BAN TACS
National Accountants Group

NEWSFLASH
BOOKLET
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Important

This booklet is simply a collection of Newsflash articles relevant to KPI's. The articles are transferred from Newsflash into this booklet so it is best read from the back page forwards to ensure you are reading the latest article on the topic first. Note that the information contained in this booklet is not updated regularly so it is important that you seek professional advice before acting on it.

Breakeven Point

This is the level of sales or gross income that your business must achieve before it can even start to make a profit. It can be calculated over any time period preferably monthly, weekly or daily. Assuming you are measuring the monthly breakeven point of your business you will need to know your fixed monthly overheads. These are the expenses that would be the same whether you opened the doors to trade or not. Your variable overheads are those expenses that increase as your sale increase. Using your phone bill as an example the line rental is a fixed overhead but the amount of calls you make in many businesses is a factor of the amount of sales you make. Many expenses are variable in the long term but fixed in the short term so the period of time you are analysing can effect your definition of variable or fixed expenses. In the short term the only variable cost you may have is the cost price of the product you are selling Your breakeven point is calculated by working out how much gross profit is left after the variable expenses are met and then working out how much gross profit it will take to cover the fixed costs. The following three examples all say the same thing it just depends which one works for you:

1) If for every dollar of sales a business makes it spends 50% on variable costs (in the short term this could mean 100% markup of goods purchased for resale or working back the other way a 50% gross margin) and this businesses fixed costs are $5,000 per week, it will need to sell $10,000 to breakeven.
2) Sales less variable costs as a percentage of sales (gross margin) tells us that half of every dollar received goes towards fixed costs so the business needs to sell twice its fixed overheads to breakeven. Or if the variable costs are only 40% of sales then 60% of sales goes on fixed costs. So every dollar sold contributes 60 cents to fixed overheads. If you divide you fixed overheads by 60 and multiply the by 100 you find out how much you need to sell to breakeven.
3) For the number crunchers, that is your fixed costs for the period divided by the percentage of each dollar sold that contributes to your variable costs (gross margin) multiplied by 100 gives you the sales required to breakeven.

$$\frac{\textbf{Fixed Costs}}{\textbf{Gross Margin}} \quad \textbf{x 100}$$

Now consider how many days in that particular period it would normally take you to meet your breakeven point. Are you cutting this too fine? For ideas on how to improve your breakeven point refer to Chapter 5 of Driving Small Business.

Gross Margins

This ratio is particularly important for taxpayers who receive cash payments as the ATO uses this margin to compare with other businesses in your industry to consider whether you may be understating your income.

The Gross Margin is simply the portion of your sales left after paying for the direct cost of those sales such as raw materials used up during the period and production wages. If you are in the retail industry this is opening Stock plus purchases less closing stock. Divide this amount by the total sales to get the percentage of sales left after direct costs.

Another important consideration of this ratio is to measure how much you have left to cover the other costs of the business and how much extra another dollar in sales is worth to you.

For example if you had a gross margin of 40% this means that for every dollar in sales 60 cents went in direct costs of producing that product for sale so there is only 40 cents left to cover the other business cost. Therefore if spending $400 on yellow pages advertising is only likely to increase your sales by $1,000 there is no benefit gained by that advertising.

Stock Turnover

This is a very easy ratio simply divide the total cost of the goods you have sold for the year (or period) by your closing stock or average stock on hand, at cost. This will give you the amount of times your stock turns over during the year or period. If you divide 365 by the amount of times your stock turns over per year it will tell you how many days it takes for your stock to turn over. For those businesses with a large amount of capital tied up in stock this is a crucial indicator.

Many small business operators would already have a good idea of these figures but how does your business compare with your industry averages? Check out www.fmrcbenchmarking.com.au for information on your industry.

Industry Examples:

Corner Stores - High income stores turnover their stock 35 times a year. Whereas low income stores only turnover their stock 10 times a year. The average is 21 times a year.

