Inventory Management

Two parts: pages 2 & 4

Floral Finance®

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FINANCIAL INFORMATION, EDUCATION AND CONTROL FOR THE RETAIL FLORIST

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INSIDE THIS ISSUE

QUICK TAKES

Ideas You Can Put to Work Immediately

1 Need vs. Vision

People generally won't commit to a "need." What they will commit to is "vision."

Do you ask your employees to give excellent service because customers expect it? Or do you share your vision of a flower shop that is respected and admired in the community because of its great service?

The second approach will be much more likely to inspire employees.

2 When Not to Use Email

Never use email to reprimand. Criticism should be done in person. The other individual needs to see your facial expressions and sense your spirit. You can correct any misunderstanding immediately.

Emails can be forwarded to others. You may have to spend hours putting out fires that never should have been started in the first place.

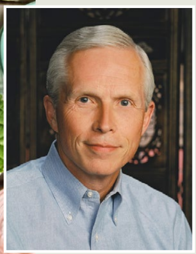
3 Your URL

It is a fact that florists who promote their URL gain business through their website. Shops that don't promote their URL only get a few online orders a month.

Make sure that every printed piece you create includes your URL. Add it to your outdoor signage. Put it on your vans. Make sure it is in all your ads. The key to a successful website? Promote it.

FROM THE PUBLISHERS
OF FLORAL FINANCE®

GETTING PEOPLE TO LISTEN



The author is unknown, but these thoughts will help anyone who wants to succeed.

- The greatest sin: Gossip.
- The greatest crippler: Fear.
- The greatest mistake: Giving up.
- The most satisfying experience: Doing your duty first.
- The best action: Keep your mind clear and your judgment solid.
- The greatest blessing: Good health.
- The biggest fool: The man who lies to himself.
- The greatest gamble: Substituting hope for facts.
- The most certain thing in life: Change.
- The greatest joy: Being needed.
- The cleverest man: The one who does what he thinks is right.
- The most potent force: Positive thinking.
- The greatest opportunity: The next one.
- The greatest thought: God.
- The greatest victory: Victory over self.
- The best play: Successful work.
- The greatest handicap: Egotism.
- The most expensive indulgence: Hate.
- The most dangerous man: The liar.
- The most ridiculous trait: False pride.
- The greatest loss: Loss of self-confidence.
- The greatest need: Common sense.

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Inventory Management

There are two aspects to controlling inventory. First is physically managing the products. Buying, storing, selling and reordering.

Second is properly accounting for them so that you have the information you need to run a profitable business.

Both aspects are important. This article will focus on managing the physical inventory. The article on page 4 will address inventory accounting.

DEFINITION

What is inventory? It is all the products you buy to resell. They may be on your shelves, in your cooler or stored away for future sale.

In a retail flower shop, perishable products are the most commonly purchased inventory items.

Sixty-five percent of the average retail florist's sales are arrangements. Other perishable sales include loose flowers and blooming plants.

Although perishable products are the top sales item, they sell quickly. At any given minute, other products represent an even larger share of the inventory sitting in a typical shop.

The other products could include gift items, green plants (they last long enough to be treated as non-perishable items), silk and dried products, balloons, arrangement supplies/containers and other hard goods (which vary greatly from florist to florist).

Keep enough items on hand to cover the sales you will have until the next shipment arrives.

YOUR GOAL

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

It's called "turns." You want the optimum number of turns each year out of each type of product you carry.

Example: Suppose you have a gift line on which you use a keystone

Part 1: Physical Inventory

markup. (The item's cost plus freight is doubled to arrive at the retail price.) An item that cost you $10.00, including freight, will be sold for $19.95.

This pricing formula gives you a 50% cost of goods sold (COGS), assuming no discounted sales or shrink.

If you sell $20,000 worth of those items during the year, you can assume it took approximately $10,000 worth of product and freight costs to make those sales.

Now look at the average level of inventory for that product during the year. If the average inventory level is $5,000, you turned the inventory two times during the year. In other words, you had to replenish your supply twice.

Two turns is not bad; but it's nothing to write home about either.

If, however, your average inventory level was $2,000, you would have turned the inventory five times during the year. You would have had much less money tied up in inventory.

Now, THAT you could write home about. For the same level of sales, you only had an average of $2,000 in inventory—instead of $5,000—at any given time.

