maximising profit margin

STUART JACKSON CONTINUES HIS SERIES ON HOW TO SURVIVE THE RETAIL SLOW-DOWN WITH A LOOK AT THE CRUCIAL ISSUE OF PROFIT MARGIN

With sales growth tough to attain and scores of shops struggling to sustain the peak of last year's boom, retailers need to look at other ways to acquire growth – in profit if not in sales.

The factor that most determines a shop's ability to make cash profit is gross margin, typically described as "profit on return" (POR) or "Gross Profit" (GP). It is the difference between the cost and selling price of one or all the products in store.

Analysis of both industry standards and individual performance is expressed in percentage terms as follows: Selling price minus cost price divided by selling price x 100 = % GP.

OUR MARKET

Comparing any one shop against industry standards and peaks is critical in order to verify that store's performance, the degree to which it can advance and to focus attention where it is most needed.

The value of GP becomes clear with a simple example. A shop with an annual turnover of £500,000 produces a £5,000 net cash profit for every 1% of GP margin that is gained. A store under performing by 4% would be throwing away £20,000 in cash!

Our industry, with numerous variations in shop style and location, generates a diversity of product mixes with each type affecting national GP averages. There are, however, some fairly easily applied guidelines. Shops tend to fall into three broad retail categories: all food, 70 or 80 % food, or 70 or 80 % non-food. The kind of margin these stores can achieve fairly comfortably fit broadly into around 27 to 29% GP, 34 to 35% GP and 37.5 to 40% GP respectively. There are, of course, exceptions at either end of the scale.

For the sake of clarity, let us concentrate on the standard published margins for each main product category (an individual store's discounts will add to these figures). Fresh foods can return between 17% and 25%; ambient foods, household and clothing products a set 25%; bodycare and most other non-food categories, 33%, all topped by VMS (Vitamins & Minerals) which although usually 33%, can offer up to 50% GP. This enormous disparity in product margin is responsible for the vastly different profit return experienced in the three aforementioned retail categories.

ACHIEVING THESE TARGETS AND FACTORS THAT INFLUENCE MARGIN

Decide which retail category your shop fits into, and whether that was by design or whether the situation developed organically. Does your store reflect the product mix you had envisaged, and is it returning the margin it is capable of? Even if performing well, could it spawn more to become one of the high-flying exceptions? These are the questions that should lead you to tackling some of the points below.

THE MARGIN OFFERED AS STANDARD BY THE SUPPLIER

This can vary, especially with VMS and bodycare. While most suppliers publish a standard 33% GP margin, some offer between 40 and 50% GP with no strings attached. It makes sense to stock those high margin brands as overall GP is pushed up. Other suppliers offer similar extra margin via free stock; either way, it's a good deal. While discounts can often be negotiated, standard high margin suppliers make life simple. Take advantage of them.

WASTAGE, THEFT, ERRORS AT GOODS IN AND REDUCED ITEMS

Throwing away or discounting product destroys margin, yet some undemanding controls can significantly diminish its negative effect. To demonstrate how destructive it can be, let's take a straightforward example. An order is placed for 10 items (no VAT) all costing £1.00 with an RRP of £1.33 returning a 25% GP margin. If just one of those items is wasted rather than sold it has the following impact:

Ten items were still purchased costing £10.00 but instead of all being sold for a total of £13.30, only nine were sold at £11.97, sinking the GP margin on that entire order from 25% to just 16.45%. It doesn't matter whether the product was damaged, wasted or simply recorded as having arrived when in fact it did not. Each scenario kills profit.

No retailer can eradicate waste or error and there is nothing to be gained by introducing a punishment regime as this will just result in problems going underground. Retailers can, however, organise wasted items to be recorded

SUMMARY

Sales are forever the most significant factor in any business, but having just enjoyed a boom that has now evaporated, we should recognise that there is much that can still be done to reap more rewards from last year's efforts. Compare your margin performance, work at improving the influencing factors and generate more net profit.

by date and quantity before being fed back into the ordering equation to lessen the amount of lost margin on the next delivery. Look for progress, not a miracle solution.

Similarly, lines that have to be reduced in price to sell have almost as bad an impact on margin and should be controlled in the same manner. While making these practical improvements, don't let the paper management fail at the final hurdle. Ensure that "goods in" notes are thoroughly checked and that invoices have the correct price and quantity charged for.

A stolen item, whether by staff or customer, has exactly the same consequence as throwing it away. While little can be done to cut customer theft, staff pilfering can be controlled with the introduction of a staff scheme using designated tills, and managers to serve and label purchased goods.

THE PRODUCTS MIX AND MARKET TRENDS

Finding a balance of the right products from the right category at the right margin is crucial to the profit well-being of your store. Achieving that balance is complicated by the needs of our independent health food retailing status.

To uphold competitive advantage over multiple retailers, depth of speciality product choice must be maintained. While meeting that goal, we also have a responsibility to offer the consumer the latest, most popular and fashionably packaged items in demand. Mainstream competitors usually stock these too. At the same time as striving to effectively blend these two moderately incompatible needs, retailers must maintain profitability and secure the independent supply chain for the future.

A strong product strategy must therefore accommodate:

- The purchasing of mainstream popular products that the consumer will recognise, often at the expense of margin and uniqueness in store.
- The supporting of strategically chosen suppliers that are dedicated to the independent retailer even where packaging and support may be lacking, as this will achieve product uniqueness, high margin return and protect our own supply chain.
- The continuous introduction of new products.

A balance of high demand lines, speciality products, independent supply and a resulting appropriate mix of high and medium margin lines can now be achieved.

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