

The Relationship between Revenue Profit & Cost

A **CostDown Consulting** Training File

Programs and Training that Improve
Driver and Fleet Performance

Overview

This simple training presentation was developed to help Managers in two areas:

1. Understand the relationship between Revenue, Profit & Cost in a typical trucking company.
2. Understand the impact their cost decisions have on Profit.

Many of my clients found this training file very useful and have used this presentation during their Manager meetings as a lead in to discussions about how they can drive costs out of their organization.

RPC Relationship: Definition

RPC is an acronym that incorporates three very familiar business concepts: (R)evenue, (P)rofit and (C)ost.

The RPC Relationship is the ratio relationship these components have to one another based on a company’s Net Profit Performance.

RPC Relationships

There are 3 RPC Relationships and they are as follows:

- Cost to Profit
- Revenue to Profit
- Revenue to Cost

Let's take a look at how these ratio relationships are calculated by using the example of a business with a 5% Net Profit Margin…

Revenue's Relationship to Profit

In a business that generates 5% net profit, every $20 of Revenue generates $1 of Profit.

($20 Revenue X .05 (5%) = $1 Profit)

The relationship of Revenue to Profit is therefore:

20 : 1

Cost's Relationship to Profit

Cost has a direct relationship to Profit. Eliminate $1 of Cost, and you increase your Profit by $1.

The relationship of Cost to Profit is therefore:

1:1

Revenue's Relationship to Cost

Since the relationship of Cost to Profit is 1:1

and …

the relationship of Revenue to Profit is 20:1

then …

The relationship of Revenue to Cost is also:

20:1

Summary of RPC Relationships

In our example of a 5% net profit margin, the following RPC relationships exist:

- Cost to Profit 1:1
- Revenue to Profit 20:1
- Revenue to Cost 20:1

Summary of RPC Relationships

Another way to express these ratios is :

- Cost to Profit **1:1**
  - If you add $1 of Cost, you lose $1 of Profit
- Revenue to Profit **20:1**
  - It takes $20 of Revenue to generate $1 of Profit
- Revenue to Cost **20:1**
  - It takes $20 of Revenue to make up for $1 of added Cost

Now let's take a look at some examples of how the RPC Relationship works in business…

Understanding the Impact of Your RPC Decisions

Example

As a manager, you are allowed to spend up to $1,000 without higher approval. You decide to buy a new desk and chair for your office at a total cost of $800.

What is the Profit and Revenue impact of your Cost decision?

The PROFIT Impact of Your Cost Decision

$800 Cost X 1 = $800 Profit

(the RPC relationship of Cost to Profit is 1:1)

Your $800 purchase eliminated $800 in Profit

The REVENUE Impact of Your Cost Decision

$800 Cost X 20 = $16,000 of Revenue

(the RPC relationship of Revenue to Cost = 20 : 1)

Your $800 purchase eliminated the Profit impact of $16,000 in Revenue

Using RPC Relationships to Understand the Impact of your Cost Decisions

Situation

Continuing with our first example, you purchased office furniture for $800. In that same month, your best driver generated $16,000 of revenue.

Impact

Your $800 office expenditure eliminated the Profit impact of that employee's entire monthly performance.

(RPC Ratio: Cost to Revenue = 1:20)

($800 Cost X 20 = $16,000 Revenue)

Using RPC Relationships to Understand the Impact of your Cost Decisions

Situation

Fuel costs increased 35% over last year. Your average terminal monthly fuel costs increased by $84,000. If you can't receive offsetting fuel surcharges, what is the impact on profit and revenue?

Impact

Profit Impact = Decrease of $84,000

(RPC Ratio: Cost to Profit = 1:1)

Additional Revenue Needed = $1,680,000

(RPC Ratio: Revenue to Costs = 20:1)

(20 X $84,000 Cost = $1,680,000 Revenue)

Using RPC Relationships to Understand the Impact of your Cost Decisions

Situation

Your 20 Field Managers each achieved their targeted $1,000 May cost reductions. How much additional revenue would your company have had to generate to capture the same Profit impact?

Impact

Their combined Cost reduction of $20,000 has the equivalent Profit impact of adding $400,000 in revenue

(RPC Ratio: Revenue to Cost = 20:1)
(20 X $20,000 Cost Reduction = $400,000)

Using RPC Relationships to Understand the Impact of your Cost Decisions

Situation

A driver had an accident that cost $45,000 in property and liability claims. What is the Revenue and Profit impact of that accident?

Impact

Profit Impact = Decrease of $45,000

(RPC Ratio: Cost to Profit = 1:1)

Additional Revenue Needed = $900,000

(RPC Ratio: Revenue to Cost = 20:1)

(20 X $45,000 Cost Reduction = $900,000)

Note: Does not include impact on insurance rates

Using RPC Relationships to Understand the Impact of your Cost Decisions

Situation

You just got a new $10,000 account. You celebrate and take the new customer, his wife and your wife out to an extravagant $350 dinner. What is the revenue impact of that meal?

Impact

The profit of the first $7,000 of revenue from that new account has been eliminated.

(RPC Ratio: Revenue to Cost = 20:1)
($350 Cost X 20 = $7,000 Revenue)

Summary

The RPC Relationship is the ratio relationship between Revenue, Profit and Cost based on a company's Net Profit Margin.

Understanding the RPC Relationship in your operation and the impact your decisions have on each of the three components is essential to controlling cost and successfully managing a profitable operation.

Open Discussion

Using the next slide, review the RPC relationships in your business based on actual Net Profit Margin.

Discuss actual Cost decisions you have made and the impact that decision had on Profit and Revenue.

RPC Ratios

Net Profit Margin	Revenue to Profit	Cost to Revenue	Cost to Profit
10%	10:1	1:10	1:1
9%	11:1	1:11	1:1
8%	13:1	1:13	1:1
7%	14:1	1:14	1:1
6%	17:1	1:17	1:1
5%	20:1	1:20	1:1
4%	25:1	1:25	1:1
3%	33:1	1:33	1:1
2%	50:1	1:50	1:1
1%	100:1	1:100	1:1

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