



Doubling Your Profit Is Easier Than You Think

Doubling Your Profit Is Easier Than You Might Think!

The average store netted 4% pretax to sales last year. Most think they made only 4 cents out of every sales dollar... that's a **dangerous** misconception.

The misconception that a store that netted 4% pretax to sales only made 4 cents out of every sales dollar gives rise to the erroneous notion that, "To double my profits I'd have to double my sales." Since most dealers know intuitively that it is probably impossible to double their sales in the near term, they reach the logical conclusion that it is also impossible to double their profits. Consequently, many dealers become discouraged and fail to do much of *anything* to improve their profitability, and that's a shame, because all that most dealers would need to double their profits would be a sales increase of somewhere between 10% and 15%. Or, if you couple an even smaller sales increase with better inventory management and careful pricing to maximize gross margins and some prudent expense control, it isn't hard to double, triple or even *quadruple* your profits!

GOOD NEWS! Expenses Aren't All Alike...

You have *two kinds* of expenses... *fixed* and *variable*. This is a very important concept to understand, because it's this difference in expenses that makes it possible to double profits with such a small increase in sales.

What Are Variable Expenses?

Variable expenses are those expenses that vary directly with sales... as sales increase, so do these expenses, and they go on forever. In a furniture store, these expenses are typically your advertising, selling and delivery expenses. The total of these expenses is usually somewhere in the neighborhood of 15% of sales. Since these expenses vary directly with sales, they apply to every sale... the first one, the last one and every one in between. If your *gross margin* is 45%, your landed *merchandise* cost of sales is 55%. Adding your 15% variable expenses to your 55% landed merchandise cost you arrive at what we'll refer to as your *total cost of sales* of 70%. This leaves 30% out of each sales dollar, referred to as your *contribution margin*. It's called contribution margin because it's the portion that every sales dollar *contributes* to cover fixed expenses. Once your fixed expenses have been covered and you've passed your breakeven point, this 30% is contributed to *profit*.

In other words, a store that nets 4% to sales doesn't make 4% out of every sales dollar. They don't make one thin dime; in fact they're in a loss position, *until* they've covered their fixed costs and passed their breakeven point. Once past their breakeven point they don't make 4% from every subsequent sales dollar, they make **30%**! Knowing that, it's easy to see why it's so very important to plan your promotional activity to "pour on the coal" to maximize sales at the end of the month when you've already passed your breakeven, because that's when you make *all* your profit!



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What are Fixed Expenses?

Fixed expenses are those expenses that tend to be fixed in amount. We realize, of course, that all expenses are variable in the long run, but fixed expenses are either static over a range of sales volumes or they vary based on some other factor, such as inventory level. Examples of fixed expenses (also referred to as overhead expenses) would be things like administrative expenses, occupancy expenses (except for percentage rents which need to be included in your variable expenses), warehouse expenses, credit department expenses and “other” expenses, such as interest.

How Do You Know What Your Breakeven Point Is?

That’s easy! Your breakeven point equals fixed expenses divided by your contribution margin. Let’s look at an example:

Average Monthly Sales	\$100,000	100%
Landed Merchandise Cost of Sales	<u>55,000</u>	<u>55%</u>
Gross Margin	\$45,000	45%
Variable Expenses	15,000	15%
Fixed Expenses	<u>26,000</u>	<u>26%</u>
Net Profit Before Tax	\$4,000	4%

$$\begin{array}{lcl} \text{Breakeven Sales} & = & \text{Fixed Expenses} / \text{Contribution Margin} \\ \$86,667 & = & \$26,000 / 30\% \end{array}$$

In other words, it takes \$86,667 of sales at 30% contribution margin to cover the fixed expenses of \$26,000.

$$\begin{array}{lcl} \text{Incremental Sales} & = & \text{Avg. Mo. Sales} - \text{Breakeven Sales} \\ \$13,333 & = & \$100,000 - \$86,667 \end{array}$$

Incremental sales are the sales made *after* you’ve passed your breakeven point.

$$\begin{array}{lcl} \text{Net Profit} & = & \text{Incremental Sales} \times \text{Contribution Margin} \\ \$4,000 & = & \$13,333 \times 30\% \end{array}$$

Consequently, we can see that the last \$13,333 of sales produces *all* the profit! All the rest of the sales went to pay the fixed expenses. The *good news* is that in this situation it will only take a sales increase of \$13,333 to *double* the profit to \$8,000! Maximizing gross margins through better inventory management and careful pricing can easily add another \$4,000 to this store’s bottom line. Better expense control might add yet *another* \$4,000! In other words, it really isn’t hard to double, triple or even *quadruple* your present profitability.



