Management Essentials
Proper Inventory Accounting *page 4*

FINANCIAL INFORMATION, EDUCATION AND CONTROL FOR THE RETAIL FLORIST

Floral® Finance

teleflora.

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QuickTakes

Ideas You Can Put to Work Immediately

1 Learn From Your Competitors

When was the last time you visited your competition to see what they are doing right?

Although you might like to think you are smarter than they are, don't believe it. There are always new ideas and better ways to market, sell, display and design. Your competition will discover many of those ideas before you do.

Visit. Observe. Copy the best ideas.

2 Have Lunch

When did you last take an employee to lunch? How many employees have you never taken to lunch?

This little act of kindness can yield big gains. Sharing a meal is a simple way to build a relationship. You'll learn more about your staff's needs and passions. And when they see that you care, they'll be more motivated to work harder.

3 Treat Yourself

Think back to when you were younger. Maybe when you were in school. What activities did you most enjoy?

Now, pick one of those activities. One you haven't done in years. Something out of your normal routine. Something lighthearted, maybe a little crazy.

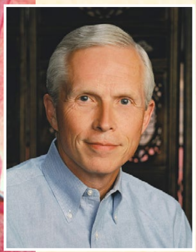
Now, go do it!

You'll be amazed at how refreshed you will be.

INSIDE THIS ISSUE

FROM THE PUBLISHERS
OF FLORAL FINANCE®

A BUSINESS IDEA



A business idea is like a river.

It starts small.

Have you ever stepped across the Mississippi River? I have. At Itasca, Minnesota, one step is all you need. That's where the Mississippi begins as a small stream.

A business idea starts the same way.

It grows.

It doesn't take long before that little stream is way too big to step across. It has grown into a real river.

You can drown in a river.

Like a river, a new idea can take on a life of its own. It can occupy all of your time and energy. If you aren't careful, it can pull you away from your core business.

Don't let a new idea pull you under. Keep your focus on the responsibilities that are most important in your business.

Others can participate.

A river is big enough for lots of people.

As your idea grows and takes shape, look for ways others can embrace it and get involved.

Eventually, many can draw sustenance from it.

If the idea grows large enough, many people can benefit from it.

Think about the source of your ideas. Take good care of whatever nourishes your idea-generating ability. For some, it is a balanced life-style. For others, it's exploration and input. For others, it is spiritual strength.

Life is like a river.

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Inventory Management

Controlling inventory has two aspects.

First is the physical aspect of buying, storing, selling and reordering product.

Second is properly accounting for the inventory, so that you get the information you need to run a profitable business.

Both parts are important. This article will focus on managing the physical inventory. Inventory accounting is covered in the article on page 4.

DEFINITION

What is inventory?

It is all the products you buy to resell. These items are on your display shelves, in your cooler or stored for future sale.

Perishable products are the most commonly purchased items in a retail flower shop. That makes sense. You are in the flower business. Arrangements account for 65% of the average shop's sales. Loose flowers and blooming plants are also perishable sales.

Even so, non-perishable products represent much more inventory in a typical flower shop. Gift items. Green plants (because they last longer, green plants are treated as non-perishable items). Silk and dried products. Balloons. Arrangement supplies. Other hard goods, which vary from florist to florist.

YOUR GOAL

Simply stated, the goal is to make as many sales as you can while keeping your inventory as low as possible.

To do so, you want to get the optimum number of "turns" from every product you carry.

Example: Suppose you have a line of gifts on which you use a keystone markup. (The item's cost, including freight, is doubled to arrive at the retail price.) An item that cost you $10 will sell for $19.95.

Assuming no discounted sales or shrink, this pricing formula will give you a 50% cost of goods sold (COGS).

If you sold $20,000 of those items during the year, you had approximately $10,000 worth of product and freight costs.

Next, look at the average inventory for that product. If the average inventory was $5,000, you turned your inventory two times during the course of the year.

In other words, you had to replenish your supply twice during the year. Two turns is not bad. However, it's nothing to write home about.

If you had an average inventory level of $2,000, you would have turned the inventory five times in the year—which means you would have had much less money tied up in inventory.

