Understanding Accounts

For

Bridal Retailers

FOREWARD

This script has been written with just one purpose

To help retail businesses, with an emphasis on Bridal Retailers do one of two things:

- Reduce or stop losses
- Increase profits

There will no new ways to sell, increase your sales, add on sales etc, nothing sexy or exciting like that

It will, on the surface appear dull and boring but the end product is to make your business better and more profitable by helping you with an area that we all know is neglected and very unexciting – UNDERSTANDING YOUR ACCOUNTS

If you cannot afford the time to do a few of these exercises every 12 months then find the time. It is vital to try to follow some of the advice on these pages. Everything prescribed within here has been written with the aim of improving your business performance and ultimately making more money for you

Business reviews and business budgeting are a vital tool for identifying your strengths and weaknesses and one of the aims of this crypt is to make these processes as easy as possible for you to, firstly understand and then to react to

Everything has been written in an easy to follow and understanding manner, it is not intended to be patronising is any way. Much use is made of examples to demonstrate the importance of the numbers in your business

With such emphasis on selling beautiful bridal gowns and accessories it is too easy for retailers to forget the aspects of the business that will decide your businesses future... the bottom line

Remember that you are in business to make money, nobody else buy yourself can do that for you

SECTIONS

- BUSINESS BUDGETING / CASH FLOW PLANNING
- PROFIT & LOSS ACCOUNT
- BALANCE SHEET
- BUSINESS REVIEW

BUSINESS BUDGETING

Ask yourself this question, *"When you started your business what was your objective?"*

Whatever your motives were (or still are) the one that should have been somewhere was *"to make myself some money".* If this motive was not one of your priorities or is still not then there is little point in reading on

The reason why this question is vital is that without stating the obvious not making profit can mean only one thing, you are making losses and this will then inevitably lead to closure. But how many of you actually know what level of sales are required to achieve profit i.e. do you know your **breakeven** position within the business?

This is a very important question for not only start up businesses but increasingly for existing companies in times of rising inflation

Let us see this in very simplified terms:

To do this exercise you will be required to know the fixed overheads within your business i.e. wages, rent, rates, insurance, etc

Example of shop's annual overhead costs

Wages (inc Employers National Insurance)	52,000
Rent	12,000
Rates	4,000
Electricity / Gas	1,500
Telephone	1,000
Insurance	2,000
Postage / Carriage Out	500
Motor Costs	750
Advertising	1,500
Internet Costs	1,000
Repairs & Renewals	400
General Expenses	900
Accountancy Costs	1,200
Bank Charges	400
Bank Interest	800
Loan Interest	1,200
Total Fixed Overheads	**79,850**

You therefore need to achieve a Gross Profit on sales of £79,850 in order for the business to **breakeven**, anything above this figure has to be profit for your business. This is without doubt the critical point for any business as anything below this will mean losses, anything above is profit

Gross Profit / Margin Calculation

Calculation of your Gross Profit (or Gross Margin as it is often known) is relatively straight forward and is based upon the percentage mark up of your buying price. However as we will discover later this area is potentially the most problematic and troublesome within your accounts

For example:

Assuming your normal mark up is 2.5 times the buying price of the product

Buying price (Nett of VAT)	£200.00
Mark up @ 2.5	Retail Selling Price = £500.00
Take off VAT @ 20% *(£500*20/120)*	*(*£83.33)
Nett selling price	£416.67
Less original cost price	(£200.00)
Therefore your gross profit =	£216.67
As a %	52%

Therefore to reach a gross profit figure of £79,850 i.e. your breakeven figure you must achieve sales of:

Net of VAT	**£153.558**
Including VAT	**£184.270**

On these sales figures and at a gross profit % of 52 we will be left with a figure of £79.850 i.e. breakeven point

To calculate the required sales figure for your own business take your fixed costs figure as calculated on page 4, divide by your gross profit % and multiply by 100

In our example Fixed Costs are £79,850

Divide by GP% 52

Multiply by 100

= £153,558

We are assuming at this early stage that **ALL** your products are sold at this same % mark up, we will ignore any product mix at the moment

