundred thousand a month, and from one club to five. That was over five million dollars a year, over fifteen thousand members, and more than six percent of the market in Northern Nevada, in a market with approximately forty health clubs in it. Since we entered that market, more than ten health club competitors closed their doors, including 24 Hour's Carson City location. All competitors from Carson City to Minden were eliminated except one.

By any reasonable measure we won.

Now do the arithmetic on the profit line. 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 difference of ten thousand dollars a month is the case for multi-unit ownership, and it's worth one hundred twenty thousand dollars a year. Some of it came from each club selling more, because five clubs grossed over eighty thousand a month apiece against fifty for the early one. I believe a big share came from fixed costs being shared, which I'll break down in a minute. Two snapshots from different years can't split the exact amount.

Then there's the other number, the one nobody puts in a company history. Our profit had been fifty thousand dollars a month. It fell to about thirty thousand.

50,000 − 30,000 = $20,000 a month; $20,000 × 12 = $240,000 a year, gone.

Here's my own explanation, written at the time.

> *"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 won't.

There's a ceiling, and I don't mean a health club ceiling. I mean yours. Your market is a finite number of human beings, and when they're 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 the number of people within driving distance times how often they eat out, and it can hit its own seats-times-turns limit before it ever gets there. A roofing contractor's ceiling is the number of roofs in the county times how often a roof gets replaced. Those are multiplication problems with an answer, and the answer is finite in every one of them.

In my industry the ceiling has a number on it. When I was making these decisions it was about 13.6 percent of a given population. By 2025 it was 26.1 percent. Even at that number, the other seventy-four percent won't necessarily walk in your door if you leave it open and turn the lights on for free. Those are non-members, some of whom

may exercise in other ways, and price alone won't move most of them. Your industry has its own version of that percentage.

Chapter 2 works that number for Washoe County. At the rate I had in 2004, that is roughly fifty thousand people in a county of three hundred seventy-three thousand. About thirty-one thousand of them were already split between six competitors, our own two clubs, and everybody else, at least on the counts the clubs gave us.

Two things are true at once and they pull against each other. The ceiling is real, and the ceiling also moves. On the published numbers mine nearly doubled over twenty years while I was busy treating it as fixed.

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.

Chapter 2 works the math three ways. I got 19,360 one way and 4,300 another, from a sheet that may have mixed two boundaries, and a third sheet said 25,500 until I found the cell had been mislabeled and threw it out, and those don't agree. What all three agree on is that the number is finite and everybody in town is drinking from the same glass.

We took market share the entire time our profit was falling. Competitors closed and we grew.

You can win a market and lose money at the same time. That's what saturation does. When there's nobody new left to sell to, the only way anybody grows is by taking, and taking is done with price and promotion, which 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?"*

You're standing on second base and you have something. Third base is obviously better than second. 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's 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. I believe that's 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."

A company with two hundred employees in Reno doesn't 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 isn't comparing prices. He's comparing how many of his people can use the thing he's buying. We couldn't have won those deals with one great club 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. 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's the same lever I used in the last chapter to close a club with two cancellations, pointed forward instead of backward.

When More Locations Do Not Help

Now the other side. 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's 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 potential overlap. Some of the people inside it would have joined your existing location anyway, and that part is your own market, about to be served by two buildings instead of one.

Let me put numbers on it with our own unit model. A ten-thousand-square-foot satellite club needs about one thousand members. Dues are thirty-nine dollars a month. Monthly expenditures run somewhere between forty-five and fifty thousand dollars, and Chapter 13 shows you that my own documents said both of those numbers about the same club.

A thousand members at $37.83 of contribution each, plus the ten-thousand-dollar floor for new memberships, personal training and pro shop, against forty-five thousand of expense, is two thousand eight hundred and thirty dollars a month on the illustrative unit figures. Chapter 13 has the table.

That is well under the four thousand a month my very first club made, and it tells you how thin a single club is until it carries more than the minimum. At the fifty-thousand-dollar expense figure the same club loses two thousand one hundred and seventy dollars a month.