The same $20,000 in sales, with only $2,000 tied up in inventory at a given time—instead of $5,000. Now, that's something to write home about!

GETTING FOCUSED

Different types of product have different turn rates. Fresh flowers, for example, turn every few days (the average is 3.5 days). They lose their freshness if they aren't sold quickly. Consequently, most florists turn their flower inventory around 100 times per year.

Concentrating on products with a high turn rate brings big financial advantages. More turns means less money tied up in inventory for a given volume of sales.

The fact that the floral business is focused on products that turn frequently is one reason the industry is so attractive to entrepreneurs. It doesn't take a lot of cash to get started.

THE 80/20 RULE

For almost any product line, 80% of the sales come from only 20% of the products. It's called the 80/20 rule.

This rule holds true for both nonperishable and fresh product lines.

Managing your inventory on the fast-selling 20% is relatively easy.

How you control purchasing on the other 80% will largely determine the number of turns you have.

NARROW & DEEP

For slower-moving lines, keep your purchases "narrow" and not very "deep."

A narrow line means you don't carry many different items in the line. Ten different styles from a given manufacturer instead of 20, perhaps.

Depth refers to the number of units of each different product you have. If you are not very deep on a particular product, that means you don't keep too many on hand.

Try to identify which items are moving slowly or not at all. Eliminate those you can. And on the ones you decide to carry, keep only a few on hand.

Deep inventory is reserved for items that move fast.

'JUST IN TIME' INVENTORY

Inventory management was changed forever when businesses began to concentrate on how best to keep inventory low.

The "just in time" concept takes advantage of today's high-speed freight transportation network to lower inventory levels.

The time it takes to reorder and deliver a given item is now the important time frame. If you can get a particular product delivered each week, you only need to keep a one-week's supply of inventory on that item.

Walmart relies heavily on this kind of inventory management. The retail giant favors suppliers who can deliver and restock products fast.

You can do the same thing. Keep only the number of items required to cover your sales until the next shipment arrives. Then, reorder before you are out of stock.

Carrying the proper width and depth of inventory will ensure maximum turns and reduce your inventory investment.

PRICE/TIME TRADE-OFFS

Keeping the absolute minimum of a particular product will not always be the best answer.

The goal is to make as many sales as you can while keeping your inventory as low as possible.

Suppliers often give generous discounts for certain order quantities. If the price break is attractive enough and the demand high enough, buying in quantity can be well worth it, provided you have the cash to do so.

Calculate how much extra money you would need to purchase the larger quantity. Then, determine how much interest you would pay to borrow that money for the time it would take to sell the extra items.

If the discount is greater than the interest, it's better for you to buy the larger quantity.

Proper inventory management takes a little work up front. However, once you are rolling, it is pretty simple. And well worth the effort.

On the next page, we'll look at inventory accounting.

Proper Inventory

The article on page 2 reviewed the physical aspects of inventory management: how to increase turns and reduce the amount of money you have tied up in inventory.

This article focuses on the accounting side of inventory management.

The goal of proper inventory accounting is to provide accurate cost of goods sold (COGS) numbers. After all, COGS is one of the largest expenses in a retail flower shop. Proper management requires that you keep COGS—particularly COGS for arrangements—as low as possible. And that requires good numbers.

Most large, non-floral retailers use computer programs to calculate their COGS. As an item is sold, it is scanned at the cash register. The computer relieves inventory one unit at a time along with each sale.

A retail floral operation doesn't lend itself to that kind of inventory management. Two-thirds of the average florist's sales are arrangements, which have varying numbers of stems of flowers and greens.

Scanning doesn't easily apply to arrangement sales. It works best with hard goods, not perishables. So, retail florists need a different inventory accounting solution.

PERISHABLE PRODUCTS

Flowers are fresh for a week or two at the most. Blooming plants last only a little longer. So, perishable products are not inventoried. They are expensed directly into COGS.

Green plants, on the other hand, can last in your shop for months. If you sell a large volume of green plants, they need to be inventoried, just like hard goods. If you only sell a few, expense them to COGS, just as you do with blooming plants.

The only items in an arrangement that are inventoried are the container and the supplies.