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But Where Do You Start... What Do You Do First?

The problem is that most retail store owners don't know where to start... what specific actions to take first that will produce the most results the most quickly. Over the years, many, many furniture dealers have told us, "We need to increase our profitability, we know that, but aside from poring over the list of expenses on our P & L Statement, which we've already done, we don't know what else to do." That statement summarizes the situation in many, many stores. We've always responded by saying, "Let's look at *all* your numbers... your Balance Sheet, your P & L Statement, your Sales Analysis by Category and Margin, your Sales Analysis by Vendor and Margin, your Inventory Markdown Aging Summary, as well as your number of employees and your square feet of show space." Complete analysis and identification of areas of strength and weakness require calculation of a number of financial ratios using numbers from all these sources and comparison of your ratios with those of the NHFA High Profit stores.

We've developed an automated analytical tool that we call the Profit Maximization Analyzer (PMA, for short). It's a program that's available for your use, free of charge, on the internet at www.profitpma.com. All you have to do is plug in your numbers, and the PMA will examine your data, comparing your key numbers with those of the NHFA Average and High Profit stores and produce a report that spotlights all the areas of strength and weakness throughout your operation.

Once you have accessed the Profit PMA web site using the url above, you'll see that there are 7 buttons that will allow you to do various things. The buttons, and their usages are as follows:

1. PSI Home – This button takes you to PROFITsystems' web site home page.
2. Introduction – This button takes you to a description of the Profit Maximization Analyzer.
3. Example – This button takes you to a sample PMA so you can see the analytical information you can receive about your business.
4. FAQ – This button takes you to a list of frequently asked questions and their answers.
5. Contact – This button enables you to send an email to PROFITsystems' VP of Financial and Operational Consulting, Wayne McMahon
6. Instructions – This button displays detailed instructions specific to PROFITwindows users to run the reports to obtain the information required by the PMA. If you are not a PROFITwindows user, you'll be able to see the information needed, which you should be able to obtain from your system or your accountant. Note that you can print out these same instructions using Click here link under the Log On button.
7. Log On – This button allows you to log on and enter the data needed for the PMA to analyze your business. If you haven't already been assigned a username and password, you can obtain one by clicking on the Contact Us link and filling out the form.



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Assembling this information and entering it into your confidential PMA may seem like a lot of work, but the information you'll receive, pinpointing as it does the areas of strength and weakness in your business, is invaluable in showing you the actions required to improve your profitability and how to prioritize your actions to maximize your results.

The PMA Report Spotlights Areas of Strength and Weakness

The report that's produced not only gives you comparisons of your financial statements and key ratios with the NHFA High Profit and Average stores, but also gives you an analysis of what the comparisons mean and where your opportunities for greatest improvement lie.

The report contains a 10 page Financial Analysis section, as well as a 5 page Inventory Analysis section contained in pages 11 through 15. We can't overemphasize the value of the PMA as a tool to identify the areas of your business that need help, and the PMA is yours to use at no charge. Please take advantage of this free service. If you need help of any kind regarding the PMA or implementing its recommendations, call me to learn more about how to get started along the road to maximum profitability.

Larry Stark is the Chairman of PROFITSystems, Inc. Larry spent the first 21 years of his working life running Stark's Furniture, the retail furniture business founded by his grandfather in 1897. He has spent the last 26 years running PROFITSystems, a leading retail furniture software and consulting firm located in Colorado Springs, Colorado. He can be reached by phone at 800-888-5565 or by email at larry@profitsystems.net.