

# Moving Your Assets — Getting Extreme Results

Knowing how to use ratios can help improve your garden center's financial performance.



By  
Bill McCurry

## Find Bill McCurry

Come by and say "Hi" to Bill McCurry during the OFA Short Course — give feedback on his columns, ask questions or just talk about the industry. Bill will be taking part in these sessions:

- Saturday, July 8 at 8:00 a.m. Lean Manufacturing Workshop
- Sunday, July 9 at 1:00 p.m. The Process of Finding The Right Manager
- Sunday, July 9 at 2:30 p.m. Industry Success Stories
- Sunday, July 9 at the Retailer Idea Exchange (this session is free to all Short Course registrants — don't miss it!)

**H**aving trouble sleeping? Try reading about traditional financial ratios. For most of us, the ZZZs will be just a moment away. Still, smart (read: immensely profitable) retailers will find a way to cut through the boredom and gain insight from the ratios that can propel their businesses to the next level and beyond. Read the ratios as you would read the dashboard gauges in your car. Each ratio can be a different "gauge," telling you what is going on in your business.

You may not be accustomed to using ratios, but ratio is just another way to represent standard financial concepts you may already be familiar with. The most common ratios are percentages we track against our sales, like gross margin, net profit, etc. When you compute your gross margin, you are really determining the ratio of gross margin to selling price. For instance, if your gross margin is 40 percent, that means it is 40 percent of the selling price, and your cost of goods is the inverse or 60 percent.

Ratios can be expressed as percentages, as a velocity (turnover) or a comparison of one number to another. Gross margin is expressed as a percentage. Debt-to-equity ratio is a common ratio that shows how much debt you have compared to your ownership investment. If you have \$200,000 invested in your business and you owe \$600,000, you have a three-to-one (3:1) ratio. Other ratios that deal with turnover (or velocity if you prefer that term) are usually expressed with an "x." If you have a \$50,000 cost of inventory and a \$300,000 annual cost of goods, you have a six times (6x) inventory turnover (\$300,000 divid-

ed by \$50,000 is 6). Your inventory moves through your system six times a year.

## Set Your Own Ratio

So, you ask, "What's the best ratio for my business?" The most accurate answer is there isn't a precise answer. Instead, I have two questions for you: What are the historical ratios of your business? What has been your overall financial performance?

To justify this less-than-precise answer, let's look at the Internal Revenue Service Audit Technique Guide (ATG) Training 3123-007 (02-2000). Agents are trained that 10-times turnover per year is average for garden supply retailers. I think that is a huge oversimplification. Not all garden supply retailers are the same. Some are open year-round and do a huge December gift business. Traditionally, though, holiday departments will have a much slower inventory turnover than general merchandise delivered in spring and summer, which might arrive three times a week. Neither of these business models is right or wrong; they are just different. Thus, the most accurate measurement is for you to track your own ratios and watch for trends.

## Compare Your Ratios

When you have established your ratio trends, look for a company with a similar operation. Get to know the owner and ask if you can compare ratios to benchmark against each other. It is more beneficial to benchmark against someone who has a similar business than to go for an industry average that may not represent what you do. ▶

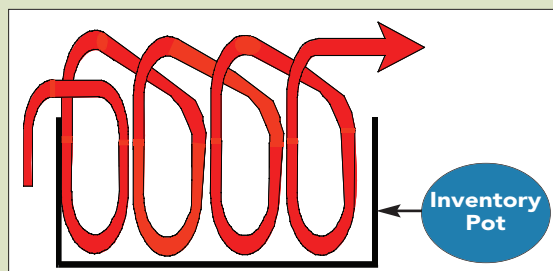


Figure 1. This is an unrealistic but simple way to illustrate the interrelation between the inventory pot and turnover. You have a \$400,000 annual cost of goods. You buy \$100,000 of goods, sell them and purchase another \$100,000, sell them and repeat the process two more times. Thus, you have "turned over" your inventory four times a year.

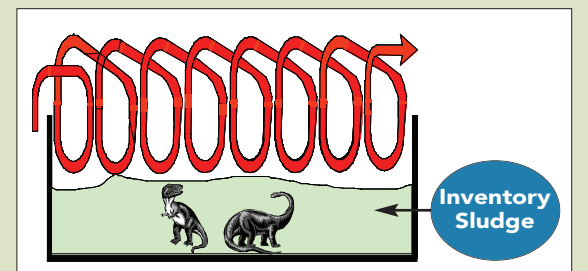


Figure 2. In this situation we use the same example of a \$400,000 annual cost of goods but are buying inventory \$50,000 at a time and purchasing eight times a year. The good inventory is selling more rapidly than in Figure 1, masking the fact that there is \$50,000 in dead or "sludge" inventory in the bottom of the inventory pot.

