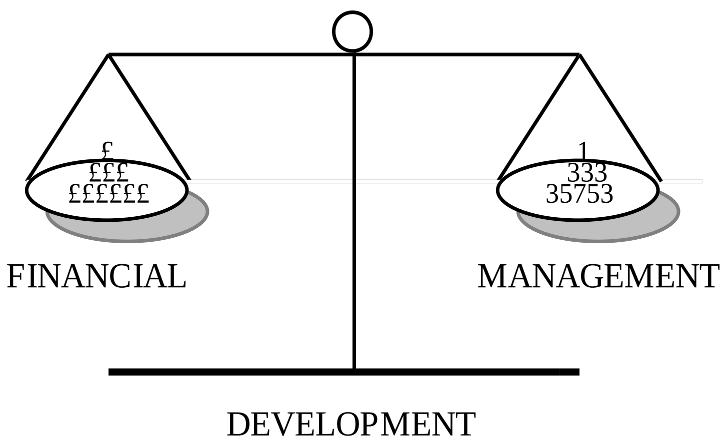
FINANCIAL MANAGEMENT DEVELOPMENT

MANAGING RETAIL OUTLETS

NO 601

RETAILING FOR PROFIT



ONE OF A SERIES OF GUIDES FOR

FINANCIAL MANAGEMENT DEVELOPMENT

FROM

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

RETAILING FOR PROFIT

Running a Retail Outlet is no different from any other business. You put time and money in and get enjoyment and money in return. This paper explores some of the ways you can improve the relationship between what you put in and what you get out. It is written from a financial viewpoint. Most things can be reduced to money, even your leisure time. What would you rather have: a two week holiday, £100, £10,000 or £100,000? Your answer sets a value on your time, the most important input you make to your business because it is irreplaceable.

Consider your business. The Profit and Loss Account, Balance Sheet and Cashflow Forecasts are vital indicators of how you are doing and therefore how you can do better.

<u>Maximising Return on Capital</u>

You want to maximise profit (the difference between Sales and Costs in the Profit and Loss Account) as a percentage of the Capital Employed (the difference between Assets and Liabilities in the Balance Sheet) without accepting too much risk (an acceptable worst case Cashflow). Look at each and consider how they relate to your business.

<u>Profit and Loss Account</u>

Sales Income is the volume sold times the price charged. If you double prices, sales income could fall because you sell less. Pricing should always be based on market reaction. Use simple calculations to help make decisions. Assume you buy biscuits at £2.50 and sell them for £2.80. If you cut the price to £2.75 how many more would you have to sell to make it worthwhile?

If you currently sell 100 packs, your profit is 100 x (2.80 - 2.50) = £30. At £2.75 your Gross Profit per pack is only 25p. To make £30 you need to sell 120 packs. This is an increase in sales of 20% to make up for a price decrease of less than 2%. How many do you need to sell if you put the price up to £2.90? (see * below). Don't calculate this for all stock lines. Pick the bigger ones where you can change prices and estimate the income effect. You may even want to ask customers!!! Would you buy 2 packs for 5p off? Be sure it is <u>extra</u> sales not just a discount on what they would have bought anyway.

Costs are the next item in the Profit and Loss Account. You must include your own time as a cost to get a realistic figure for profit. Remember these calculations are to help you. They are not for the Accountant or the Taxman; so be realistic. Once you have decided upon a reasonable hourly rate you can use it to make decisions. Should I spend two hours going to the cash and carry to save £20 or have goods delivered by the wholesaler? Should I spend six hours writing up my books or pay an accountant to do it in three hours etc.? You can also use this data to negotiate. For employees a reasonable guide to the cost of their time is to value each hour based on their salary divided by 600. Typically consultants are charged out at three times their salary (one for salary, one for overheads, one for profit/interest/risk etc.) In a typical year, with six weeks holiday (inc. statutories) there are 1,840 working hours (46 x 40 hr week). This divided by three gives about 600.

Retailers need to recognise that many costs are fixed i.e. do not go up with volume. You want to maximise sales to gain best value. Opening longer hours is one way but make sure the gross profit from the "extra" sales covers the extra cost. Use the extra takings times some average gross profit percentage (sales price less cost price as a percentage of sales price 10.7% (30p/280p) in the above example) as a guide. Staying open one hour to sell £5 worth of goods is a poor use of your time. Opening one hour longer to sell £100 worth at a 50% gross profit means an extra £50. Maximising gross profit per metre of shelf space (square metre for floor displays, cubic metre for freezers) is the main management tool for large retailers. Adapt this for yourself. Which items take up most space? Do you get more value from displaying other items? Don't consider everything - look at the big stuff. In most businesses 80% of sales come from 20% of products.

Balance Sheet

Don't be frightened by the concept of the Balance Sheet. It is what you own less what you owe. Think of the things the business owns (assets). You provide the funds, unless someone else lends them to you (liabilities). Assets will probably consist of Fixed assets, (property, cars, equipment, etc.) which you use in the business; Stock, (on the shelves and in the storeroom); Debtors and Prepayments, (people who owe you money or services); and Cash.

Consider whether to lease or buy your fixed assets. Financing costs are low now but don't get carried away. Fixed assets are there to work and their benefit to the business must more than recover their cost. Minimise the investment in fixed assets.

Hold minimum stock levels - You need to forecast demand - particularly on perishable items. Aim for sale or return wherever you can. Bulk buying to gain a discount may be false economy. Unwanted stock ties up your scarce money as well as using up space that could be used to sell other goods. Sell surpluses off (even at a loss if you have to) and learn from the experience.

Avoid allowing any credit to debtors or prepay any expenses. If you do, price accordingly or get a discount. Manage your creditors. If you pay fast, get a discount. The more money you owe the less you need to invest your own cash in the business.

Cash Flow

Watch your cashflow. People only go out of business from lack of cash. Always plan ahead for payments like Income Tax, VAT, etc. Consider the timing of payments for purchases. There are only two rules: maximise the speed of cash in (bank fast and often) and minimise and delay the cash out.

Financial information is there to be used. It does not have to be a monthly or annual chore. Make estimates, use them and then move on to another area. Maximise the value from your time.........and enjoy it!

*Only 75 so you could afford a drop of 25% in sales volume from a less than 4% price rise, but do consider what other sales you might have got from the customers you lose.

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development and has been an Ordained as a Deacon in the Catholic Church.

He has worked as a Financial Controller and Company Secretary in the Finance industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material. He has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website: **FinancialManagementDevelopment.com** including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).