You can immediately see therefore that this simple piece of information is as vital a tool for measuring your financial success as anything else in your accounts. You must use it

For a start up business it is imperative that you know what sales are required to breakeven for at least 3 years ahead

For an existing and profitable business it is equally as important when your overhead costs are rising to know what increase in sales is required in order to keep your profit level as it is

If your overhead costs were to rise by 3% to £82,245 as in the example then your breakeven sales figure rises to £158,163 as increase of £4,605 on the previous year

This is **business planning**

You are now looking ahead and trying to foresee the potential problems / issues that you and your business may face in the short term

By doing the above you may or may not like what you see but it is only by forecasting in advance that you do something about it and plan ahead

CASH FLOW PLANNING

Without stating the obvious, cash flow is vital to businesses. However, the idea that a business cannot fail if it is making profits is a very large misconception

There are many examples of businesses both small and large that have failed and gone out of business whilst making profits. Old fashioned as this may sound but in business CASH IS KING and in the present economic climate high street banks are unlikely to be very benevolent and at worse ruthless when trouble strikes for businesses, so the best avoidance method is to **plan ahead** and know what cash you will require and when you will require it. Planning ahead is key

It is quite normal for businesses to require an overdraft to operate. In our own UK bridal market we are all subject to the seasonality of weddings and the subsequent cash flow problems that this can bring, but the secret is to use this knowledge in advice and to plan ahead with a cash flow forecast that will show you your requirements for the coming 12 months. This can be taken to your bank or lender if financial assistance is required

Although a cash flow forecast will inevitably be based upon future assumptions there is a lot of information already available to you within your own business

To generate a basic cash flow try the following:

1. Write down your monthly cash receipts and monthly cash payments for the past 12 months
2. Write down your opening bank balance for the period
3. Work out the closing balance for each month
4. Carry this on for every month and you should get a feel for how your cash flow will project out over the year

	Receipts	Payments	Closing Balance
Open Balance	12,000		
Month 1	10,100	14,000	8,100
Month 2	15,800	25,000	(1,100)
Month 3	20,500	20,000	(600)
Month 4	15,000	22,200	(7,800)
Month 5	16,600	29,500	(20,700)
Month 6	22,800	16,000	(13,900)
Month 7	25,500	15,000	(3,400)
Month 8	22,800	16,900	2,500
Month 9	23,500	17,000	9,000
Month 10	14,900	16,100	7,800
Month 11	17,000	20,000	4,800
Month 12	14,500	15,800	3,500
Closing Balance	3,500		

You can now build your own cash flow forecast based upon previous year's figures and your own assumptions based upon future sales and purchases etc

This simple exercise can quickly and easily identify your basic cash requirements for the period ahead, assuming that all costs and receipts are in line with the forecast. With our example month 5 is obviously the point when finances are at their lowest and unless an overdraft is in place finance may be required

As with most things in life, if you are prepared for a situation happening then you can deal with it more effectively. Cash forecasting within your business is a good example of this

Control of Cash Flow

Within your cash flow forecast however there is an area that represents probably your largest expense and the one expense that **YOU** can control

In the bridal market particularly it is a vital tool within retail businesses and it will either make you profit or lose your money, it is your **sample** or your **stock purchases**

The most important aspect of your cash flow planning therefore is to build into your cash flow forecast your stock purchases or anticipated stock purchases for the year ahead

If you are on track with your sales forecasts then stick to your purchasing figure when placing your sample / stock orders, if you are ahead or expanding your business then you may want to increase these orders to take advantage of the buoyant sales but the most important point to remember is that everything has to be paid for and a cash flow forecast will tell you if you can afford to or not

Remember that your purchases at trade shows which may total £50,000 in September will likely turn into deliveries in your shop and then purchase invoices totalling £60,000in December and January. You are therefore going to need this level of cash either then or 30 days later if you are granted a credit facility by the manufacturer

The simple cash flow exercise above should give you an indication of how much you can afford to spend on stock and sample purchases within your budget. Once again it is vital that you have a plan and that you stick to it. Unless you are cash rich and can afford to buy extra gowns and accessories you will immediately be under cash flow constraints which will then affect other parts of your business. So the golden rule for purchasing which you should never break is to *"have a plan beforehand and stick to it"*

Why not split the deliveries so not everything is payable at the same time, simple measures can be very effective without causing too many problems, talk to the supplier maybe they will give you extra credit period to pay?