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 didn't add a thousand members. You added six hundred, along with forty-five to fifty thousand dollars a month of brand-new fixed cost, which Chapter 13 will remind you is a promise that doesn't care how the sales went.

A new door that moves revenue from one of your own doors isn't growth. It's a very expensive way to rearrange your customers.

Here are the three questions I 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's the one people skip because it's uncomfortable. Total revenue almost always goes up when you open a location. Average revenue per location is one of the numbers that tells you whether anything real happened. The final test is whether the company as a whole makes more cash.

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's 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's a memory, not evidence. A strategy is most persuasive right after it worked, which is exactly the moment it's least likely to be examined.

Look at how I stated the trigger for the whole research project, too. "The problem is sales and profits have leveled. We are not growing the way we want to."

That's a symptom. Chapter 24 is 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 doesn't have a tidy ending in my records and I'm not going to invent one. What I

can tell you is where it landed. Today there are six Parkway Athletic Clubs. My companies own and run four of them, in South Reno, Downtown Reno, Sparks and Carson City. Fernley and Fallon are affiliated clubs. For years Main Corp also licensed the Fitness For $10 brand to independent operators in other states and in Canada; those licenses have since ended.

The licensing lesson is worth more to you than the club count. Licensing a brand is growth that doesn't require signing another lease. When your own market saturates, the question isn't only where else can I put a club. It's what else can I sell that isn't a club.

The Second Door: Stop

Nobody writes this chapter, so I will. You're allowed to stop opening locations.

A company that has stopped adding units hasn't 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's true of a repeat diner, a maintenance contract renewed, and a patient who doesn't switch practices. In my clubs every saved member was thirty-nine dollars a month. When we surveyed our members, cleanliness came back at 6.74 out of ten against scores in the mid-eights everywhere else, and we put a maintenance person in every club for five hours a day on top of the nightly cleaning company. That's growth, even though it doesn't 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 doesn't require a sixth building.

Stopping is a legitimate answer. It isn't the same as quitting, and an owner who can't 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've started more than ten small businesses.

> *"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 aren't building an exit because you intend to leave. You're building it because a business you could sell is a better business than one you couldn't, 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. This is the simplest one, and it can be very effective.

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. I wrote down a caution 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's permitted to sell it hasn't 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.

The trigger is one line. The exit strategy is utilized if the competition begins to pose a big threat.

Build the Exit Before You Need It

Here's the practical argument, and it has nothing to do with wanting out.

Ask what a buyer is buying. It isn't your building, and it isn't your equipment, which is depreciating and half of which 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.** Checklists for every position, tasks completed on a two-hour cycle, reports filed every two hours, and training on video so the best person in the company trains everybody instead of the nearest person. A business where the owner is the system isn't an asset. It's a job with inventory.
4. **Contracts that transfer.** Leases, equipment, billing, the member agreements themselves.
5. **An ownership structure that doesn't blow up on contact.** We had one owner of the two ladies clubs who wasn't 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. I'm not arguing that you should sell. I'm arguing 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've been doing budgets and sales projections for over ten businesses that I've started. My projections have never been right. I've been close, but never perfect.

Everything I've 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.

So the point of the analysis in this chapter isn't to produce the right number. It's to tell you how wrong you can afford to be. A base runner doesn't 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's what these numbers give you: distance to the bag, not certainty.

There's a question underneath all three doors, and it isn't how big can this be. It's whose is it. I'm going to name it here and leave the answer to the next chapter.

If the resources aren't really mine, then growing past the point where growth destroys value isn't ambition. It's 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're 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.
Estimate how many new customers inside that overlap would have bought from your existing location anyway, 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. An existing customer who only switches locations moves nothing.
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 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'm not being modest. Main Corp Enterprises, Inc. is a Nevada company I founded in October of 1994, I'm 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's absolutely mine.

I mean something else, and it's 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've been circling since Chapter 10 and haven't answered. Handed by whom?