THE RIGHT FOCUS

Different items have different turn rates. Fresh flowers, for example, turn every few days. (The average is 3.5 days). They must be sold quickly because they'll lose their freshness. As a result, most florists turn their flower inventory 100 to 150 times per year.

Concentrating on products with a high rate of turns brings a big financial advantage. The greater the turns, the lower the amount of money tied up in inventory for a given volume of sales.

The fact that the floral business focuses 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.

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

Managing your inventory on the 20% that sells fast is relatively easy. How you control your purchasing of the other 80% will greatly determine the number of turns you have.

WIDTH & DEPTH

For slower-moving items, you need to keep your purchases "narrow" and not very "deep."

A narrow line doesn't have many different products. Perhaps 10 different gift items for a particular line instead of 20.

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

Depth refers to how many units you have of each different item. If your inventory for a given product is not very deep, you don't keep too many on hand.

Try to identify which items are moving slowly or not at all. Eliminate what you can. If you want to keep a slow mover because it does sell once in a while, keep just one or two on hand. Only have depth for items that move fast.

JUST-IN-TIME INVENTORY

Inventory management was changed forever when businesses started to concentrate on keeping inventory as low as possible.

The just-in-time concept uses the speed of today's transportation as a significant partner in managing inventory levels down.

The amount of time it takes to reorder a given item and get it delivered is the focus. If you can have a particular product delivered each week, you only need to keep a one-week supply of inventory on that item.

Walmart stresses this kind of inventory. Suppliers that can deliver products in a way that keeps Walmart's inventory low are preferred over those that can't.

You should follow the same strategy. Keep enough items on hand to cover the sales you will have until the next shipment arrives.

Order only the amount necessary to get you through that period of time. Then, be sure to reorder before you are out of stock.

Keeping the proper width and depth will ensure maximum turns for your inventory and thereby reduce the amount of money invested in inventory.

PRICE/TIME TRADE-OFFS

Sometimes, you'll want to make exceptions. There are occasions when buying more than the minimum will make sense. Often, suppliers and manufacturers will give generous price discounts for higher order quantities.

If the price break is enough, buying in quantity can be a good move, provided you have the cash to do so.

Take the amount of money it will require to purchase the larger quantity. Then calculate how much interest you would have to pay to borrow that money for the period it will take to sell the extra items.

As long as the discount is greater than the interest, it makes sense 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.

See page 4 for "Inventory Management Part 2: Proper Inventory Accounting."

Inventory Management

Part 2: Proper Inventory Accounting

The article on page 2 reviews the physical management of inventory. This article addresses inventory accounting.

The goal of proper inventory accounting is to provide accurate cost of goods sold (COGS) numbers.

Controlling COGS, especially for arrangements, is essential for profitability. After all, COGS is one of the largest expenses in a retail flower shop. Proper management of COGS requires good data. You have to know your numbers.

Today, most large retailers use computers to track their COGS. As each item is purchased, it is scanned at the cash register. The computer relieves inventory one unit at a time as it is sold.

A retail flower shop doesn't lend itself to that kind of inventory management. Since two-thirds of the average florist's sales are for arrangements, which have varying numbers of stems and greens, scanning would be impractical. Scanning works best with hard goods, not perishables.

PERISHABLE PRODUCTS

Flowers are fresh for only a few days. Blooming plants last a little longer. Even most green plants are around for only a few weeks. Consequently, for accounting purposes, expense perishable products directly into COGS. There's no need to inventory them.

The container and supplies in an arrangement, however, are inventoried—the same as any other hard good.

HARD GOODS

Expensing nonperishable products directly into COGS would distort your numbers.

Here's why.

You might buy a six-month supply of containers or gift items all at one time. If you expensed the full amount to COGS at the time of purchase, your COGS for that month would be artificially high for the sales made.

Similarly, COGS for the following months would be artificially low, as compared to your sales.

With that kind of accounting, it would be difficult to know exactly how you are doing each month

A proper inventory accounting method matches each month's sales with the appropriate amount of COGS. You do this by putting purchases into inventory accounts on the balance sheet. Then, as sales are made, you move the product from inventory to COGS.

This is called "accrual accounting."

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

It's the second step—moving those purchases out of inventory when sales are made (relieving inventory)—that causes the trouble.

The most accurate way to handle this task would be to count your nonperishable stock at the end of each month. Then, you would know exactly what was sold.

