

How Do You Measure Up?



By David Shappee

After our second year in business, I looked forward to our next meeting with our accountant. We'd finally started to regularly turn a profit. "Well," I said, "how are we doin'?"

"How well do you think you should be doing?" he replied.

"I mean," I said, "compared to other small businesses—you know—are we profitable enough?"

"How much do you need?" he asked.

"As much as we can make," I said impatiently, "but what I want to know is *how are we doing*—are we as successful as we should be?" I insisted.

"David," he replied, "what are your expectations? What do you want from this business? Why are you in it in the first place?"

All good questions... from my psychiatrist. From my accountant I expected more. A rating, a score, praise or criticism. Something to let us know how we measured up, to the competition, and to ourselves, our potential. From the perspective of the last 21 years, however, his response was eminently wise. While we are all "in it for the money," if it was *just* money, we'd probably have given up by now. The many aggravations of small business are too great to be offset by mere profit. Nonetheless, here's some ideas on how to measure how you're doing. They used to be called Key Performance Indicators (KPI), however the current generation of MBAs, perhaps in a nod to internationalization, prefers "Metrics."

It all begins with sales, of course. The question for an MPC is *what kind of sales?* Whenever I talk to another owner and they start telling me what their gross sales

are I'm frequently impressed—until I ask them what they were *less stamps, money orders, utility payments, and other "not for profit" offerings*. I call this **Adjusted Gross Sales**. The franchises label it "NSR," Not Subject to Royalty, and for good reason. It's because we don't make enough profit on those services for them to be worth doing, if it weren't for the "traffic," the people they bring into the store. And please, don't argue with me about postage stamps as a profit center. Until I meet an owner who's successfully keystoneing them (selling them for twice what they cost), I'll consider them more a marketing or service cost than a retail product. Retail products are sold for 50% or more gross profit.

Now, just because they aren't a profit center doesn't mean stamps, money orders, and utility payment collections shouldn't be watched carefully. They

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should. Many operators discover they are losing money on stamps, despite their markup, due to poor inventory control (see *MPC Today*, August 2008, "How to Increase Sales 6%"). Regarding money orders, well, I know an owner right now who's facing a \$6,000 bill from their money order company from an ex-employee's "mistakes." And utility payment collections? You're welcome to them if you really need customers who can't pay their bills on time, and you have controls in place to protect yourself from the liability for holding thousands of dollars of cash for someone else. Again, I know of two owners who have faced judgments of over \$20,000 from the utility companies for lost funds, one blamed on a partner, the other on an employee.

When you look at your day's or month's sales, think in terms of **Adjusted Gross Sales**, total sales minus postage stamps, money order sales (face amount, not the 50¢ or \$1 commission), utility payments, Western Union, and any other "pass through," low or non-profit collections. Including these things not only distorts our perception of how we're doing—ever have a "great day," then realize half of it was stamps?—it becomes even more important when we calculate our gross profit.

Gross Profit, the difference between what we sell things for and what we pay for them (Cost of Sales), is the profit fuel of business. In retail, that fuel is "high octane" when it exceeds 50%. That is, if everything we sold in a month totaled \$25,000, and our Cost of Sales—UPS and FedEx bills, packaging supplies consumed, retail inventory gone, postage meter used, etc.—was \$13,000, then the \$12,000 difference, our Gross Profit, was 48% (\$12,000 divided by \$25,000).

But look at the difference when calculated based on Adjusted Gross Sales:

Gross Sales:	\$25,000	Gross Sales:	\$25,000
		Less Stamps:	\$2,000
		Adjusted Gross Sales:	\$23,000
Cost of Sales:	\$13,000	Cost of Sales:	\$13,000
		Less Stamp Purch.	\$1,800
		Adjusted Cost of Sales	\$11,200
Gross Profit:	\$12,000	Adjusted Gross Profit	\$11,800
	48%		51%

When we make decisions about our margins, what we markup and how much, we need to do that based upon what we can control, and what we can't. There's not much we can do about the piddlin' markup most of us take on stamps, and the outrageous quantities we sell as a public service, except exclude them from our calculations, so they don't distort our overall

perception of our business. In the above case, we might be raising prices on boxes or shipping in an attempt to achieve a 50% overall Gross Profit, when in reality we've already done it.