What I Actually Believe

I'm a Christian. Three of my other books say so at length, and this one mostly hasn't, because this one is about contribution margins and checklists and I should be able to hand it to any person who works for me, whatever they believe. I've kept my faith to the places in this book where it was load-bearing, and this is the last one.

Here's the position. I didn't manufacture my ability to work. I didn't 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. 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 didn't 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's the consequence of it, which I left alone at the time. The digging was always mine to do. The capacity to dig wasn't something I built. That's 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 isn't 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 isn't theirs and 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. It's a parable about a management agreement, not about ambition or caution.

Then look at how the two producers are graded. They weren't handed the same amount and they didn't 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's done.

The third man is the one this book is about. He didn't lose anything. He returned one hundred percent of the principal. There's no shortfall on that balance sheet, and if you handed it to an accountant he'd find nothing wrong with it. And he's the one who gets taken apart, because the standard was never "did you avoid losing it." The standard was "what did it produce."

The master's own alternative is the most practical sentence in the story. Put it in the bank and collect the interest. That's a floor, not a demand for brilliance. The man was condemned for producing nothing at all with something that wasn't his.

That's the same standard I've been applying to a front desk for thirty years. Hard work has no value. Production has value. I didn't get that from an accounting textbook.

The Content Point

Now the practical part, because a belief that never touches a bank statement is only a preference. I set a content point.

A content point is a monthly income figure that I've decided, in advance and in writing, is enough, and I don't mean enough for now. I

adjust it about three percent a year for inflation and otherwise I leave it alone.

Everything the businesses produce above that line doesn't come to me. It goes two places. Some of it goes to God's work. The rest goes back into investment, which mostly means back into businesses that employ people.

I'm not going to print my number, because my number isn't 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.

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, in dollars per month, 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 wouldn't have felt extravagant doing it. Lifestyle doesn't inflate through one big decision. It inflates two hours at a time: 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 or 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 thousand, and he can't tell you where it went.

I have two more rules under the content point and they're both blunt.

I will own one residence. It isn't a rule I'd impose on another human being, and I know men I respect who own two. It's my line and I don't 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 percent, and most years the content point's three percent for inflation is the whole of it. That gap isn't deprivation. It's where the giving comes from and where the next business comes from, and both of those employ somebody.

Why This Is Not Restraint

Here's the part I want you to take, and it's the opposite of what most people assume when they hear a man talk this way. This isn't restraint for its own sake.

I'm not a frugal man by temperament, and I'm not sitting on my hands. I've started more than ten businesses. I built a system that required every sales representative in every building to book two appointments every two hours, and I checked. I've 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 does ten to twelve million dollars a year today. 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's happening in a man who hasn't drawn that line. Every gain he makes moves his own target. He gets his company to

four hundred thousand a month in gross and four hundred thousand becomes the new floor, and now he needs five hundred thousand, and that extra hundred thousand isn't for anything. It's just the next number. He'll tell you he's building a company. What he's really doing is running from a floor that moves every time he steps on it.

That man can't make a clean decision. He can't close a location that's bleeding, because closing it means less. He can't pay people what they're worth, because every dollar out is a dollar off his number. He can't 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've watched greed make people slow, cowardly and stupid, in that order. It doesn't 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. 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 isn't for me, and that's why I can be ruthless about it.

That's why a book full of break-even arithmetic and two-hour checklists arrives here instead of somewhere softer. The stewardship is what lets the operating manual be run at full speed.

Take the System and Leave the Theology

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 isn't for you. That's a perfectly reasonable place to land. I've 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 doesn't care what you believe. Neither does break-even, operating leverage, free cash flow, or the cost of a dollar. The two-hour checklist doesn't 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 doesn't ask.

So take the operating system and leave the theology if that's where you are. I'd rather you run a good business than agree with me.

I'll only ask you to do one thing, and it doesn't 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're accountable to God, to your family, to your employees, or only to the man you intend to be at seventy, the mechanism works the same way. A number you set in advance protects you from a number that sets itself.

I've 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.

