overheads and profit

PART FOUR OF **STUART JACKSON**'S GUIDE TO SURVIVING THE RETAIL SLOW-DOWN

In preceding months we have, hopefully, maximised our profit performance and product sales. Let's now examine how we can control and cut costs to ease the burden on our businesses.

THE IMPACT OF OVERHEADS

Every retail shop, just by starting to trade, incurs a base level of 'overhead'. There's rent or mortgage, rates, shop fitting, wages and so on. Sales and the gross profit produced must outweigh these costs in order for the business to be viable and create net profit.

Unprecedented growth in 2004 led many to invest in staff, services and equipment that raised overhead cost, which is now being exposed as too heavy against today's sales performance.

All retailers are trained to think in terms of turnover, and in the everyday battle to stay afloat, there is an understandable tendency to focus on the creation of more sales. In a market where new sales are tricky to come by, however, retailers would be well advised to look at a solution that is readily within their grasp: controlling overheads. It is standard practice for busy, owner-operator retailers to control overheads by gut instinct, with few of them equipped to apply a management strategy that would bring greater savings.

THE 20/80 RULE

The 20/80 rule is a great method of attacking any business problem for the first time. This involves identifying where 20% of the effort will return 80% of the result!

When an operational feature is to be enhanced, the existing system always has a "core" function bordered by a multitude of smaller influences. It is not uncommon for projects to be approached so methodically that the one action capable of producing the major benefit is either overlooked or not tackled until it surfaces part way through a list of improvements. The key is to identify that major issue first and

steamroll through the objections to fix it.

When it comes to overheads that core issue is wages.

In retailing, the industry average spend on wages is between 15% and 17% of annual turnover. At either extreme, this percentage bottoms out at 11% and tops at 22%. Translated to hard cash, an example store turning over £500,000 annually would incur a wage bill of £55,000 and £110, 000, respectively. While these cost extremes tend to occur in diverse environments, this is not always the case. There are often variations of around 5% between very similarly sized shops.

Consider, in our example, that 1% of wages against sales equals £5,000 net profit and it is easy to appreciate the significance of controlling staff scheduling and performance.

THE SALES CLIMATE

Although some stores are managing to maintain sales growth this year, many are struggling to hold the ground taken and a few are losing 20% and more.

To emphasise how tackling wages excess can help, let's use our example store with a turnover of £500,000 per annum and a sales decline of 10%, causing income

Tackling the wages issue

Unless the business is haemorrhaging cash, there is nothing to be gained from a radical shake-up that will probably leave the shop ill-equipped to function. Begin, preferably, using a spreadsheet, listing all the current staff down the left hand side and the days of the week across the top columns. Under each day and against the relevant employee, enter the number of hours normally worked and the shift times, if known (ignore holidays). Total across and down to arrive at a normal weekly working hours schedule.

Now start analysing what events take place on each day (deliveries, stock-taking, ordering etc.) and look to see where shift times can be shortened, moved or hours eliminated. Much of the present schedule will have formed organically during last year's boom period and have remained, expensively, in force by default.

The goal is to make a reduction in the hours allocated and used every week until the percentage wage bill meets the new target. At this point it is now the budget for the future, which can only be changed with expressed permission. A manager should be responsible for maintaining control and reporting on the schedule. Use events such as sickness to save more hours by coping without a substitute and when an employee leaves, re-assess whether their role requires replacing at all or in part.

to drop to £450,000. If the shop returns a good GP margin of 35% per annum, it would have produced £175,000 gross profit last year, whereas with £450,000 turnover this year, that same margin would generate only £157,500 gross profit. That's £17,500 less to pay for the overheads.

If a 1% reduction in wages (against sales) equates to £5,000 saving in expenditure, cutting back just 3.5% of the salary bill can eliminate the loss of profit. If a shop is still showing growth or holding its own, instigating controls on wages will simply add even more profit to the bottom line.

In reality, it is not necessary to regain all of that £17,500 loss through wages alone, as collective savings from other overheads (see further below) can contribute at least a third of that total.

DIRECTOR'S REMUNERATION

If the business is a limited company, consider paying the director/shareholders by dividend and not through PAYE, which incurs huge tax and NI burdens. Dividends can only be taken from trading profit but attract far less tax and NI than PAYE (none at all in the case of lower tax bracket earners!).

Instead, dividends paid are treated as net profit by the Inland Revenue and taxed under the corporation rate. A complicated comparison results in dividends being far more tax efficient, especially for owner/director/operators. Consult your accountant for the details!

CONTROLLING OTHER OVERHEADS

It is the very diversity and quantity of overheads that make them so difficult to control, yet with just a little effort that can change. Most retailers permit their accountants to group together a number of different expense types under general headings. Convenient as this may be for the accountant, it provides little useful information for the retailer.

Take the opposite approach and categorise each different type of expense, then create a nominal code that identifies it. Once costs are allocated correctly it becomes easy to recognise how much was spent on each cost centre every year. This year's or even this quarter's expenditure in a particular area can now be reported by percentage increases or decreases against that which went before. It is now easy to look at a column of percentages to spot, and focus energy on, any increased expenditure.

SUMMARY

Accounts communicate, at a glance, everything a retailer needs to know about business and staff performance. Such knowledge permits focused application of the retailer's talents on those areas most affected by profit. Why is substantial energy expended trying to make an extra sale when so much can be gained with just a little of that endeavour transferred to saving on costs?

If you have any questions for Talking Shop or would like further information on Stuart Jackson's consultancy service, contact him on 0131 315 0303 or email stuart@forceofnature.co.uk or visit www.forceofnature.co.uk