A Warning

A large and unbudgeted overspend on stock at any stage of your business life and particularly following a trade show (when potentially all your stock can arrive at the same time) can have a significant and negative impact on your cash flow. If the overspent stock samples do not sell sufficiently well then the problem will be compounded and very quickly you will have a significant cash flow problem. For those businesses operating without a bank overdraft this can create sudden problems. This can happen quickly so be aware at all times of overspending

The solution, as detailed above is to plan ahead and avoid all unnecessary surprises.

A positive outlook on this is that your chances of getting a bank overdraft will increase significantly if you can display your understanding of cash flow forecasting and then produce one, on paper for your business. Your bank will take the view that the risk factor is slightly less if the borrower has a good understanding of their own business and the cash flows less involved

PROFIT & LOSS ACCOUNT

Most of you will be very familiar with this document showing your sales and costs for a set reporting period – usually 12 months

In very basic terms it will show if your business is making or losing money

But what does the P&L account tell you about your business?

Sales less the Cost of Sales will give you the Gross Profit, but how does your Gross Profit compare with the previous year? Have you improved it or reduced it?

If you are able to explain **why** your gross profit has changed from last period to this period i.e. the reasons for the change then you are some way to having a good understanding of your accounts

Understanding your accounts will mean that you:

1. Know what is hidden behind the figures
2. Can do something about them if there is a problem or improve them

Your Product Mix

The understanding of your gross profit figure and % cannot be stressed enough as it is probably the single most important area within your accounts. It is also the area that is within your control as you can set your retail selling prices

Gross Margin calculation in more detail based on our example:

In our example sales of £153,558 (at a full Gross Profit percentage of 52%) are required to breakeven at £79,850

However what if your products are sold at different profit margins, e.g. wedding dresses at 52%, bridesmaids at 40% and accessories at 55%. This can have a significant impact on the overall profit margin

Example of breakdown of sales:

Wedding Dresses	£90,000
Bridesmaids	£45,000
Accessories	£18,558
Total	**£153,558**

The gross margins on the above would be:

Wedding Dresses	£90,000	*	52%	=	£46,800	
Bridesmaids	£45,000	*	40%	=	£18,000	
Accessories	£18,558	*	55%	=	£10,207	
Total	**£153,558**			**=**	**£75,007**	**= 48.8%**

With the above product mix we have a new Gross Profit % of 48.8% and a new breakeven figure: £79,850 divided by 48.8 * 100 = £163,627

As can be seen the breakeven sales figure has now risen by over £10,000 from £153,558 to £163,627 quite a significant amount

This example is normal accounting practice. It is important that retailers understand this even in a basic form as per our example

Discounting

Or more concern to retailers and in particular bridal retailers is the use of discounting to gain retail sales

The use of discounting the retail price of products and / or price matching, and in particular bridal gowns is frequently now used by retailers in the UK in order to gain sales. The effect however on your profit can be dramatic and creates a vey false and damaging position for your business

The example below will demonstrate:

Full retail price of gown (Inc VAT)	£850.000
Retail Price (Nett of VAT)	£708.33
Cost Price	£335.00
Gross Margin	£373.33
Gross Margin as %	52.7%

What if the retailer drops the price to get the sale by:

(a) £50 to £800
(b) £100 to £750

The result is as follows:

Full Price (Inc VAT)	Nett of VAT	Cost Price	Gross Margin	GM as %
£850.00	£708.33	£335.00	£373.33	52.7%
£800.00	£666.67	£335.00	£331.67	49.7%
£750.00	£625.00	£335.00	£290.00	44.6%

