

Meeting Profitability Threats

“What if” scenarios challenge operators to overcome any hurdle.

By Dick Meyer

This past April, I got the first call from a retailer, shocked that his credit card fees went up \$10,000 per month. He calculated that because of the higher selling price of gas, it was costing him 5 cents to 6 cents per gallon to sell fuel via a traditional credit card (e.g. Master Card/Visa, American Express). Another marketer told me of a high-volume retailer (HVR) opening within a half-mile of one of his premiere sites, killing the volume of his 200,000 gallon per month “pumper” virtually overnight while depressing margin by 12 cents! Both of these situations are shocking and, unfortunately, lately convenience store operators have been telling a lot more stories like them.

The more I try to analyze the industry’s strengths and examine its vulnerabilities, the more I am impressed by the operators that find remedies to any “What if?” scenario or other profit squeeze that emerges. After all, there are two choices in business. One set of operations people will point to the cooler summer or road closing or minimum wage hike as rationale for not meeting budget. The other, possessing a “Lee Marvin Dirty Dozen” sense of ownership and passion, understands their mission is to make “X” dollars return on investment. Thus, they evaluate the impact of the latest threat to that goal and develop a revised plan of attack to keep the team on course.

I’m not naïve to think that there aren’t situations when you just can’t make the intended budget; i.e. where market influences are so dramatic that rallying an alternative offense is virtually impossible. But, isn’t it surprising and even sometimes enjoyable when we see our in-

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dustry challenged by adversity (cigarette/tobacco stores, legislation, tight labor markets) and find new avenues to increase profits? Is Casey’s just plain lucky to improve profits quarter after quarter or does plain hard work (and smart work) and resourcefulness have its rewards? Is it possible that we sometimes put our imaginations on cruise control, without looking for new profit centers, when gas margins are comfortable, turnover is minimal, and customer counts are rising?

What follows is a Profit Sensitivity Analysis designed to help executives stay in tune with the big picture.

As part of the budgeting process, I simply suggest that retailers surface for themselves the primary areas of volumes, margins and expenses where a small variance from projection would trigger a major impact on bottom line estimates, albeit favorably or unfavorably. Without excep-

tion, going through this exercise produces a new focus for at least a few people in the company and, typically, new profit ideas. So, this is my year 2000 gift to CSP readers. Cost to you: one Christmas card or sleeve of golf balls!

I developed a sample for a chain of 50 stores with somewhat average volumes and margins. Many companies envelop this type of budget monitoring already. For those that do not, you can quickly adopt this format by replacing the bold data with your numbers. I guarantee if it’s the first time you use this approach, your next Monday morning management meeting will ignite a new wake-up call requiring lots of follow-up.

In brief, an important element in the annual budget process is solidifying the company’s risk and reward potential if actual results sig-

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nificantly vary from projections. While all marketers quickly surmise that a penny a gallon impacts their bottom line by “X” dollars, it’s equally critical to monitor other barometers for measuring potential profitability, then implement immediate action plans to make up for potentially major negative deviations. When your company is passionate about fixing shortcomings, or storing away extra cash flow from unexpected favorable market differences, then you’re ahead of the pack. If your management team’s culture, however, is “it’s not something we can do anything about” then you’re dead in the water. You’re letting the marketplace control your destiny and you should call me to help you find a buyer before your company’s intrinsic value deteriorates much further.



Profit Sensitivity Capsule

This illustration presumes a chain of 50 c-stores, all with fuel. It further assumes per-store average volumes, margins and aggregate labor cost approximating those published in the

1. Gallons and margin impact

- (A.) Volume variance—If total gallons sold are 1% more/less than the current year’s budget of 50 million gallons, then pre-tax profit (presuming 12.0 cents/gallon budgeted margin) will vary by:..... **\$ 60,000**
- (B.) Margin variance—If gas gallons (50 million) = budget for the year, but gas margin is one cent more/less than budget, then pre-tax profit will vary by:..... **\$ 500,000**

2. Merchandise sales and margin impact

- (A.) Volume variance—If merchandise sales are 1% more/less than budget of \$43.0 million, assuming budgeted gross profit margin (32.0%) is attained, then pre-tax profit will vary by:..... **\$ 138,000**
- (B.) Margin variance—If merchandise sales (\$43.0 million) = budget, but the gross profit margin is 1 % more/less than the overall projected margin, then pre-tax profit will be different by:..... **\$ 430,000**

3. Inventory shrink

To the extent that actual inventory shrink and bad merchandise differs from the aggregate projected shrink of 1.0 % of \$43.0 million inside sales, each variance of 1/2 of 1 % will impact pre-tax profit by:..... **\$ 215,000**

4. Store wages

If actual total store labor (including payroll taxes and fringe benefits) are 5% higher/lower than total projected labor cost (of \$ 7.7 million), then pre-tax profit will be impacted by:..... **\$ 385,000**

National Association of Convenience Stores’ *State of the Industry* report. To apply this concept to your chain, so that your team is sensitive to potential variances in your projected profitability, simply replace the bold-faced data with your company’s numbers.

Quiz:

What if ... shrink equals 1.5% versus 1.0% budgeted for the year, and you spend 5% too much on labor? Or, suppose you keep the expense areas in line and volumes meet budget, but merchandise margin is off three-fourths of 1% and you miss the gas margin by three-fourths of a penny? Calculate the budget shortfall for these dilemmas.

Answer:

In the first scenario, your estimated profit will be short \$600,000! In the second situation, profit will be approximately \$700,000 lower than budget—ouch!

What do smart companies do when they see that they’re off their budget plan?

They call together their “managers” and ask for input on how they can make up the shortfall. Sometimes it’s belt-tightening, but it can’t always be reducing costs. Adversity has been a good teacher to c-store operators and has often made us better “marketers,” forcing us to seek out new profit centers to enhance our bottom lines. □