HARD GOODS

How do you handle non-perishable products?

You might buy a six-month's supply of containers or gift items all at one time. If you immediately expensed the entire purchase to COGS, your monthly COGS would be way high relative to the sales you made in that first month. Similarly, COGS for the following months would be distorted to the low side.

Proper accounting requires that you match each month's sales with the appropriate amount of COGS.

The best approach is to put all those purchases in inventory accounts on the balance sheet. Then as sales are made, move the product from inventory to COGS.

This is called "accrual accounting." The products are accrued into inventory accounts until they are used.

The first step—putting the purchases into the inventory accounts—is easy. If you buy $2,000 worth of containers, that's the amount you put in the inventory account for arrangement supplies.

The second step—moving products out of the inventory accounts when sales are made—is the one that causes the trouble.

Theoretically, the most accurate way to handle this task would be to count your non-perishable stock at the end of each month. Then you would know exactly what you sold.

Some industry folks have recommended this as a practical procedure. Unfortunately, nothing could be further from the truth. What florist has the time to count inventory each month to determine how much of each product was used?

Sophisticated inventory systems help businesses with a large variety of product lines that are both wide (many different items) and deep (many of each item). A

Accounting

floral wholesaler, for example, needs a sophisticated system.

However, even florists with a healthy gift business do not have large quantities of a broad variety of items. Most florists carry only a few of each product they sell. A sophisticated inventory system would be far more trouble and more expensive than it would be worth.

SIMPLIFIED RETAIL METHOD

The system recommended by *Floral Finance* is a simplified retail inventory control method based on your pricing formula.

If you buy a gift for $10 (including freight) and sell it for $19.95, you are using a double markup (usually called a "keystone" markup).

Using this pricing formula, your COGS, by definition, will be 50% of the retail sales price as long as you sell the product for the marked price.

As a result, you could take 50% of your monthly sales of the product, relieve that much from inventory and put it in COGS.

That procedure would be correct, except for two problems: discounted sales and shrink due to breakage or theft.

Inevitably, you will sell some items for less than full price and lose some to breakage or theft.

Consequently, if you have a double markup, your actual COGS will be a bit higher than 50%. Adding another 2%–3% usually is sufficient to cover discounted sales and shrink.

Here is the recommended "easy-for-a-florist" method to relieve hard goods inventory:

- Based on your pricing formula for a given product group, relieve inventory each month as a percentage of the product group's sales.
- Once or twice a year, take a physical inventory. Compare the physical inventory numbers to the balance sheet inventory account numbers.
- Adjust the inventory accounts to match the physical inventory total, as needed.
- Then, adjust the percentages you use to relieve inventory each month to more accurately reflect your actual COGS percentages.

For example, if the physical inventory shows that your stock is 5% lower than your inventory accounts reflected, adjust your COGS percentage up slightly. This will increase the speed at which the inventory is relieved. The next time you conduct a physical inventory, you should be closer to the mark.

If you sell a large volume of green plants, they need to be inventoried, just like hard goods.

After a few cycles, you will find this method to be quite accurate.

CONTAINERS & SUPPLIES

Florists use a lot of supplies and containers. How should you handle inventory for them?

Set up an inventory account for arrangement supplies and containers. Typically, 8% of an arrangement's retail sales price is attributable to the cost of supplies and the container.

In other words, a $49.95 arrangement will have about $4 in cost for the supplies and container (maybe 5% for a standard utility container and 3% for supplies).

Put all container and supply purchases into the arrangement supplies inventory account. Then, relieve that account each month as a percentage of arrangement sales.

Put expensive, special containers in a separate gift inventory category. Ring crystal vase and copper container sales separately as a gift sale in order to best control COGS.

SUMMARY OF INVENTORY ACCOUNTING STEPS

INITIALLY:

Use your pricing formulas to determine the percentages you will use to relieve hard goods inventory each month.

MONTHLY:

Step 1

Create a sheet of journal entries to show how much product is to be moved from each inventory account to COGS.

Multiply the total sales associated with each inventory category by the appropriate COGS percentage to get the dollar amount you will relieve from inventory and move to COGS.