Shoe Shops - High income stores turnover their stock 2.48 times a year. Whereas low income stores only turnover their stock just under once a year. The average is 1.77 times a year.

Giftware – High income stores turnover their stock 4.75 times a year. Whereas low income stores only turnover their stock 1.86 times a year. The average is 3.22.

Hardware – High income stores turnover their stock 6.79 times a year. Whereas low income stores only turnover their stock 2.58 times a year. The average is 4.27.

Jewellery – High income stores turnover their stock 4.50 times a year. Whereas low income stores only turnover their stock 0.74 times a year. The average is 2.03.

Menswear – High income stores turnover their stock 3.54 times a year. Whereas low income stores only turnover their stock 1.45 times a year. The average is 2.52.

Newsagencies – High income stores turnover their stock 12.55 times a year. Whereas low income stores only turnover their stock 4.34 times a year. The average is 8.01.

Hints to Improve Stock Turnover:

1) Do the above calculation on an individual basis for each stock line to identify slow moving lines and consider their relevance to your business.
2) Introduce a computer controlled stock system to track this information more readily and allow you to be able to re-order stock at the last minute because you know exactly how much you have and what your average daily needs for that item are.
3) Sell slow moving stock on consignment only so that it is not tying up capital.
4) Have a sale to clear obsolete stock, or give obsolete stock away as a promotion to buy other items.
5) If you must hold slow moving items make sure your margin on those items is higher than other stock items as slow moving items take up a larger share of overhead, both in space and cashflow.

Rate of Return

In short this is how many years it takes you, out of net profit, to make back your purchase price. Simply divide your expected net profit by your purchase price to get the percentage of your purchase price that you will get back each year. This is useful in comparing businesses you are considering buying. It may be acceptable for some businesses to have a lower rate of return than others if their market place is much more stable. For example if you were about to buy a takeaway food store in a area that McDonalds or a Pizza chain has just pin pointed for a future store you would expect to get your purchase price back more quickly than when buying a business that has a stable market share, as when the other shop opens your profit may drop considerably.

Gross Profit Ratio

This is simply the amount you mark your goods up by. It is not the calculation that is the eye opener but the comparison of this ratio between the rate you use when setting your pricing and the rate that is shown in your accounts. For example if you buy goods for resale at a cost to you of $100 and you normally work on a 140% markup then you would put the item on the shelf at a price of $140. Accordingly, when you receive your financial statements for the year you should be able to divide your sales by your cost of goods sold and get a 1.4 ratio. If this is not the case you need to consider why. Note this ratio analysis will not be correct if your stock take is simply guess work. Otherwise some of the possibilities that could contribute to a difference here are:

- Discounting
- Wastage and obsolesces
- You are not consistently applying the markup to all goods sold
- Stock is being stolen
- Your staff are pocketing some of the cash you have received from sales.

Be careful that you understand the way percentages and markups work. If your markup is 40% on cost and your cost is $100 the selling price will be the cost times 140% which is $140 but if you are working back the other way from your selling price the cost of goods sold is 71.4% of the selling price (i.e. $100 divided by $140). A simpler example is when you mark up goods 50% this means that stock purchased by you for $100 will sell for $150 (half again) but when you work back from the selling price the cost of the goods sold is 2/3^{rds} or 66.6% (150 divided by 3 times 2 equals $100).

Book review

Driving Small Business – Noel Whittaker and Des Knight

I would like to encourage all our business clients to read this book. Although it is now out of print, try to find it in a secondhand bookstore or on a friend's bookcase. It will help you understand and utilise the financial statements we produce. The book is also very consoling as you face the ups and downs of owning a business, so it is a good read.

There are untold business books around, some of which cover a particular topic and harp on about it for the whole book saying, just in a different way what was already said in the first chapter. Some are extremely boring and complex, yet do not cover enough relevant issues. Many are not even written in Australia. When a person truly understands their subject they should be able to break it down into laymans' terms. Driving Small Business uses laymans' terms with examples and simple dialog, just as we are used to from Noel Whittaker. Many varied topics are covered very succinctly.