Large retailers who deal mostly with nonperishable products use scanners to accomplish this task. Every time an item is sold, the computer, in conjunction with the cash register, takes the item out of inventory and places it into COGS.

However, this would be prohibitively expensive and unnecessary for most florists.

Sophisticated inventory systems work best for businesses with product lines that are both wide (many different items) and deep (a large number of each item). A floral wholesaler, for example, needs a sophisticated inventory system.

However, florists typically only carry a few of each item they sell in a gift line. A sophisticated inventory system would be far more trouble than it would be worth. Even florists that do a lot of gift business rarely have big quantities of many different items.

SIMPLIFIED RETAIL METHOD

The inventory control system recommended by *Floral Finance* is a simplified method based on your pricing formula. Here's how it works.

Assume you buy a gift for $10.00 (including freight), and sell it for $19.95. Your COGS for that item will be 50%. The pricing formula determines that your product cost 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 the monthly sales of that product and reasonably assume it represents your COGS. Each month, you could relieve that much from inventory and move it to COGS.

That would be correct, except for two complications: discounted sales and shrink due to breakage or theft. Every shop sells some items for less than full price. And every shop loses at least a few items to breakage or theft.

Consequently, if you use a double markup, your true COGS will be a bit larger than 50%. In most shops, adding another 2% to 3% will be sufficient to cover discounted sales and shrink.

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

1. Every month, relieve inventory for each product group as a percentage of sales based on the pricing formula for that product.

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2. Once or twice a year, take a physical inventory. Compare the numbers obtained through the physical inventory to the numbers carried in the inventory accounts on the balance sheet.
3. Adjust the inventory accounts to match the physical inventory totals, as needed.
4. Then, adjust the percentages you use to relieve inventory to more accurately reflect the actual COGS percentages.

For example, if the once- or twice-a-year physical inventory shows that your stock is 5% lower than your balance sheet inventory accounts, adjust your COGS percentage up slightly. This will increase the speed at which the inventory is relieved in future months. The next time you conduct a physical inventory, you should be closer to the mark.

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

CONTAINERS & SUPPLIES

Florists use a lot of supplies and containers. How should they be handled?

Set up an inventory account for arrangement supplies and containers. Most florists will find 6% to 8% of an arrangement's retail sales price is attributable to the cost of the supplies and a utility container.

In other words, in a typical $44.95 arrangement, you will have between $2.70 and $3.60 in costs for the supplies and container.

Smaller Shops

If your annual sales are less than $500,000, you might want to expense every purchase directly to the appropriate COGS account. It's a much easier method.

Admittedly, this approach won't be as accurate for the months when you buy a lot of hard goods. However, as you move through the year, your year-to-date figures will be quite accurate. And the ease of the system will more than offset the lower accuracy of the monthly numbers.

Put all container and supplies purchases into an arrangement supplies inventory account. Then, relieve the arrangement supplies inventory account by 6% to 8% of arrangement sales each month into a COGS–supplies account. (*Floral Finance* recommends that your COGS–arrangements contain only fresh flowers and greens.)

For even better COGS control information, put expensive, special containers into a separate gift inventory category. Crystal vases and copper containers should be rung up separately into their own gift sale category.

Summary of Inventory Accounting Steps

INITIALLY:

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

MONTHLY:

Step 1.

For each sales category that has an associated inventory account, use your pricing formula to determine the percentage of sales that will go to COGS. Record all the percentages on a spreadsheet.

Multiply the total sales associated with each inventory category by the appropriate COGS percentage to get the dollar amount to be relieved from inventory and moved to COGS. Record these calculations on the spreadsheet

Your accountant can then use the spreadsheet to make monthly journal entries that will accurately reflect your COGS for your hard goods sales.

Step 2.

Place all nonperishable product purchases (including freight) into the appropriate inventory account.

Note: When you buy both perishable and nonperishable products from the same supplier, split the coding to expense the perishable products directly to COGS and the hard goods directly to inventory. Allocate the appropriate amount of freight to both items.

EVERY SIX OR 12 MONTHS:

Step 1.

Take a complete physical inventory for each inventory account.

Step 2.

Compare your actual inventory with the inventory carried on your balance sheet. Determine the amount by which each inventory account is high or low. Have your accountant make the necessary adjustments.

Step 3.

