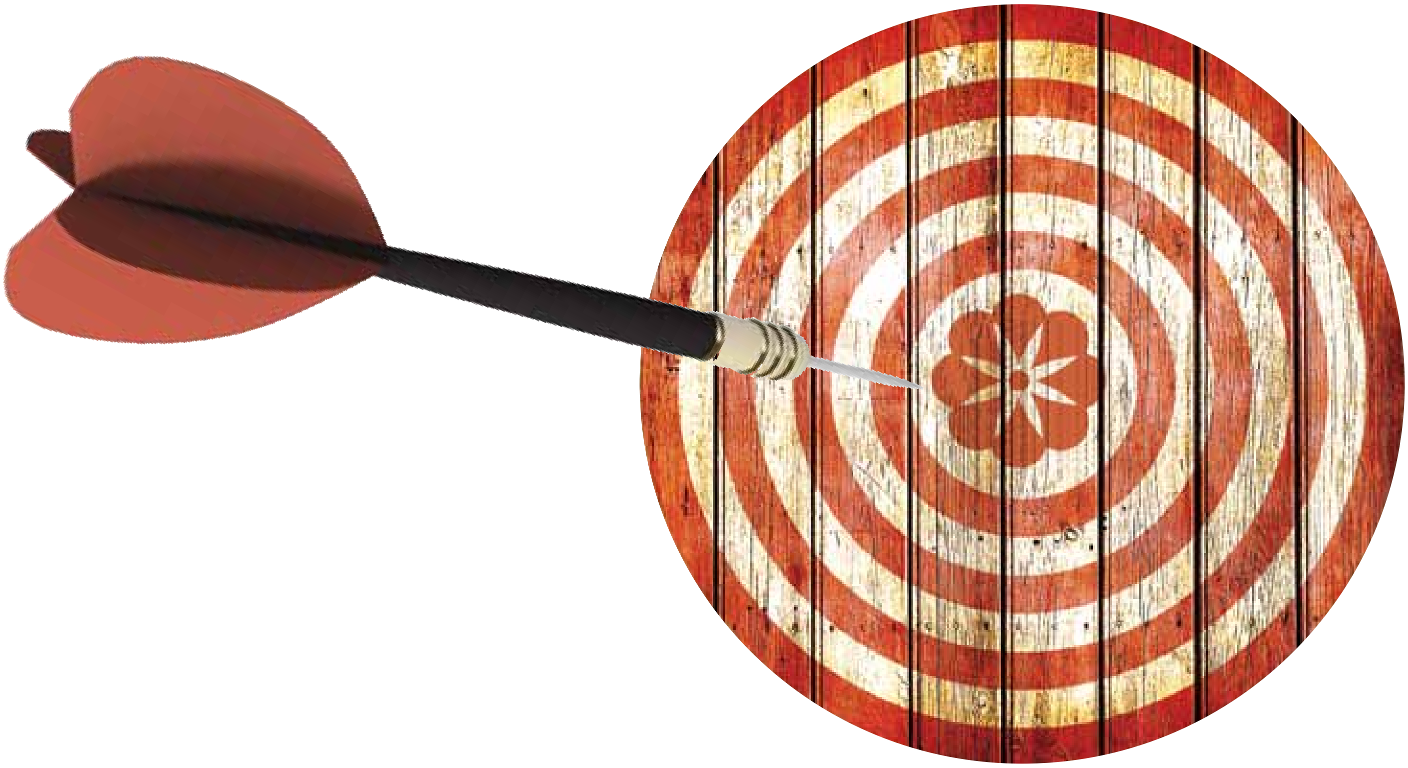

Stay on Target:

COGS, Labor, Facilities and More

BY PAUL GOODMAN, PFCI, CPA

My New Year's resolution was to be more profitable, but Cost of Goods Sold (COGS) for arrangements is 40 percent. Can I turn a profit with these numbers?

> Not likely. COGS equate to "product costs." For green plants, COGS is the cost of the plant and the cost of any container or supplies. For a plush bear, it's the cost of the animal.

For arrangements, COGS is trickier — as you've found out. COGS for arrangements represent the cost of the flowers, foliage, container and supplies. As a general rule, COGS for **arrangements** should not exceed **33 percent** of the retail price of the arrangement; the **flowers and greens** should not exceed **25 percent** of the retail price. Of course, exceptions exist: Florists in **major metro markets** should strive to keep COGS even lower than the 33 percent target, to make up for other costs that are higher (labor, overhead, etc.). I've found that **27 percent** is not uncommon. Similarly, these florists should target flower and greens costs as low as **20 percent**.

To be profitable, you must properly control COGS for arrangements. That's your No. 1 priority. The average retail florist makes about 65 percent of his or her sales in arrangements. If that's close to your mix, your **total COGS** should fall between **35 percent and 38 percent.** (If you don't already break down COGS by product line, start doing so immediately; otherwise, you can't truly know your COGS for arrangements.)

