



## Understanding the Financial Metrics

All furniture retailers should be receiving timely, accurate financial statements either from their in-house business management or accounting system or from their external or internal accountants. These financial statements should be providing the dollars of such P&L components, as sales, expenses and net profit, as well as such numbers as receivables, inventory and payables. Without question, these accounting statements are vital for the reporting and tracking of overall business performance. However, much more useful information can be provided for management purposes, if the financial data is in the form of ratios or percentages, in addition to absolute dollar values.

The key financial ratios and percentages can be easily compared to specific retail furniture industry statistics, to determine how your company compares to other similar retail furniture operations. For example, a great analysis of certain aspects of your business is obtained through the determination of a ratio such as the value of sales produced per payroll dollar. The percentage, of total payroll expenses of sales, provides a tremendous insight into the efficiency in which your company utilizes its payroll dollars for a particular timeframe or in comparison to other furniture retailers.

The use of the key financial metrics, as a supplement to the absolute numbers, contained in your financial statements will provide you with the knowledge of both financial performance and the financial position of your company. The ability to use this information to improve the efficiency and profitability of your business will result from the understanding of these financial metrics.

### What are the most important Financial Metrics?

The most important of the key financial metrics and the most frequently referenced is net profit, as a percentage of sales. Since net income and income tax, in a small business, are often influenced by factors outside of the normal course of operating a business, it is suggested that net profit before income taxes be used as this key measurement. For example, if abnormal management remuneration has been taken, due to tax planning considerations, it is further suggested that the net profit before income taxes, be normalized in order to provide a truly meaningful and comparative financial ratio. Historically the typical retail furniture store has generated net profits before income taxes, in the range of 3 to 4 percent of sales. However, the top profit performing operations achieve double-digit net profits before income taxes. How can we identify the reasons for this profit gap between the typical and the high profit store?

Net profit is contingent upon the effectiveness of merchandise buying, pricing policies and procedures and the control of both fixed and variable expenses.



The typical furniture retailer will achieve a gross margin of 43 to 44%. The attainment of a higher gross margin can mean that net profits will increase, in corresponding fashion, but only if adequate expense controls exist. Conversely, a lower gross margin, than 43 to 44%, may often mean that net profits will be lower than the typical 4% of sales. However, not always does this relationship apply. Some furniture retailers have developed a business model whereby low selling prices and low gross margins are more than offset by the effects of excruciating expense controls, so that high net profits are obtained.

The typical retail furniture store spends 39 to 40% of sales or 90% of its gross margin dollars on operating expenses, leaving only 4% of sales or 10% of gross margin dollars as the net profit before taxes.

### **What are the key financial ratios, which make up most of the Operating Expenses?**

Payroll expenses, including wages, salaries, bonuses, taxes, group insurance and benefit plans, typically consume half of the total operating expenses, at 19 to 20% of sales.

Building-related or occupancy costs will usually be in the 7.5% of sales range, but in major metropolitan areas may be even greater as a percentage of sales.

Advertising Expenses should be held to the average of 5 to 5 ½% of sales, a ratio that is attained by the typical furniture retailer.

The three major expense categories of payroll, occupancy and advertising usually account for about a third of sales dollars or 75% of gross margin dollars.

To obtain better than average net profits, to achieve double-digit net profits, these 3 expense categories must be kept under control, at ratios better than the average. Sometimes the results are achieved by exceptional sales per square foot or outstanding gross margins. However, the key to your successful business model must be the understanding of the importance to net profits of not only suitable sales levels, but also the dollars remaining from gross margin dollars after providing for the 3 primary expense classifications.

If you plan and monitor these important financial ratios to ensure that they do not exceed or are less than the average furniture retailer, you too can achieve double-digit Net Profits.

For information on how you can gain a better understanding of the financial metrics of your business, please contact Wayne McMahon at 800-888-5564 or by e-mail – [wayne@profitsystems.net](mailto:wayne@profitsystems.net).