

SageTalk

Building Dynamic Relationships

Price We Pay

By eliminating variables, we arrive at *one* thing certain.

This is a story of three entrepreneurs: Eric the electrician, George the geek, and Lorna the landlord. The mystery for us to solve: Although unrelated by blood and marriage, how can they all have the same big sister, Iris, who requires their support?

Lucky for us; we have *The Magic Formula* as a guide to the answer. It is available by clicking the image above, or this [Link](#). Much more than a guide, the Magic flows from an awareness of our resource choices: Time and Money.

Eric is an industrious fellow, who has a passion for service. He has completed years of formal training; has worked his way through the ranks of Apprentice, Journeyman, and Master Electrician; and, now wants to live the dream of being his own Boss. Captain of his own ship, Master of his own destiny, a Servant of the people: taking care of his very own Customers.

Since Eric has all of the tools and seed money necessary for starting his Company, there is no need for a Banker, as a partner. Based on the household budget, he knows that his family needs \$40,000 per year, *after* taxes.

As a self-employed individual, he will pay both halves (Employer *plus* Employee) of Social Security and Medicare taxes, for a combined rate of 15.3% on *all* net profit of his business. Much trickier are Federal and State income taxes, which are calculated on a progressive scale. At the lower brackets of income and with benefit of tax credits under current law, income taxes are of minimal concern. He anticipates an effective *total* tax rate of 20%.

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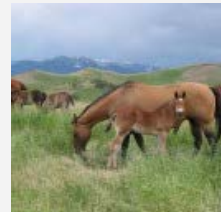
Your Business, Inc.
The Magic Formula

Assume: Information Reported to Taxpayer (Money)	
The Expense	
Salaries (To Customers)	
Direct Costs (Materials - "Materials")	(Income)
Net Sales (Price Multiplier * "Sales")	
Overhead (Fixed)	(Income)
Net Income	= \$5,000.00
The Distribution	
Taxes	(Income)
Owner / Retain	= \$4,000.00
Net Income	=

* This is the same number!

Assume: Money (Time)	
Time	
Hours Work Time	
Multiple Income	
Hours Per Hour (Price Multiplier * Multiple Income)	

RELATIONSHIP BUILDER



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In business, Overhead is a gracious way of saying: There is a price for Eric's dream. Technically, Overhead is the delivery system of value from provider to consumer. For the joy of having that magnetic sign on the side of his truck and walking into his shop each morning to switch on the lights, at a minimum, Eric will pay \$60,000 each year.

Now we're ready to do 4th Grade math. We will simply Add, Subtract, Multiply and Divide.

Because taxes take 20% of Eric's total Net Profit "pie", his *after tax* \$40,000 must be 80% of that same pie. Thus, we Divide \$40,000 by .80 to know that Eric needs \$50,000 of Net Income for the year. To prove that this target is accurate, we double-check the numbers: First, we Multiply \$50,000 by .20 to find that, indeed, Taxes are \$10,000; then, we Subtract \$10,000 from \$50,000 to breathe a sigh of relief in knowing Eric has \$40,000 for his family.

Before Eric even gets to Net Profit, he must first make Sales to Customers of \$60,000 each year, just to cover his Overhead and "keep *his* lights on". Therefore, we Add the amount of Net Income (\$50,000) to Overhead (\$60,000); Eric knows exactly his sales target for the year, which is also a representative value of his time to provide quality services: \$110,000.

Remember that needy sister, Iris? Your suspicion is right. Her nickname is IRS, the Internal Revenue Service; the one in need of that \$10,000, above!

Now, the *fun* really begins, because we are to the point of this story: Who pays taxes? Is it, *really*, Companies and Businesses, as the **Governor** of the State of Montana believes? What happens when **Big Sister** decides she "needs" twice the amount of support and will use new **tactics** to take it?

Let's answer these questions by reviewing the components of *The Magic Formula*. Does Eric need \$40,000 for his family? Yes. Is the effective tax rate under current law approximately 20% for those in Eric's income bracket? Yes. Does every business have expenses of Overhead in delivering value to the marketplace? Yes. Since these are all accurate variables, we find ourselves with the ultimate question: From where does the money come? Answer: Customers.

Who are customers? That would be: You and Me.

We pay Eric for the value he provides to us: the value of understanding the dynamics of electricity and how to bring it into our homes for the benefit of our families. He, in turn, shares portions of this *Price* with Vendors, Government and his Family.

“

At this point in our story, some may ask the question: "Why doesn't Eric just keep on working for his current Employer?" For those individuals who are unemployed, the answer is obvious. For the ones still employed, the answer is two-part:

1.) *Eric has discovered a better way to light up the lives of Customers, which*

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AS WE THINK ...

able actions boundaries care **change**
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 family fun give grow journey kind
 learn **life** listen **love** mind
 Montana passion power receive respect
 right serve **success** think thought
 thoughts time truth unique value will
 willing **work**

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his current employer is unwilling to accept.

2.) Because of the Universal Financial Principle above, Eric's base compensation from any company is limited to, approximately, one-third of what he produces for an employer; Taxes and Overhead take the rest.

Prices are not arbitrarily set by businesses. Every business wants to be competitive in the marketplace and they know Price is one measurement of Value, subject to the perception and judgment of Customers.

Now, what happens when big sister, Iris, wants more? Not just a little more, a lot more! In fact, she wants to double her **consumption**. Let's do the math.

Eric still needs \$40,000 for his Family and he still has Overhead to pay. So, by using the structure of *The Magic Formula*, we can solve for the amount of Taxes and the *new* Price his customers will pay. \$40,000 divided by .60 is \$66,666 (Net Income) multiplied by .40 is \$26,666 (Taxes), which leaves \$40,000 for Eric and his family. *If* all of Eric's business expenses (Overhead) remain at the \$60,000 amount, his Customers will need to pay \$126,666 for the value of his services.

From \$110,000 to \$126,666, we (Customers) pay \$16,666, more!

Remember the rest of our cast of characters: George and Lorna? George provides computer services to Eric; and, Lorna provides the building space for his shop. What do you think George and Lorna will be doing to the price of the value *they* offer to the marketplace? If they want to stay in business, they will be doing what Eric was forced to do: raise their prices, too. George and Lorna are *part* of the \$60,000 in Overhead that Eric needs to pay each year. When that \$60,000 amount increases, who pays? Yes, once again, the answer is: We the **People!**

This is for certain: We pay a price for everything.

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by SAGETALK on AUGUST 6, 2010 • PERMALINK • EDIT POST

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Your Business, Inc.

The Magic Formula

Financial Information Measured In Dollars [Money]		
The Source		
Sales [To Customers]		
Direct Costs [Variable = "Materials"]	(minus)	
Net Sales [Your Value = "Time"]		
Overhead [Fixed]	(minus)	60,000.00
Net Income	*	
The Destination		
Taxes	[20%]	
Owner / Banker		40,000.00
Net Income	*	

* This is the same number!

Productive Units [Time]	
Days	
Hours Each Day	
Billable Hours	

Rate Per Hour [Your Value / Billable Hours]	
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