My landlord wants to raise our rent. How do I decide if the expense of moving is less painful than the expense of staying and paying more?

> **Ten percent** is the do-not-exceed target for facilities expenses, which include rent, utilities, maintenance and repairs and facilities insurance. We know that **8.5 percent is the average** expense for retail florists in North America. In other words, most retail florists don't have a problem with facilities expenses, so you might be able to pay more without sacrificing your profit. When facilities expenses exceed the 10-percent level, however, profitability disappears. If that happens, your shop will be providing a profitable living for your landlord, but not for you.

EDITORS' NOTE *Paul Goodman, CPA, PFCI, and Derrick Myers, CPA, CFP, love a good financial management challenge, however big or small. Send your questions to fmeditor@safnow.org, and we'll challenge the experts to tackle them in an upcoming article.*

For financial purposes, how do I define sales?

> The short answer is, **all sales plus wire-ins at 73 percent and wire-outs at 20 percent.** This accurately reflects the amount of money you are going to receive. Floral Finance recommends that you divide sales into the major categories for Product Sales and Non-Product Sales for income statement purposes.

Major categories for Product Sales include arrangements, plants, silk and dried products, gifts and any other items you sell that comprise at least 5 percent of your sales. You shouldn't have separate categories for sales that don't represent that minimum amount. Non-Product Sales include any sale that is not a product (e.g., wire-out service charges, wire-out commissions, rebates, delivery charges, labor charges, interest or rebilling charges, and other miscellaneous non-product sales). Wire-out commissions are the 20 percent of the wire-out that you get to keep. You owe the remaining 80 percent to the wire service.

Enter incoming wire orders in the same sales category as a local order at 100 percent of their value. The only difference between a local order and a wire order is how it is paid for and the 27 percent commission on incoming wires. To handle the 27 percent commission, set up a Wire-In Commission category under Non-Product Sales. This will end up being a negative sales number (to take the 27 percent away from your sales). We like to place it right under the Wire-Out Commission sales category, which keeps your two wire commission accounts together on your income statement.

MORE TARGET PRACTICE

ADVERTISING: Advertising should run between **3 percent and 4 percent** of sales. If you are aggressively growing your business, you might increase this by a percentage point or two, but remember, this will impact your bottom line by a similar amount.

VEHICLES: Vehicle expense in most retail flower shops runs in the **3 percent to 4 percent range.** Occasionally it is higher when an owner/manager drives a vehicle that the business owns. In such cases, include that perk as part of the owner/manager's compensation package. (And keep that package within the limits discussed in the final Q&A of this month's column.)

NET PROFIT: Although a few very well-managed shops will produce 16 percent on the bottom line, for most shops, a realistic target is 10 percent.

Our shop does about $300,000 a year, and our prospective manager wants to be on the payroll. How do I calculate what to pay her (and stay profitable)?

> Like COGS, labor costs constitute a large portion of your expenses, and you're right, they need your attention if you want to be profitable. Here, your shop setup plays a role.

If the owner/manager is on the payroll, your total payroll should not exceed 30 percent of sales. (Payroll is defined as wages, payroll taxes and employee benefits.) If the owner/manager is not on the payroll, payroll should not exceed 20 percent of sales for a shop doing $500,000 or less in annual sales. If a shop exceeds $500,000 in sales and the owner/manager is not on the payroll, payroll costs will rise as a percentage of sales because the business will have to hire one or more managers, at additional costs. No matter how large the shop, total payroll with the owner/manager on the payroll should not exceed 30 percent; however, once a shop exceeds the $500,000 sales mark and begins adding managers, employee payroll will climb as a percentage of the whole.

A good rule of thumb for the owner/manager compensation is as follows: For a shop doing **less than $500,000 in sales**, the owner/manager can have a compensation package, including taxes and benefits, equal to approximately **10 percent of sales.** Once the shop **exceeds the $500,000 sales level**, the owner/manager can expect a compensation package to be 10 percent of the first $500,000 in sales plus 5 percent of sales above $500,000. In other words, for a shop doing $1 million in sales, the owner/manager could expect to take a compensation package of $75,000. By the time a shop reaches $1.5 million in sales, the owner/manager can expect a compensation package to move into the $100,000 range.

Remember, when payroll is too high in a flower shop, the problem is usually in the design room, with too many hours of design wages paid for the amount of volume sold.

Paul Goodman, CPA, PFCI, is founder of Floral Finance Business Services, based in Tulsa, Okla.; editor of *Floral Finance*; and author of *The Profit-Minded Florist*. **plgoodman@aol.com**

Taking Facility Expenses By the Reins

Facilities expenses are one of "the big three" cost centers that can make or break profitability. Here's how to keep them under control.