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## DOLLARS & SENSE



You can develop ratios to help manage your employees.

Track your ratios over the last five years to spot the trends.

Evaluating your company's financial ratios will show you places to improve your profits and economic performance. It is also possible the data is masking improvements in one area while hiding deteriorations in the same area. In Figure 1, page 22, we see a garden center with an average product inventory of \$100,000, annual cost of goods of \$400,000 and a traditional 4-time (4x) inventory turn. Figure 2, page 22, also has a \$400,000 cost of goods; however, Figure 2 has an eight time (8x) turn and \$50,000 of inventory that is "sludge," dead inventory sitting in the bottom of the inventory pool sucking up space and dollars.

### Evaluate Your Assets

First, let's make sure we are all using the word assets the same way. When I say assets, I mean everything you use to help run your business. "Current assets" will be turned to cash in less than one year. Ideally, this would include all of your inventory, accounts receivable, cash and short-term investments. "Fixed assets" are equipment, fixtures, buildings, land, etc. — those things with an anticipated life of more than one year.

A mistake many business owners make is to ignore assets that are written off and/or paid for. How many large garden centers do you know that have an old tractor, beat-up pickup or other vehicle in the back corner? Because the owners know it is paid for and fully depreciated, they do not pay any attention to it. It is still an asset to the company; if it is not used, it should be liquidated. Even if you get \$10 as scrap, that's \$10 more than it brings gathering

dust. Get rid of it — today! Put the proceeds in the bank. A side benefit of clearing out old "junk" is it will make your overall business look cleaner and fresher and engender a more business-like attitude in you and your employees.

How many assets should a business have? Most people would say to accumulate as many assets as you can because that means you have great wealth. A true entrepreneur believes the fewer the assets employed in a business, the more assets available to invest. Investors want return on their assets so the fewer assets employed, the greater the percentage return on those assets. Everyone agrees the key to extreme wealth and financial success is to have every asset working very effectively.

An example of this is the garden center that generates \$100,000 net profit with \$1,000,000 in assets (a 10 percent return on assets). If that garden center can reduce its inventory so the total assets drop to \$800,000, the return goes up to 12½ percent.

### Measuring Employees

Getting back to ratios, let's look at what is probably your biggest cost — payroll. It makes sense to focus on getting more return from your payroll dollars. Have you ever thought of using ratios to manage your human resources?

When it comes to employees, we should be pragmatic realists. This is 2006, not 1956 or even 1986. Remember, the day of guaranteed employment for life is gone. The best anyone can strive for is continued employability. Everyone must be a productive member of the team — that includes old timers and family members.

**Want Free Help?** Bill McCurry will be conducting a research project for The Ohio State University Nursery Short Course on how garden retailers can benefit from better understanding their finances. If you would like to be part of this confidential project and get free financial advice from Bill, please E-mail him at [wmccurry@mccurryassoc.com](mailto:wmccurry@mccurryassoc.com). Please put "OSU finance study" in the subject line. Limited number of participants, hurry!

All our hero did was use a ratio: number of castings compared to one shift. By tracking the number, by publicizing it, by making it fun — even though he never said it would be fun — he changed the dynamic of the foundry. Think what you can

do in your garden center using numerical targets. ✎

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"If you can't measure it, you can't manage it." How do you measure the results of your employees? Three employee ratios come to mind:

**Gross margin generated.** Take the entire company's gross margin and divide it by full-time equivalent employees (FTE). FTE factors each part-time employee as a fraction of a full-time employee based on annual hours. In other words, if you have five full timers with five part timers working 20 hours a week, you end up with 7½ FTE.

**Sales per employee.** The entire company's sales divided by FTE.

**Individual Average Transaction.** All retail stores can track retail salespeople by individual average transaction, i.e., total sales divided by number of customers waited on. This will show if one employee is selling a lot more or less than others.

### Make Ratios Fun

Depending on the size of your business, you can create metrics to measure many positions. Your employees may fight it since most employees do not like to be measured or held accountable. The best way around this is to make a game out of it.

There's an old story of the newly minted business school graduate hired by a local foundry that casts metal casings 24 hours a day. Our scrawny young hero, the first college graduate the firm had ever hired, was assigned to be the night supervisor. He was to supervise a team of eight huge, muscular foundry workers, none of whom had even finished high school. His first night he just watched and listened. When it came time to go home, he took a piece of chalk and wrote a huge "3" on the floor. Everyone asked, "What is that?" He quietly said, "That's how many castings we finished tonight." When the day shift supervisor saw the number he just laughed. His shift could beat that! Sure enough, that night the evening shift found "6" written on the floor. You know how this story ends. The average shift production went to between 12 and 15, absenteeism went down and people enjoyed their jobs more.

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