You or your accountant can then use this sheet to make the journal entries that will accurately reflect your monthly COGS for hard goods sales.

Step 2

Enter all new non-perishable products purchased during the month (including freight) into the appropriate inventory account. All checks written for hard good purchases should be coded to the appropriate inventory account.

Note: When you buy both perishable and non-perishable products from the same supplier, split the coding to expense the perishable products to COGS and the hard goods to inventory.

EVERY SIX OR 12 MONTHS:

Step 1

Take a complete a physical inventory for each inventory account. Count all your hard good products and add them together by inventory category. (See next month's *Floral Finance* for more on how to take a physical inventory.)

Step 2

Compare your actual inventory with the inventory carried on your balance sheet. Determine the amount by which your inventory account is high or low. You or your accountant can then make the necessary adjustment to the inventory accounts.

Step 3

Change the percentages by which you relieve inventory each month to reflect the adjustments you had to make.

MANAGING YOUR MONEY

ON A PERSONAL NOTE

For some people, managing money is easy. For others (probably most of us), it is a challenge.

Financially challenged people who don't seek advice, don't plan, don't save and spend wildly end up in trouble. Sometimes, serious trouble.

However, those who admit their need for help, seek out advice and then follow that advice can be as successful with their money as those who were born with financial talent.

RECONCILIATION & TRACKING YOUR ACCOUNT

Successful money management starts with balancing your checkbook or tracking your online account. To keep yourself out of trouble and plan your investments, you must know how much you have in the bank at all times.

Believe it or not, there are doctors, lawyers and other highly educated professionals out there who never balance their checkbooks or track their online accounts. The result can be thousands of dollars in overdraft charges. All due to simple neglect.

Basic account tracking rule: Keep a running check register balance at all times and reconcile your checkbook with your bank statement each month. Or, similarly, take advantage of your online banking tools to track your balance regularly. Set a schedule to do this at least once a week if not on a near-daily basis.

Balancing a checkbook doesn't require a math degree. Just the discipline to add and subtract.

TO KEEP YOURSELF OUT OF TROUBLE AND PLAN YOUR INVESTMENTS, YOU MUST KNOW HOW MUCH YOU HAVE IN THE BANK AT ALL TIMES.

Some people use duplicate checks to ensure they have a solid record of what money went where. That's fine, but you also must enter the checks in your register and do a monthly reconciliation.

No excuses. No whining. Just do it. And don't ever write a check (paper or electronic) when you don't have the money in the bank to cover the amount.

A MONEY DIET

It's called a budget. Before you sigh and walk away, read this short explanation. A formal budget is the best way to manage your money. A budget is merely a plan for how you will spend the money you expect to come in.

Truth: Most people don't have the discipline to make a formal budget and, if they do, they often don't follow it.

So, here's a practical approach. We'll call it "kinda budgeting."

You probably follow similar spending patterns in most months. So, track what you spend for a typical month or two. See how you are spending your money.

Don't forget all the little purchases you make with cash. They add up.

At the end of the month, total what you spent and how you spent it. Rent or mortgage. Food. Transportation. Entertainment. Charitable contributions. Clothing. And other obvious categories.

Compare what you spent to the total amount of money you brought home. Did you have any left over? Or did you spend more than you made?

NECESSARY ADJUSTMENTS

If you spent less than you made, you're on the road to financial success. If you spent more than you made—the typical situation—you're on the road to financial ruin.

If you are in the latter category, there are only two possible solutions. Spend less or earn more.

First, figure out where you can make cuts. A little here and a little there. It all adds up.

Then, if you can't cut enough, find a way to increase your income. Work a few extra hours. Have another family member contribute.

Too often, people live above their means. Their house is too big. Their cars are too expensive. The answer? Move to a smaller house. Trade in your cars. Take the pressure off.

A must-read book for everyone who is serious about money management is *The Millionaire Next Door* by Thomas Stanley and William Danko. Get a copy. Start reading it. We'll look at the highlights next month.

Accountants & Bookkeepers:

Maximize Their Use ... Minimize the Cost

Whether you like it or not, financial tasks are a part of running a flower shop. Successful or unsuccessful, you are required to maintain adequate records and file appropriate tax returns.