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

TAKING A PHYSICAL INVENTORY

WHY IS IT NECESSARY?

Cost of goods sold (COGS)—the cost of the products you sell plus freight—is one of your largest expense areas. It's important to track it and control it.

Few florists have a scanner at the register or point of sale (POS) that counts all products that are sold. And every florist loses at least a few items to theft or breakage.

Consequently, the only way to know exactly how much product has been sold, used or lost is to take a physical count of what you have left in the store.

A physical inventory is necessary for accurate financial statements.

WHEN?

How many times a year should you take a physical inventory?

Once a year is the best option for most shops. Don't even consider more than two. It's just not practical. And it's not necessary.

If you conduct one physical inventory a year, do it at your fiscal year-end. That's the point at which your financial statements reflect the end of your tax year. For the majority of retail florists, the end of the fiscal year is the same as the calendar year, December 31.

CONSIDERATIONS

Ideally, you want to take the physical inventory when the shop is not busy. You also want to choose a time when you've sold a lot of products and your inventory is low. You'll have fewer items to count.

December 31 fits both of those criteria nicely. Even though you may be tired from the holidays, the week after Christmas is usually fairly quiet and your stock is at a low for the year.

IT'S NOT THE MOST FUN

You can make a game out of taking inventory. Offer your employees rewards and prizes for speed or participation.

However, beyond that, inventory time is more of a "have to do" than a "want to do."

Roll up your sleeves. Dive in. Doing inventory goes with the territory.

HOW TO TAKE A PHYSICAL INVENTORY

As you count your inventory, there are several steps that can save you time and others that will help you be more accurate.

Step 1. When it comes to supplies and containers, do not count the items in any partial boxes. It's not worth the trouble. Assume any partial box is a used box.

Also, do not count any perishable products—flowers, greens, green plants and blooming plants. They should be expensed when purchased, because they do not last long.

Step 2. Break the job down by counting the inventory on each fixture or storage shelf separately. This also makes double-checking each count fairly easy.

Step 3. Place (tape) an inventory form on each fixture or shelf. This could be a copy of a form from *The Profit Minded Florist* or a simple, blank sheet of paper.

The form should have six columns:

1. **The name of the item**
2. **The number of items**
3. **The retail price of the item**
4. **A total column**
5. **Your markup**
6. **Inventory at cost**

Step 4. Count every item on each fixture or shelf and place the number on your form. For the highest level of accuracy, double-check your math.

Step 5. Gather up all the inventory forms. Multiply the number of an item by its retail price to get the total retail dollars for that item.

Step 6. Using your pricing formula, determine your markup for each item.

Example: Suppose your pricing formula is to double a gift item's cost. If you buy something for $5, you will sell it for $10. Your markup on that item is 2.

Step 7. For each item, divide the total retail dollars column by the item's markup to determine the approximate inventory at cost.

Step 8. Finally, tally all the final amounts in the inventory at cost columns from all the inventory sheets to determine your total inventory for each inventory category.

Step 9. Give these totals to your accountant so the proper adjustments can be made to your financial statements.

Charging for Supplies

Most florists know they can't put extra flowers into arrangements and make a good profit.

For years, *Floral Finance* has preached the doctrine of counting every flower. As a result, many florists have dramatically improved their bottom line by simply enforcing the requirement to count everything in every arrangement.

ANOTHER CULPRIT

Even if you count every flower and green and charge for each one, your cost of goods sold (COGS) still may be too high. Why? Because flowers and greens aren't the only things in arrangements.

Everyone recognizes that the container is an expense that needs to be covered. However, you might be surprised to learn how many florists don't charge for supplies.

"Supplies can't cost that much!"

Think again.

When was the last time you figured out exactly what your supplies cost?

Take a look at the box below. Supplies are more expensive than you might think.

Typical Cost of Supplies in a $49.95 Arrangement

Floral Finance had several designers calculate the nature, number and cost of supplies in a typical $49.95 arrangement. The results might surprise you.

ITEM	QUANTITY	PRICE
Foam	½ brick	$0.35
Tape	1.5 feet	0.16
Card/Envelope	1	0.12
Pick	1	0.03
Invoice	1	0.17
Box	1	0.40
Tissue	3 sheets	0.09
Plastic Wrap	4 feet	0.08
Ribbon	3 yards	0.45
Care Tag	1	0.04
Preservative	1 packet	0.10
Total		**$1.99**

If you use all the supplies listed, the cost is $1.99, or 4% of the retail price of the arrangement. If you don't charge for supplies, you would add 4% to your COGS without realizing it.