Although on the surface these may still appear to be healthy profits and not too significant, the facts are that your bottom line, the profit that you work for is being given away for nothing

Look at it from this angle,

If you discount half of your gown sales as our example by £50 then

You lose sales approaching £6,350 and you lose profit of £6,350

If you discount half of your gown sales as above by £100 then

You lose sales approaching £12,700 and you lose profit of £12,700

This is straight to your bottom line, straight to your profit; there is no equivalent decrease in the cost of the gown. It is final and straight off your profit and ultimately your earnings

Indeed if we again follow our example then the breakeven figure for your business rises even higher with discounting and puts even more pressure on you as a business. For you to make up this £12,700 loss you will have to sell another £25k of products, quite staggering

Maybe there are easier ways of closing the sale e.g. offering the bride a veil or a hair accessory free of charge. Possibly you sell these items at a full retail price of £120, the true cost to you is likely to be nearer £30 Nett of VAT but the bride is under the impression that she is getting a product valued at £120. However you are still giving away your profit with these items

The golden rule is that discounting is dangerous for your business and it will slowly eat away at your profits and ultimately your business

Look around your industry and ask yourself how many of your suppliers give you discount just for asking, the answer will be none

Overhead Costs

For the normal fixed overheads within small businesses a simple review and comparison to the previous period is a quick and very effective exercise that takes 5 minutes and can be done as little as once per year

Line up your overhead costs as shown on page 4 and do the same for the previous year / period then look for the variances

You are looking for large variances either positive or negative

As in the section above the secret is to find the large variances and to be able to explain the reasons behind them

Finding problems quickly within your business and then dealing with them can only benefit you and your business

It is only by highlighting and acknowledging that a problem exists that you can do something about it. A large increase in wages for example whilst your profits are decreasing should tell you to take some form of action to address the situation. Increase sales or decrease costs

You do not need to wait for your accountant to tell you this and then be charged for the privilege; you can and should be doing this yourself

BALANCE SHEET

On the surface your balance sheet (and anybody else's for that matter) is uninspiring to the point that it is frequently ignored by the owners of businesses

However, for your business it is the most important tool for measuring your business performance. If your Profit & Loss account is a snapshot of your business performance over a 12 month period, your balance sheet gives you information on how much your business us worth, how cash rich or poor it is, how much you own and are owed. It is a vital tool and basic understanding of it can only help your business to improve

The Balance Sheet will tell you where your business is on an overall perspective

To try to gain basic understanding of Balance Sheets for the purpose of this exercise we will look at what is relevant to your retailing business

Assets

These are split between Fixed and Current Assets

Fixed Assets are also known as Capital Expenditure and cover items such as buildings & property, motor vehicles: generally items that are long standing and long term. For the purpose of this exercise we do not need to look at this area very closely

Current Assets are items such as, debtors stock and cash. These are the crucial parts of any business as they are the most *"liquid"* of assets i.e. they can be turned into cash more quickly and easily that say a vehicle or building

Debtors: Money due in from your customers via invoiced sales or other monies due into your business that has been invoiced

Stock: The value of your stock at a certain point in time, nearly always at your financial year end. How you count and value your stock can have a large bearing on your Profit & Loss Account figures so this area needs looking at in more detail

If we take an example that you have purchased wedding dresses at £200 (Nett of VAT) you buy 50 gowns at this price at a total price of £10,000

At the year end when you do your stock count there are 10 of those gowns left over. At a full cost price the valuation is £2,000

However is it good policy to value these gowns at the full cost price?

Of the 10 gowns remaining maybe 5 are good sellers, 3 are to be reduced in the sale and 2 are damaged beyond repair

Normally then, the stock valuation method would change to reflect the saleability of the gowns. In other words, *"write down"* the value of the unsalable / poor selling styles

For example:

Saleability	Units Remaining	Unit Cost	Total Cost	Written Down Value	Total
Good Sellers	5	£200	£1,000	£200	£1,000
Sale Dresses	3	£200	£600	£100	£300
Damaged	2	£200	£400	-	-
		Totals	£2,000		£1,300

How you decide to value your stock is entirely ***your decision*** but in the example above if you valued your damaged gowns at £400 rather than the more realistic written down valuation of £0 then your balance sheet would show current assets £400 more than it is realistic to collect. You should then ask yourself if you will receive £400 from customers for those 2 gowns.

