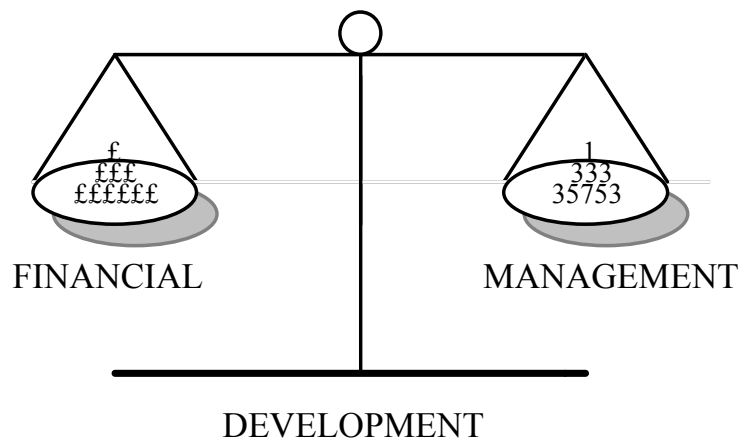


# FINANCIAL MANAGEMENT DEVELOPMENT

## MANAGING RETAIL OUTLETS

NO 603

### MAKING SPACE FOR PROFIT



ONE OF A SERIES OF GUIDES FOR  
FINANCIAL MANAGEMENT DEVELOPMENT

FROM

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

## MAKING SPACE FOR PROFIT

As a Retailer you have to make lots of decisions. These include -

- How long should I open?
- How many staff should I have?
- What goods should I sell?
- What goods should I promote?
- How should I display my goods?

This paper concentrates on the last three questions but the ideas behind it can be used for most business decisions, which are really only one question: How can I make most profit from the resources available?

In another paper it notes the approach the large multiples use to maximise their profits - concentrating on contribution per linear, square or cubic metre. There is nothing very difficult about this. It is an application of common sense and simple arithmetic.

Consider your business. At its most basic it consists of the offering of goods and services to the public. You provide the retail surroundings, your time and your staff's time. Customers come to you and pay for those goods and services and you make a profit. You do not make the goods you sell, you buy them in from suppliers and therefore you can only make a profit if you sell them for more than you pay for them.

Another paper covers how you can work out the best method of buying your stock cash and carry, or on credit, and what level of stock you should buy and keep. Again these are a mixture of common sense and basic arithmetic. This article looks at the financial considerations behind your shop layout, promotion and use of space.

Your business could be expressed like this:-

	£
Sales Income from Goods/Services	X
Cost of Goods/Services	(X)
	----
Gross Profit (or Contribution)	X
Cost of having the shop open	(X)
	----
Profit	X
	==

Let's just look at goods. The more you sell the more profit you make..... but how much profit does each item make and which are the most profitable lines? You need to know this in order to decide what to stock and how to display it.

To answer these questions you need to consider your costs. The cost of having the shop open is fixed. That is, it does not vary with the amount you sell. But the cost of the goods sold does vary. The more you sell the more you have to buy. Splitting your costs into those which are fixed and those which are variable can give you vital information to help make decisions. In all businesses, some costs are fixed e.g. property costs and some vary with volume e.g. cost of items sold. Most businesses use this information to help make decisions.

Imagine you sell two products A and B - both sell at £1 and both make the same "profit". But the contribution is different. Contribution is another name for Gross Profit i.e. Sales less cost of goods sold.

	PRODUCT A	PRODUCT B
Sales	100	100
Variable (Cost of Stock Sold)	80	10
	----	----
Contribution	20	90
Fixed (Cost of Space used)	10	80
	----	----
Profit	10	10
	====	====

If you promote either product you will double its sales, but you can only promote one. Which should it be?

Twice as much A gives an additional 20p of contribution, fixed costs stay the same and therefore profit goes up to 30p (A three fold increase).