Task	How you verify 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, divide your fixed number for one month by your contribution margin on one unit, or write what one person will accomplish in the next two hours.	The count, the division, 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.
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? I don’t mean your goal. I mean the monthly figure at which you’d 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

This book was written for three people, so let me not leave you with one undifferentiated you.

If you have an idea and no lease, don't 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're looking for one number, which is how many customers are unclaimed. Don't sign anything until you've written it down.

If you're already open and stalled, don't go looking for more sales on Monday. Go find your contribution margin on one unit and your fixed number for one month. Then divide. The fixed number over the contribution on one unit is the count you have to sell before a dollar is yours, and the gap between that count and what you sold last month is the whole distance between where you are and where you want to be.

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. 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 takes a week. Each takes about an hour and can be started before lunch.

What a Decade Is Made Of

I'm going to end where the book started.

A goal without a plan is just a dream. I've 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's the whole method in one line, and it's the line I want you to keep.

Completed tasks = objectives obtained = GOAL achieved.

Every word in it is carrying weight. Completed means a person who didn't do the work confirmed that the work was done. Obtained means counted and not felt. Achieved means a stranger could look at your business and tell you so without asking your opinion.

You don't get a business in one decision. There's no morning where you decide to be successful and then are. The five million dollars in annual gross wasn't 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 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 and not the plan, and I've written plans for more than ten businesses and never once had one come out right.

The discipline of the two-hour task is what reaches the ten-year goal.

I constantly accomplish the objectives, so I reach my goals.

Read that as flatly as I wrote it. There's no luck in that sentence and no instinct in it either, and I'm the man who told you at the start that instinct is the part I can't give you. What's in that sentence is repetition, verified, over a very long time.

Your decade is made out of your Tuesdays.

It isn't made out of your plans or your best year. It's made 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's two thousand five hundred working days, and you'll remember maybe thirty of them. The other two thousand four hundred and seventy are the decade.

The same is true of the part of your life that isn't the business. Nobody becomes generous in a single afternoon. You don't 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 didn't choose the description. You earned it in two-hour pieces without noticing.

So find out whose resources you're 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 don't 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 don't have to hunt through the book to find a formula while you've 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. Where an example comes out of a chapter, the arithmetic here is identical to the chapter's. A few examples, marked as teaching numbers, go one step past what the chapters worked. If you find a place where the two disagree, 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 can't answer these questions isn't that the math defeated them. It's that nobody ever told them these were the questions.

A formula doesn't 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's 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 doesn't 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)
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

One membership, one month	
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?

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" isn't 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 $17	$3.00	$20.00	.15

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'll 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 isn't an opinion about retail. That's 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've written down in two places as $45,000 and $50,000. I'm not going to quietly pick the flattering one, so here are 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. These are illustrative unit-model figures. If billing is already inside the expenditure totals, each break-even drops by roughly thirty to forty members.

Expenditures, treated as fixed (illustrative)	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 wasn't 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'm 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 doesn't tell you what is possible. Drosselmeier's plant can produce 2,400 units a year. You can compute a perfect break-even on a market that doesn't 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
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 can produce 2,400 units a year, so the correct answer created a problem the company didn't 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**

On the same illustrative figures, 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: what the order brings in > every cost it adds, including any setup cost and the contribution of any full-price business it pushes out

Value of the order = (offered price − variable cost) × units − setup cost − contribution given up

Full cost is irrelevant here. You already paid the fixed part. With spare capacity and no setup cost, the last two terms are zero and the test is just price against variable cost.

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

Scenario	Arithmetic	Effect on operating income
300 units at a discounted 50, plant has room	(50 − 36) × 300	**+4,200**, income goes to 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's about $28 of contribution each, or $5,600 a month that didn't exist, with fixed costs that don't 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's the treadmills at six o'clock on a Monday in January. When a full-price member can't get a machine, he doesn't 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's the most expensive one in this appendix: a special order is only easy money while you've spare capacity. Once you're full, it has to beat the business it pushes out.