This is an important and often overlooked issue for most retailers

What is as important is that your **"stock policy"** is consistent. If you decide to write down old / damaged / discontinued stock as in the example above then apply the sale rule (s) every year

There is also a double edged sword policy (assuming that you are reducing the value of your stock) and a positive one!

If you reduce your stock valuation by £700 as in our example you will reduce your profit in the P&L and you will pay less tax!

Liabilities

Your liabilities are normally the next item within the balance sheet and will list how much you owe, both short term and long term. In most cases trade creditors and any bank overdrafts will be shown within this section as well as other amounts owed to the government, e.g. PAYE and VAT

Monitoring of these liabilities is vital for your business; an annual check of the level of your creditors against the previous year's figures will take you a couple of minutes but will tell you if you are overspending or if you're buying less or maybe paying your suppliers quicker than previously

Checking your bank balances against last year's figures will also give you as very good indication of how your cash flow is performing, it is important to take into account any significant changes in your business during the past 12 months i.e. lower or increased sales and costs when doing this exercise

BUSINESS REVIEW

A normal scenario for small businesses including bridal retailers would be to receive your accounts back from the accountants every year, look at the Profit & Loss Account, see how much profit or loss has been made, check how much is to be paid to the government and then file it away

Is this correct?

Before you file them away a few minutes spent looking at these figures could well highlight problems and potential problems within your business

It may also offer opportunities that you didn't know existed, opportunities to make more profit by increasing your gross margin or by cutting your costs

Look at ways in which you can maximise or increase your Gross Margin, it is this area that creates the wealth for you. Is there enough flexibility in your pricing to increase the price of certain products? Is it worth trying, if it does not work then revert back to your old prices

If possible **AVOID** at all costs discounting the retail price of the wedding dress, as discussed in detail it will eventually destroy your business

Look at all opportunities to cut costs. The obvious areas are:

- Review your advertising cost and its effectiveness. Is it worth keeping the most effective campaigns and getting rid of the useless ones? Can you measure how effective each method of advertising is?
- Utility cists
- Rate review / appeal of your premises
- Get a quotation for accountancy costs as this can be a large expense annually
- If you operate without a bank overdraft, even now there are offers of free banking for customers moving accounts although they are not as widespread
- Merchant fees for credit card transactions, look to alternative suppliers e.g. via your trade association RBA

Unless you are losing money at an alarming rate the advice is to think very carefully about any reduction in staff costs unless an opportunity arises to reduce costs, for example a staff member wishes to reduce hours permanently and the reduction will have no effect on your business

Legal advice should always be taken before action is taken

Any reduction in staff costs, redundancy etc must be a last resort unless the business is losing both cash and incurring loses

In addition to the measures discussed in this document there are a number of other methods of looking at your business

Calculations:

Return on Investment

This is a fairly straightforward calculation detailing in basic terms the % return on your investment in your business

To do this:

Take you nett profit

Divide by total debt owed to you + total investment

Times the amount by 100

This should give you a % for example Nett Profit = £3,000 total investment = £25,000

Your return on investment = 12%. Try to do this every year and compare with previous years

Creditor & Debtor Days

This basic measure will tell you how long it is taking your business to make credit payments and to receive debtor payments

Trade Creditors divided by Sales multiplied by 365

Trade Debtors divided by Sales multiplied by 365

Both these simple calculations are easy to follow and are very effective in telling you how your cash is performing within your business

Use them both wisely

This script is intended as a guide for Bridal Retailers to assist with all aspects of understanding accounts and improving performance

The intention is that you will start to increase your gross margins, reduce some of your overhead costs and at the end of the day make more money for yourself

Good Luck

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