PROFITABILITY

The average retail florist in North America makes a bottom-line profit of less than 5% before paying taxes. *Floral Finance* has long held that a well-run flower shop should pay the owner/manager a reasonable salary AND produce a 10% profit.

Much of the difference between what shops are making and what they ought to make often can be traced to not charging for supplies. A florist using the supplies listed above would be putting an additional $1.99 of cost into each $49.95 arrangement and dropping 4% from the shop's bottom line.

What if you don't use all the supplies listed? Maybe you won't use the ribbon, delivery box or plastic wrap. Even so, you could easily have $1.50 or more of supplies cost in a $49.95 arrangement. That would increase your COGS by 3%.

WHAT TO DO

Fortunately, the supply problem is not hard to correct. You don't even have to worry about keeping track of every single piece of wire, tape and foam.

Simply estimate the average cost of supplies for each of your arrangement prices. Then, mark up that amount using your pricing formula and add in the total to the cost of the arrangement before allocating money for the container and flowers.

Example: Suppose a florist uses a 2× markup for supplies and figures a $1.50 (3%) cost of supplies for a typical $49.95 arrangement. In that scenario, the florist should allocate $3.00 (or 6%) of the retail price to cover the supplies.

A Short Cut …

For those who don't want to go to the trouble of figuring their own supplies costs, here's a cheat sheet.

ARRANGEMENT RETAIL PRICE	SUPPLY CHARGE	PERCENT OF RETAIL
$29.95	$2.40	8%
34.95	2.80	8
39.95	2.80	7
49.95	3.00	6
74.95	4.50	6
99.95	6.00	6
99.95+		5

FAMOUS FINANCIAL WORDS

"Last week is the time that you should have either bought or sold, depending on which you didn't do."
—Leonard Louis Levinson

"It doesn't matter if you're rich or poor, as long as you've got money."—Joe E. Lewis

"People will buy anything that is 'one to a customer.'"
—Sinclair Lewis

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Inquiries & Answers LETTERS

WORKING AT HOME

"My bookkeeper works pretty independently. She has asked if she can do half of her work at home so she can take care of a young child. Should I agree?"

Be careful.

Working at home is a trend in many sectors of the economy. Some workers and jobs are particularly suited to this kind of arrangement. However, you need to be careful.

If your bookkeeper is working at home to take care of a child, she will not be as efficient as she would be at the shop. There will be many interruptions. The quality of her work could suffer. If she keeps some of the shop's records at home, this could cause some inconveniences if you need those records at the shop.

Also, consider how the other employees might react. They may wonder why they, too, can't work at home.

If you want to experiment, set a trial period. See how it works out. And make sure you are not paying by the hour. Use a fixed rate for the work that is being done.

BACKUPS

"Why is it important to have a backup of my computer file? I've never had a problem—ever!"

It just is. Trust us.

What would you do if you walked into the shop tomorrow and discovered that your computer had literally lost its mind?

Would you have any way to re-create your customer files? Do you have all their addresses and phone numbers? What about the balances they owe you?

No, a crash doesn't happen very often. Hopefully it never will. But it could. And that's the point. It's called "disaster recovery" for a reason. When you need it, you really need it.

A computer is a mechanical thing. It can go bad. If it does and you have a backup of your data, you can be up and running again in no time flat.

The easiest way to back up your data is to use a provider on the cloud, such as Carbonite or MozyPro. Backups are handled automatically throughout the day. If you do backups manually, make sure you do so every day. Set up your system to automatically back up every night. Every morning, replace the backup device and put the fresh backup in your purse or briefcase to take home.

NORMS

GIFT SALES

Gift sales represent 4% of total sales in the typical flower shop.

Does that surprise you? It shouldn't. Retail florists are in the flower business, not the gift business. Even though you compete with other gift-giving businesses for customer dollars, your customers' gift of choice is flowers.

Most retail florists carry only a few gift items. Florists who have ventured out into the hard goods gift market find it requires a significant increase in inventory. And all too often, product turnover is slow.

Retail florists are, well, florists. Most of your products and services revolve around perishable products. Flowers are what you're good at. Flowers also will likely give you the best return.

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