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're 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, on the same illustrative unit figures, 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)**

Members	Dues contribution	Plus other income	Less fixed	Monthly profit
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 don't tie. Contribution divided by operating income there's 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're looking at. If you build a table like it for your own business, know which question you're answering.

The Boeing crossover, on the same teaching numbers. Two cost structures, both making exactly one hundred million dollars at forty-two airplanes. The lighter one is the structure above, nine hundred fifty million fixed and forty-five million variable per airplane. The heavier one carries one billion thirty-four million fixed and forty-three million variable. Sell forty-three and the heavier fixed structure makes 127 million against 125. Sell thirty-eight and the heavier structure is underwater while the lighter one is exactly even. Below the crossover you want low fixed costs. Above it you want low variable costs. There's no structure that's right at both ends.

The question it answers: how hard will my profit swing when my sales move?

7. Free Cash Flow (Cash After Maintenance Capital Spending)

Cash from operations – capital spending required to stay the same size

The plainest sentence I can give you: free cash flow, the way I use it, is cash after maintenance capital spending, the money left over after you've paid to keep the business the size it already is. Most published figures subtract all capital spending. And it isn't yet money you can take home. Loan principal, growth spending and anything else you owe still come out of what is left.

Worked, the short way. Nike's fiscal 2004 cash from operations was 1,514.4 million and capital spending was 213.9 million. Nike doesn't break out how much of that was standing still, so subtract all of it and treat the answer as the conservative one.

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 isn't 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're 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. This is the textbook version, called free cash flow to the firm. It's the cash available to lenders and owners together, before either one is paid. 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's a seven percent swing in the final number from one assumption most people never look at.

The question it answers: how much cash did the business actually produce after standing still, 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), when the interest is fully deductible

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 six inputs. I'm giving you both instead of the pretty one. I've 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. Don't 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'm allowed to accept?

What it's for, in one sentence: if a project can't beat the cost of the money, don't 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	891,795
3	2,000,000	1,281,315
4	2,600,000	1,435,957
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's twelve hundredths of one percent. Miss year five by $14,608 and the whole thing is zero, and that's 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 sets 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, before any discounting, 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 isn't an opportunity. It's 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 isn't a dollar today?

What it's really for: it doesn't 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. The first matrix is the raw ratings, one to ten. The second multiplies each rating by its criterion's weight, 7, 10, 7, 10 and 9 in the order shown, and totals the row.

	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	35	50	28	50	72	**235**

	Maint Share	Inc Share	Low Overhead	Inc Profit	Ethics
in Reno					

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 ratio	How many, or how much revenue, before I stop losing?
Target profit volume	(fixed costs + desired profit) ÷ unit contribution margin	How many to make what I want?
Special-order test	(price − variable cost) × units > setup cost + contribution pushed out	Take the discounted order?
Operating leverage	contribution margin ÷ operating income	How hard does profit swing?
Free cash flow (after maintenance capital spending)	cash from operations − maintenance capital	How much cash is left after standing still?

Calculation	Formula	Answers
	spending	
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. Don't adopt this appendix as written. The specific tasks in a health club aren't 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 doesn't 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've found something more important than a checklist.

I'm 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 doesn't argue. It hands you the shape.

What is a reasonable reconstruction is the individual line items on the sample lists below. I don't have the 2004 checklists in front of me and I'm not going to pretend that I do. What follows is what lists for the front desk, a sales representative and a general manager 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 with each sample list. We don't pressure sell anymore and we don't 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've 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 website. 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 aren't told what to do each hour of the day, they will do nothing. That isn't

an insult and I include myself in it. Chapter 16 answers the objection to that sentence in full, and it's 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 don't 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 completed two member favors every two hours—going above what a member expects, like thanking him for his business and handing him a free T-shirt. Two of them, every two hours, by everybody in the building.

Every sales representative booked 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 doesn't 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 don't 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's the whole reason I'm handing you a shape instead of a list. The tactics the shape was built to serve are gone and the shape isn't.