Here are some extracts to wet your appetite:

> "So many people, when confronted with unfavourable conditions, are unable to accurately assess the effect of those changed circumstances. They live in a mental fairyland devoid of reality. It is unfortunately very common, presumably part of a mental "denial" process that paralyses people from taking decisive and sensible action."
>
> "Most manufacturers can shorten the operating time cycle to at least half the time previously take without any disadvantages to the production process."
>
> "…Finally Sally was persuaded by her accountant to take a cold, hard look at her takings, her outgoings and the pattern of her appointments, and suddenly she realised how close she had come to ruining her own successful business. Each appointment required fresh towels and a fresh robe, plus time set aside to clean and prepare the treatment room. All this cost money. In addition her business clients rarely bought product for their own use, unlike the older women. Sally began to focus on her older clientele and ran an advertising campaign in suburban newspapers promoting her business as part of the perfect city shopping experience. Soon she could afford to gracefully turn away some of the quickies!"
>
> "…Investigation soon found a competitor's new product was superior to his own, causing the market to abandon his company's outdated technology. In response, his team had begun to shave prices and margins as a means of competing. When the competitor launched a large-scale promotion of its new product, Jason's business declined even further. … Jason had the following options:"
>
> "…A typical gambit used by some buyers is to seem keen, then attempt to renegotiate the whole deal at the last minute – they will drop the price, ask for terms or better terms, or attempt to enforce more difficult or stringent conditions. The experience is as common in business sales as it is in property sales. The real purpose of such maneuvers is to test your nerve, in the hope of forcing you to panic and thus reduce your price or concede to terms that strongly favour the purchaser. Don't be fazed by such a tactic – even though it often succeeds with more naïve vendors. Keep a cool

head and regard it as simply an indication that your purchaser really wants to buy your business and is merely angling for a deal."

Driving Your Small Business not only gives you helpful strategies it helps you "listen" to your business and understand when changes are needed. The book shows you how to analyse your cashflow, product turnover, breakeven point, operating time cycle, cash time cycle and other key ratios and indicators. It also discusses how you can go broke while making a profit, how to prepare a business plan, how to arrange your finances, the dangers of competing on price and how to sell your business.

As the GST has forced many businesses to reconcile their accounts more frequently we would like to help you take advantage of this new up to date information on your businesses' health. Driving Small Business explains, very well, how to do this but if you need any help selecting what is relevant to you or need to discuss your findings, we will be glad to help.

Stock of the book has been difficult to get our hands on but hopefully we will get some copies soon so it will be easy for you to purchase it through our office, no excuses.

Ask BAN TACS

For $79.95 at Ask BAN TACS, www.bantacs.com.au/ask-bantacs.php, you can have your questions regarding Capital Gains Tax, Rental Properties and Work Related Expenses answered. We will include ATO references to support our conclusion. There is also a notice board where some askbantac users have generously allowed their question and answer to be published. Lots of good real life information.

More Information

Please make sure you continue to keep your knowledge up to date by subscribe to our Newsflash reminder. There are many other booklets available on our web site http://www.bantacs.com.au/booklets.php in fact the whole web site is full of useful information so also have a look around under topics.

How to Make Sure Your Next Property Is a Good Investment

- Do you really know how much the property is going to cost you to hold?
- What name should the property be purchased in?
- Will this property fit your investment strategy and goals?
- What does the contract say about GST?
- How does the price compare with similar sales in the area?
- If it is negatively geared, how much capital growth is required before you breakeven?
- Do you know what records you need to keep and how?
- Are your financing arrangements maximising your tax deductions?
- What happens if interest rates rise?

......and the list goes on!

To ensure you don't make a costly mistake with your next purchase make sure you see a BAN TACS Accountant before you sign

Disclaimer: The information is presented in summary form and could be out of date before you read it. It is only intended only to draw your attention to issues you should further discuss with your accountant. Please do not act on this information without further consultation. We disclaim any responsibility for actions taken on the above without further advice as to your particular circumstances.