**BUT** twice as much B gives an extra 90p of contribution, profit goes up to 100p (a tenfold increase). Promote B!!!

There may be other factors. Knowing your contribution for your main product lines is essential for many decisions. However it is only a start. You will need to consider customer reaction and apply common sense. Just because inflated balloons may make the best contribution does not mean you don't sell anything else.

In a retail outlet, the biggest fixed costs are property/time related. Effectively you provide a fixed cost space and fill it with goods for your customers to choose from. Which products should you display in the best positions?

If the two items A and B took up the same space then B is still the best item. But if B occupies ten times the space required by A, you might be better off displaying lots of A rather than one B (if that's what helps you sell more). If space is limited then you need to review the relationship between contribution and space occupied.

You do this by working out the contribution per linear metre for items on shelves, or square metre for items on floor displays, or cubic metre for items in freezers etc. (You get similar information if you work in feet!). As with all management information the calculation doesn't have to be precise. If magazines only give you about £2 contribution per foot and crisps give you about £4 it doesn't matter if it is really £1.98 and £4.15. You can still use it to make decisions.

#### How do you work it out?

Contribution is Sales less Cost. It is also known as gross profit. You are probably used to working out gross profit as a percentage of sales (sales margin). This approach merely compares the gross profit made to the space occupied (or time taken to sell it, or whatever is your limiting factor.) You can look at it by item or by category e.g. confectionery, stationery, toys, frozen food, etc. It is best to stick to the main categories although if you want to be really detailed you could look at different pack sizes on the same basis. Space is space; so measure it. Some wholesalers specialise in this sort of analysis and very often they provide a service to do all the hard work for you. In many cases they can produce an "ideal" plan for you to work towards.

#### What do you do with the Information?

Firstly you may well identify space which is not being used. Look around the shop... is every square inch being used? The large multiples have recently noticed that the floor is not being used for product promotion. Watch this space as they say on television!

Not all large products have to be displayed in the shop. A picture might do. Some products may not be selling - stop buying them.

We all know that customers tend to buy more of items placed strategically. That is why impulse buys like sweets are near checkouts at the multiples and why the high contribution lines are at the end of aisles. Have you got your best contributors in the best positions? Have you stocked up with small, high contribution items or is your key space full of low margin goods? You may have to stock low margin lines to bring in customers but you do not have to give them prime position. Beans at 4p a tin attract customers and the multiples aim to sell them everything else once they had got them in the door, so they do not put them near the front of the shop.

#### Layout makes a difference

Does your layout encourage customers to buy? Don't have untidy layouts with slow moving or poor contribution items at the front.

Do you make it easy for customers to pay? Queues are fine if you want to slow people up so they take an impulse buy as they go past, but not so good if they decide not to bother when they see how long they have to wait.

Plan your space and profit from it.

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development.

He has worked as a Financial Controller and Company Secretary in the Finance Industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over thirty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, The Post Office, Rothmans and Zeneca. International training experience includes work in Denmark, Kenya and the Czech Republic for Unilever, in Dubai for Al Atheer, in Holland and the U.S. for Avecia and Zeneca and in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. A key output from the training is demonstrable use of the knowledge and skills acquired to enhance corporate profitability. In addition he has run courses in acquisition evaluation (The Economist, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). He has also developed material for delivery by in house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP) and post course reinforcement workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material, he has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants and the need for taxation awareness training for general managers. He is also an active promoter of the need for the demonstration of the benefit of Christian values in the workplace, as a founder member of the Christian Institute of Training and Development.

He is married with one grown up daughter and his outside interests include being a Trustee of Crew Trust (Catholic Charismatic Renewal in England and Wales), a Trustee of the Sion Community for Evangelisation, The Treasurer of the Hospice of St. Francis (Berkhamsted), a Governor at Dunstable College and a member of the Catholic Evangelisation Services Team (producing video series on the love of God for His people expressed through His Church) and the Catholic Alpha Training Team (Promoting the Alpha course on Basic Christianity). He was a Governor of Luton University for nine years and a school Governor for four years.

**This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared with all (Matthew 10:8).**