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 didn't weren't in the same business. If your day is eight hours, it's 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 every item is a single action a person can start and finish inside the block, 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 hasn't 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 don't 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. Do two favors for members. Write down the member's name and what you did. 2. Pull every staff member's checklist in the building. 3. Confirm the favors and the appointments actually happened. Spot-check one. 4. Note any position that's behind and correct it now, not at the end of the day. 5. 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's 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. Do two services for members, written down by name, in place of the two favors. 2. Confirm the services and the presentations actually happened. Spot-check one. 3. Walk the club and confirm it's clean. Don't take a checked box for that one. 4. Pulling the checklists, correcting what is behind, and filing the report don't 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 isn't a narrative. Nobody reads narratives every two hours. It's 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 table below is my version, in club language. It has more rows than six because a category can need more than one count: appointments, tours and memberships are the sales category at three stages, and favors completed is the service side of the same category.

Field	What it captures
Appointments booked this block	By representative
Tours given this block	By representative
Memberships sold this block	Count and dollar value

Field	What it captures
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're 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 don't change. That's 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's the entire answer, and it's 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 can't see from inside one building. Five clubs reporting the same weak block on the same weekday isn't five problems. It's one problem, and it's usually a staffing schedule.

If you run one location, or one crew, that reader is you. The job doesn't disappear because the company is small. It just doesn't 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've 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's documented too. My own recollection, which isn't 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'm not going to invent the other nine for you, and I wouldn't 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 demonstrates each task on camera isn't the manager. It's 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's the one I would give first if you only read a page of this appendix.

Don't 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's room above it. If yours gets longer every month and nothing ever comes off, or if items start describing manner rather than action, you've 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's nothing left to rewrite from.

The Rule Under All of It

A checklist isn't 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've 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 us roughly thirty thousand dollars, in lost sales and in money spent trying to fix it.

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'm saying it again here because the single most common reason a small business doesn't measure satisfaction is that somebody quoted them a price for it. Nobody needs to quote you a price for this. It's twelve statements and a photocopier.

Neither instrument is about fitness. The first one asks a customer whether you're 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's deliberate. Whoever your customer is, you're 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 won't 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's anonymous. Each staff member evaluates their supervisor, not the other way

around. Anonymous isn't a courtesy. It's the mechanism. Take the anonymity away and staff members write things they think their supervisor wants to hear, and then you've paid for paper to be told you're 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'm satisfied with the club.*

It's 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	The staff handles

Slot	What it measures	Mine said
	wrong	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’m satisfied with the club,” and once as “the staff helps with my fitness goals” and “I’m satisfied with Nevada Fitness.” They are the same questions with the company name swapped in and a word dropped. I’m printing the version above because it’s the one that generalizes. If you’re wondering whether a difference that small matters, it might. Small wording changes can move answers, which is why you should write your five statements once and then never change a word of them again. Reword a statement and you can no longer be sure this year’s score is comparable to last year’s, and comparability is most of the value. If you must change one, write down when and how, and if you can, run the old and new wording side by side once to see whether the score moves.

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'm 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 don't 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 don't. I'm 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. Don't 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 can't 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'm happy in my job." That last one is the check on the other six. When statements one through six come back high and statement seven comes back low, you've a reason to go look, because the problem may be somewhere other than the manager, or at least not only there.

How to Run Them

1. **Customers: about three hundred per location. That's 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 don't survey everybody. You don't 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 aren't anonymous no matter what you write on the form. In a small team, collect the forms centrally and combine the team with another before you report, because an average of three people can still point at one.**

3. **Average the scores. Statement by statement, manager by manager, location by location. That's 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, something is skewing the number, maybe one loud group, and the average may be telling you a story that isn't 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 the survey a second time and comparing, and the results were similar. That's a rough check on the instrument, not proof. A single survey is still a snapshot. To measure change, run it again six months later.**

What Ours Came Back As

I'm printing this so you've 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 below every other score.

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 the national figure of about seventy I was using, 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's 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 don't 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 didn't care, and you won't get an honest answer out of those people

again for years. You've 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, don't run the survey. Save the paper.