So, accountants and bookkeepers are a necessity. The key is to use each professional in a way that will minimize your total cost while still meeting all your financial needs. Don't have an expensive accountant do what a less expensive bookkeeper could do.

BOOKKEEPERS

A bookkeeper is your right arm for everyday financial tasks in the shop. Typical duties include:
- Accounting for daily sales
- Making daily deposits
- Processing accounts receivable
- Processing payables
- Processing payroll
- Making payroll tax deposits
- Reconciling wire-service statements
- Reconciling bank statements

These repetitive tasks don't require the training and expertise of an accountant. Today, computers also do much of the number crunching, which makes these tasks even easier. You don't need to pay an accountant's hourly rate for this kind of work.

An extremely competent and experienced bookkeeper also may do these additional tasks:
- Filling out sales tax reports
- Completing payroll tax forms

Although many bookkeepers can learn to fill out tax forms, rarely is a bookkeeper capable of preparing financial statements. Financial statements are almost always left to the accountants.

ACCOUNTANTS

An accountant is a true financial professional who has extensive training. Most have their Certified Public Accountant (CPA) credential.

To become a CPA, an accountant must meet very specific experience and educational requirements, and pass a rigorous examination.

Accounting has so many facets and details that individual CPAs often specialize in certain areas, like tax or auditing. Would it surprise you to know that many CPAs don't handle their own tax returns? They hire a CPA who is a tax specialist. Just the same as anyone else.

CPAs are almost always needed for two key tasks:
- Preparing financial statements
- Preparing tax returns

In addition, many small business owners require help with business planning needs, such as budgeting, sales forecasting and cash-flow analysis.

Although many bookkeepers can learn to fill out tax forms, rarely is a bookkeeper capable of preparing financial statements.

Be sure to discuss your shop's year-end financial statements with your CPA. The CPA will be able to point out potential problem areas and money-saving possibilities.

A good accountant is invaluable. However, these professionals are expensive. Use them wisely—not for tasks that can be done at a lower cost by your bookkeeper.

FAMOUS FINANCIAL WORDS

"We have no superstars at Walmart. We have average people performing in an environment that encourages people to perform way above average."—David Glass

"Expecting something for nothing is the most popular form of hope."—Arnold Glasow

"Everything now seems to be under federal control except the national debt and the budget."—Bob Goddard

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INQUIRIES & ANSWERS Letters

LOCATION

"I'm looking for a new location. Does it matter what side of the street I am on?"

Possibly.

Most retail florists do better on the homebound side of the street rather than the side that gets the morning rush-hour traffic.

People are more likely to pick up flowers on their way home than when they are rushing to get to work on time. People also will resist stopping if they have to make a left turn out of your parking lot. So, all things being equal, the homebound side is best.

However, two other considerations are even more important. First, make sure your location is on a street where people stop to shop, rather than a street that is mainly used as a commuting route. Second, you want a location that is in the primary area you serve.

INTERNET OPTIONS

"Should I treat orders I get off our website differently than phone or walk-in orders?"

Yes and no, but mostly no.

Yes, because you want to track them separately, so you know how much business your website is generating. By tracking internet orders, you can gather data about your online customers.

For example, in most shops, the average internet order is larger than other orders. Why? Perhaps more affluent customers are shopping online. Or perhaps your salespeople don't understand what your customers want. As your internet business grows, you can train the salespeople to focus on the most popular products.

No, in the sense that internet orders enter into your financial control system the same as any other order. Include internet arrangements in your arrangement sales and arrangement COGS calculations. Otherwise, those key metrics will be distorted.

If you have a point-of-sale (POS) system that can track the source of an order, it will keep the data you need. If not, a simple log sheet is probably the quickest and easiest way to monitor internet sales volume.

NORMS

EMPLOYEES

In case you missed it, the IRS mileage rate went up quite a bit this year. In 2018, it was 54.5¢ per mile. The big jump was because the price of gasoline rose last year as the price of crude oil increased.

If you have used your personal vehicle for shop business since January 1 and claimed less than 58¢ per mile, go back and claim the difference as an additional expense.

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