Gross Profit on Sales is the primary benchmark for an MPC. We are a kind of hybrid in the retail world, part Service, and part conventional Retail, but the universal truth is you can't have a Net Profit without a Gross Profit that at least covers your costs. Gross Profit margin varies by industry. If we were a pure service business, like a law firm or advertising agency, Gross Profit is expected to be high, approaching 70%, because Cost of Sales is low—what they really sell is labor. Conversely, for manufacturing or construction, where Cost of Sales is high, Gross Profit is expected to be low, around 30-40%. Small retail, like us, has consistently

struggled whenever Gross Profit drops below 50% of sales. Let that be your benchmark objective for overall performance: Gross Profit equal to or greater than 50% of Adjusted Sales. Seldom do I see a successful MPC with less than that.

Several other metrics key off of Adjusted Gross Sales. A fundamental retail standard is **Sales Per Square Foot**, the simple

quotient of annual sales divided by the square feet of your facility—not just the "retail space," back room separated from showroom, but everything you rent or own under one roof where sales occur. For most mail and parcel centers, this ranges between \$200-\$300/sq. ft., consistent with other local retail businesses. The average Wal-Mart or Costco, on the other hand, might do \$400 or more. Sales Per Square Foot is why I love mailboxes. Three hundred mailboxes, at 80% occupancy, take up such a small footprint of your retail space that sales per square foot works out to be \$600-\$700! That's right up there with Rodeo Drive fancy boutique sales, yet so many MPCs struggle with, then abandon, mailbox rental.

A converse to this is **Rent Per Square Foot**, one of the great equalizers of retail real estate, and it is certainly proven in the MPC business. The most successful MPCs actually pay more than the average for their locations, but it doesn't cost, it pays—in higher sales and profitability. Indeed, I'm seldom impressed when a retailer tells me how much they're saving in rent. Low rent invariably means low traffic and poor exposure. Now that's no reason to run out and rent the most expensive property you can find. Other factors are involved. But it's certainly a good reason to be skeptical of the cheapest.

Rent/sq. ft. is typically calculated as an *annualized equation*. That is, if your monthly rent is \$2,000, multiply that by 12 (= \$24,000) then divide by your square footage. In this example, if your property was 1,500 sq. ft., annualized rent per sq. ft. equals \$16. Usually it's reasonable to include CAM (Common Area Maintenance), a typical additional cost with most landlords, in that rent total. The average MPC pays about \$16/sq. ft., with many prime locations approaching \$50/sq. ft. If that seems high, perspective can be gained with

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a stroll down New York's Fifth Ave., where rent is \$1,350/sq. ft.!

Rent as a Percentage of Sales is a better factor for uniform comparisons. Theoretically, a relevant, if not constant, ratio will be maintained between the two, i.e., higher rent means a better location, better location gets you better sales. In malls and shopping centers, rent is usually a combination of a fixed minimum plus a percentage of sales, swinging on a "breakpoint," after which rent is purely a percentage, about 5-7% these days. This doesn't include CAM and taxes, which can add another 3-5%. The average MPC's rent is in the 7% range, although smaller volume stores suffer a sales handicap that pushes their rent percentage as high as 17%.

Dub Johnson, CPA, MBA, and partner with his wife Cindy in several MPCs in New York, really believes in **Sales per Customer** for evaluating their stores, and I agree with him. This is simply obtained by dividing the day's (or month's, or year's) Adjusted Sales by Customer Count. Dub says, "if your sales per customer drop below \$10, you've got a problem." Go back and compare your December Sales Per Customer to any other month, and marvel at the difference—multiple packages, big boxes, more international—it all adds up to high Sales Per Customer, and a good reason to upsell every customer, every day, during the regular year. And please, asking customers if they need a book of stamps isn't upselling (unless your service charge is \$5 or more).

Sales per Customer is a good reason to examine your market for high-gross opportunities like print-for-pay, bulk mail processing, and alternative freight. Although small package shipping might be considered "easy," it gets harder every year to make a buck at it, especially when you consider that your average package weighs 8 lbs. or less. How much revenue can you squeeze out of that? Compared to the average AMPC Freight sale (\$600), short-run copy and finish job (\$125), or bulk mail service (\$800), a couple of those per week really affects that average sale, and your bottom line.

Steve Goble, Marketing Director at Annex Brands' Handle With Care Packaging Stores, points out that at their stores, which specialize in "alternative freight" (they're frequently located in industrial parks instead of retail space), the average job is in the \$600-\$1,200 range. What matters is that at the end of the day, after all the little-old-lady single copies, books of stamps, and 1st Class flats, is that you have some big sales, too, or you're just getting nicked and dimed to death. Literally. Constant small sales eat up labor without producing profit.

Most small business owners fulfill dual roles in their companies, one as manager, and another as investor. It stands to reason then that they should earn two rewards. First they should pay themselves for their work as CEO, the 50 or 60 hours per week they spend running their business. Beyond that, they deserve a return on their investment as owners, the ones who took their hard earned savings, retirement account, or spouse's inheritance and "invested" it in their very own business. That is a matter for the Balance Sheet, which must wait for another discussion.