Appendix D: Questions for Thought and Reflection

Each chapter ends with one thing to do now. This appendix collects five questions for each chapter, including its closing task. They are here rather than in the chapters so that a person reading straight through isn't 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-term goal in one sentence. Does it contain a number and a date? Could a stranger tell you, on the date you wrote, 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 isn't 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 can't fill in a single number, what does that say about how ready you're 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? Then tighten the circle, make sure your competitor list covers the same area, and subtract again.
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've in the bank right now? Say the number out loud.

3. Your revenue projection: what happens to your business if it's correct but arrives four months late? Does the business survive that, or just the plan?
4. If you've 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 don't 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're using, and if you can't name one, you haven't 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. How many customers does your current price need before it pays, 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're 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 shouldn't 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 don't, 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, a threshold and a date. What result would prove you wrong?
4. Who outside your company has read your plan and told you what they didn't 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 can't, 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’re counting a fixed cost twice.
3. What is your contribution margin ratio? If you’ve 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’s 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. Then name whatever is left. It may be payables or other working-capital or financing items.
3. What does it cost you every year, in real checks, simply to keep your business the same size it's today? If you can't answer that,

you don't know your cash after maintenance spending, which is what this book calls free cash flow.

4. Is there a part of your business right now that you're calling unprofitable when it's really a cash flow problem? Would you act on a different timetable if you called it what it's?
5. Whose money is in your business besides yours, and what would they say about how closely you're watching it?

Chapter 15: What a Dollar Costs

1. What return could you earn, safely, if you sold your business tomorrow and put the cash somewhere else? That rate, plus something for the risk you're carrying instead, is what your equity costs you every year.
2. Write down your hurdle rate. Not a feeling. Six inputs and a few lines of arithmetic, 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've 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 aren't 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've 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's?
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've never addressed?

4. If your power in this company shifted tomorrow, which of your people would stay because they believe in where you're 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 don't 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's no such number, you haven't built employees-first. You've 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 does a customer bring in over twelve months, and how much of that do you keep after the cost of serving him? Write both numbers down. Does the person authorized to say no to a credit know them?
4. What is the last thing your business did for a customer that it wasn't obligated to do at all? If nothing comes to mind, you aren't producing service. You're only avoiding complaints.
5. Is there a customer in your business right now whose business you shouldn't 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've 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've 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 wouldn't 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 can't, do you actually know what success looks like?
4. The last time somebody behind on their numbers asked you for money, would you've 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're 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 didn't intend to say?
3. Is "do nothing" on your list of alternatives, and did you actually score it? If not, you've left off the option you're 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 wouldn't 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've started, what is the number and the month at which you'll admit it didn't work? If you can't answer, you haven't set a deadline. You've 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 can't produce that figure, you don't know whether you're 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’re currently unable to make cleanly because of what it would cost you personally.
4. If everything you’re 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’re 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 couldn't 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 isn't the twenty thousand. It's the fifty-nine thousand that never got spent.

That club, the company's first, opened in February of 1995. 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 Parkway Athletic Club has six locations across Northern Nevada. Steve's companies own and run four of them, in South Reno, Downtown Reno, Sparks and Carson City. Fernley and Fallon are affiliated clubs. For years Main Corp also licensed the Fitness For $10 brand to independent operators in other states and in Canada; those licenses have since ended.

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's where he formed the conviction about employees he has argued for ever since, and it's the subject of 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 five previous books.

He has spent 40 years in the gym business, owning gyms since 1994, and hosts Vitality and Wellness, a health and fitness channel for adults over fifty—a natural home for someone who's spent four decades 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 five 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's the most technical of the five, and it's 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 isn't 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.

Stronger After 50. Published in September 2026. Strength, nutrition and staying capable for adults over fifty, written for the same people who watch Vitality and Wellness.

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The channel is linked from stevemain.com

Hometown Strong
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Every one of these is reachable from stevemain.com. If you're reading this years from now and one of the addresses above has moved, start there.