The Top Line Versus the Bottom Line

In business, the sales force is considered the revenue center, while all other functional areas within the company are viewed as expense (i.e., cost centers). This practice is obviously the result of the income statement where sales (revenue) leads at the top, less all other cost centers to obtain the bottom line (profit, or loss). Because sales pay for the expenses incurred by the company, the sales force is typically the most compensated and monitored area within a company. But the objective of a company should be to obtain the highest profit (i.e., bottom line) for the shareholder, not just the top line (i.e., sales). Below is the structure of the income statement in very simplistic terms:

Revenue -Variable Expenses – Fixed Expenses = Profit

Because variable expenses track with revenue, their net value must pay for the fixed expenses within the company, and surpass the fixed expenses in order to break even and ultimately make a profit. Clearly revenue is important, but it is not the only way to increase profit, which is the objective of the company. Other ways to increase profit include:

1. Increasing the value proposition to the customer of the company's products, thus bringing in more revenue. A company can achieve their maximum value proposition by being the highest quality and highest price (e.g., Apple Computer), or being the lowest cost provider (e.g., Wal-Mart), or by being a niche player in a specific market (e.g., NASA). Mass customization is a more modern practice, where a company obtains the highest quality but at the lowest cost, and is often based on selling platforms versus a product (e.g., Oracle).
2. Decreasing variable expenses through automation, economies of scale, and six sigma/lean best practices.
3. Decreasing fixed expenses by eliminating excess staff, unprofitable product lines, locations, or even business units; improving footprint of stores, offices, distribution and/or storage centers; and improving the utilization of assets, both physical and human.

Unfortunately the easiest path to profitability is the elimination of fixed expenses, which is often chosen over the more difficult paths of increasing the value proposition to the customer, and/or in optimizing the company's operations and improving its asset utilization.

Let's look at this a little closer, and examine what each of these mean to the company, and its shareholders. We'll assume that sales is currently at $100, variable expenses $50, and fixed expenses $35, leaving a profit of $15. What then does a variance of $5 mean for each of these variables?:

- Sales increased by $5 leads to an increase in profit of $2.50 (profit up by 16.7%) because incremental variable expenses of $2.50 are incurred
- Variable expenses decreased by $5 means an increase in profit of $5 (profit up by 33.3%), plus improves the profit of each future sales dollar by 2.75%
- Fixed expenses decreased by $5 means an increase in profit of $5 (profit up by 33.3%)

The elimination of expenses are double the value to the company's bottom line, yet the sales department will be the only group recognized and rewarded for their achieving an increase in revenue of $5. Unfortunately expense reduction is finite, because at some point the company will be hurt by its reductions in expense (i.e., its value proposition will be damaged and/or its optimization turned into a competitive disadvantage), but sales are also finite, and can be restricted by the company's market penetration relative to competitors, life cycle of the company's industries and products, and the company's competitive strategy (i.e., its value propositions), yet the opportunity for revenue generation is often perceived through a more optimistic lens than strategic expense reduction.

Great companies and leaders follow the road less traveled by creating real value propositions for their customers, while maintaining their competitive advantage through the optimization of their operations and utilization of their assets. Recognition and merit awards should be considered equally for proven reductions in fixed or variable expenses, and it could be argued proportionally more since dollar-for-dollar a reduction in expense yields more value to the shareholder than an equivalent increase in revenue.