Whether you pay yourself a salary or take a periodic owner's draw, if you pay yourself a lot or a little, what you deserve as manager depends on your market and your degree of involvement in the business. A full-time retail manager for an enterprise like yours is worth a certain wage, depending upon the volume and complexity of your business. Most of us would be hard-put to find a competent and committed manager for less than \$25,000/year. On the other extreme, few of us have to pay more than \$35,000. You deserve at least that for your efforts, unless you're "part time," in which case you're going to be paying some of it to someone else.

Whatever you pay yourself, be sure you include it when you calculate the next two metrics, **Payroll as a Percentage of Sales** and **Sales per Employee**. For the purposes of the KPI, comparing your store to others, consider yourself an employee, whether that's full-time, part-time, or overtime, and include your salary or draw, or, even if you're not taking home anything, an amount that you would, if you could. You might work for free, but an employee wouldn't. The average MPC's payroll

(including taxes and benefits) is about 24% of sales, comparable to a typical service business, but way above the average in retail of 13%.

Where the service nature of our business really asserts itself is in Sales per Employee. The average MPC is lucky to get \$125,000 per employee (or more exactly, Full Time Equivalent, "FTE"), the retail standard is over twice that. We are more comparable to the service sector, where the average is a little over \$160,000 per employee, but they have an important advantage: Gross Profit Margins of 70%! I have yet to meet an MPC with that degree of profitability.

Graybeard guru Jim Baer, one of the original MPC pioneers and counselor to industry buyers and sellers, says that one of the benchmarks he looks for is simply daily customer count. "If you aren't seeing 50 customers a day—I mean real customers, not drop-offs or mailbox pickups—you're either not the typical MPC model, or you're not profitable," he observes. Interestingly enough, Dub is adamant about the same thing: tracking daily customer count. Jim also flips that around and recommends that if you don't have 50 per day, you only need a single employee, or FTE (that means you, MPC Owner, instead of someone you have to pay).

Net Profit in the closely held small business, compared to the public, or at least major companies, in its category, is a result that must be taken with a grain of salt. There are so many tax and cash advantages that each can manipulate. Net Profits for a service business average almost 10%, compared to retail's meager 3%. Most MPCs fall in between, with an average of 5%. Remember, those industry averages include the paychecks for their CEO's, so you include yours.

2009 is going to be a tough year in retail. There's no "rescue plan" except bankruptcy for Linens N Things, Mervyn's, Circuit City, KB Toys, and maybe even General Motors. The International Council of Shopping Centers projects that there will be over 148,000 storefront closings this year. Colin McGranahan, a retail analyst with Sanford C. Bernstein & Co., is quoted in the *Wall Street Journal* saying,

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“Potentially, 10% of retailers could face significant restructuring, bankruptcy, or liquidation.” Certainly, if the holiday season of 2008 is any indicator, the national economic pressures that we all face will have the same proportionate impact on MPCs: it isn’t unreasonable to expect that 10% of us will face “significant restructuring,” etc. Getting a handle on the financial facts of your business will be one of the best ways to stay on the right side of that equation.

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**Metrics That Matter--
Suggested Financial Standards for the MPC**



(Note all Sales are "Adjusted", which does not include Stamps, Money Orders, etc.)

<u>Measurement</u>	<u>Industry Avg.</u>	<u>Most Successful</u>
Adjusted Yearly Sales	\$250,000	>\$350,000
Gross Profit	46%	54%
Sales/sq. ft.	\$200	\$300
Sales/Customer	\$12	\$17
Rent/sq. ft.	\$16	\$28
Rent %/Sales	7%	8%
Payroll %/Sales <small>(Including Owner's Draw)</small>	24%	22%
Net Profit	5%	10%
"Net to Owner" <small>(a variable term that seeks to restore tax and cash benefit advantages of ownership to the total financial picture)</small>	16%	30%

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David Shappee and his partner Kathryn founded The Shipping Depot®, a Montana chain of retail business service centers, in 1986. David consults in customer service & retail management, and has served as trainer to AMPC, the American Bankers Association, Honda Motor Corporation, the Medical Managers Association, and many other businesses. From 1997 to 2000 Mr. Shappee ran *The Numbers News*, the first and only financial reporting and feedback program for MPCs, which included over 200 mail & parcel centers nationwide of all sizes. He is a partner in MPC Coaches Network, a business consulting service devoted exclusively to the success of MPCs. Contact at daves@mpccoaches.com.