Profit leverage effect

[Business](), [Marketing]()

Profit leverage effect definition:

Theprofit leverage effect dictates that reducing operating expenses is more efficient than increasing sales. Situated at the beginning of the production process of a product or service, the procurement stage is in an excellent position to reduce overall costs, especially in the short term

Profit leverage effect Formula

- Operational Leverage Effect Measure (OLE)

OLE = Contribution Margin Ratio / Return on Assets

- Financial Leverage Effect (FLE)

FLE = Operating Income / Net Income

- Total Leverage Effect (TLE)

TLE = FLE*OLE

Profit leverage is a very important aspect when it comes to logistics. Potential profit leverage can result to increased efficiency in logistics and can contribute to the development of interests in logistics management. Profit leverage effect has three main areas in which a company can achieve a profit increase. First, a strategy in which profit generation is obtained by increasing marketing efforts. In this strategy, a company can experience a difficulty in increasing the sales because of reasons like resource problems, competition and other market conditions.

Second, a company can generate profit by increasing the price of their products. This method is the most unlikely method to be used because price increase is not possible on some market conditions. Price increase in a firm's product can only be done when the cost for creating such product increases. Last, a company should resort to reducing its cost of doing its business. Cost-cutting is one of the most used methods in profit leverage and is the most successful of all the three methods.

Cost-cutting in logistics is one of the most unseen ways of reducing a companies cost and at the same time increasing its profitability. Increase in sales may have been achieved in an extraordinary way. A proper logistics management can have a greater impact not only in cost-cutting but also in increasing the sales of a firm. Sales can be associated to some costs. These include costs of good sold and logistics-related costs.

If logistics is properly handled, a dollar saved in logistics will not incur costs to any other area of the firm. Thus, a dollar saved in logistics is already an increase in the profit of a firm. Thus, a proper logistics management is one of the greatest cost saving opportunities in logistics. Better control of logistics activities means reduce cost. An example given is an appliance firm which does not proper manage its logistics problem. At first the firm has a logistics cost of 20 million dollars.

After realizing logistics as one of the major cost center of the firm, a logistics executive was hired to furnish its entire logistics problem. After all the problems were done, the firm created a 10 million savings that made a huge impact in its profitability. If the firm decided not to take logistics solution and decide to take other profit leverage, they may have ended with a smaller and insignificant sales increase because of competition, slow market growth rate, and the firm's limited resources.