By Paul Goodman, CPA

How's this for a sobering reality: Facilities expenses can make or break your business. If they're kept under control, then you're in good shape. If not, then, best case scenario, your bottom line isn't as healthy as it could be could be. Worst case: You could be on a downward spiral toward failure. Here's some guidance for keeping facilities costs under control.

The Industry Standard

Facility expenses are more than just the rent you pay. It's all the expenses associated with occupying your building: rent, utilities, facility insurance, repairs and maintenance, security, property taxes (for land or buildings), snow removal and parking lot repair and maintenance. All of these are a part of the cost of hanging your shingle at your present location.

The industry average for facility expenses is 7 percent to 8 percent of sales. We discovered that when facility expenses exceed 10 percent of sales, profitability almost always suffers. The florist is making money for the landlord, not themselves. In fact, most retail florists with a 10 percent facilities expense generally do not make any money.

Keeping facility expenses at or below the 7 percent to 8 percent target is easy for most shops. However, there are a few categories of retail florists who have trouble trying to meet the goal: shops in regional malls, upscale strip centers or high-priced cities like New York, or shops that just have too much space.

Fortunately, there are not many florists in regional malls — that location is just not conducive to a retail floral operation. Their required hours are too long, which drives up payroll. Delivery is often a problem. And, customers generally don't like to carry fresh product around a mall.

The other two high-priced locations, upscale strip centers and expensive cities, pose a challenge and require a careful analysis by each retailer to determine if they can make money with rent so high.

Last, but not least, are those shops that have rented more space than they need. Their sales volume does not justify the square footage that is occupied.

Facilities Costs that Drive Sales

One way to justify a higher facilities expense is to count your excess expense as a part of your advertising budget. Perhaps you are located in a high cost facility because you believe that will draw customers. Part of your rent dollars are advertising. Of course that means your other advertising expenses need to be lower to offset the amount being allocated to facilities expenses.

Too Much Space

This is the most common reason for facilities expenses to be out of control. You are paying for more space than you need or your sales can justify.

Many florists think it's nice to have a large shop. They envision this beautiful shop that customers will just love to visit and browse around — a place where they can show off all their design talent. So they open a shop with way too much display space. However, there are serious drawbacks to having too much space. And it all boils down to money.

The problem is twofold. First, you have to buy enough materials to fill the space. That's money tied up in non-perishables that probably are not going to turn over more than twice a year. Most florists do 5 percent or less of their sales in giftware, which ends up being a lot of what you display. Don't tie up your money in slow moving products just because you have a lot of space that needs filling.

Second, you also have to have someone on staff that can do display well and then pay them for the time it takes to keep it all up-to-date. And you need sales staff to monitor and service the area. Remember, most sales in the typical retail flower shop come in over the phone. You don't need much display area for those customers.

More than once I have counseled retail florists to cut down on their display space. Put up a false wall — whatever it takes to lower that display square footage.

I Own The Building

Many retail florists have facility expenses considerably lower than the 7 percent to 8 percent average. The reason? They own the facility. The shop has been in the family for a couple of generations and was paid for a long time ago. It's not unusual in this case to see facility expenses as low as 3 percent to 4 percent of sales. (On a side note, if you own your property and building, you should have them in a different legal entity than the flower shop. The entity that owns the property should "rent" it to the flower shop at a going market rate. Then you really will see that some of your income is from being a landlord.)

Of course it is wonderful that the facility is paid for. Unfortunately, many florists don't take full advantage of the cost savings.

If your rent is lower than average, your profitability ought to be that much higher — but not because you are a better retail florist. The extra profit will be there because some of your income is (and should be) a result of being a landlord.

Whatever your situation, don't let facility expenses get out of line. Facilities expenses are one of the big three expense categories in a retail flower shop. Control these expenses properly and you'll definitely help your bottom line.

Paul Goodman, CPA, a 30-year floral industry veteran, is founder of Floral Finance Business Services, based in Tulsa, Okla., editor of Floral Finance, and author of The Profit Minded Florist. E-mail: **plgoodman@aol.com'**

Why 'the Big Three'?

Our identification of "the big three" expenses in a retail flower shop was not based on a random guess. In 1989, when Floral Finance Business Services first started preparing monthly financial statements for retail florists, we believed that most retail florists were not getting good financial data. We also believed that if they got good data they would perform better and make more money.

We produced everyone's financial statement using the same format. That allowed us to combine everyone's data into a database. As the number of florists being processed every month approached 100, we began using the database to see who was making money and why.

It wasn't long before the most critical areas of profitability were obvious: cost of goods sold for arrangements, payroll expenses and facility expenses. Ever since, we have called these items "the big three" expenses of a retail florist.

In one respect that was not surprising, since these three are the largest expense categories in a retail flower shop. If those three were controlled properly to industry targets, the shop was invariably profitable. When those three were not controlled to industry standards, money was lost.

— P.G.