

HOW RISKY IS YOUR BUSINESS?

Do you lay awake at night worrying about your opposition cutting prices and taking your customers? Trouble sleeping, wondering if your store will survive? Do you stare at the ceiling concerned at how you will appease your bankers? Not really knowing how risky your business is?

These are common concerns of any retailer. One Key Performance Indicator can tell you the answer I am asked constantly by Retailers. Will I survive? The calculation is called the Margin of Safety.

The Margin of Safety is a financial ratio that will tell you the percentage of sales you can afford to lose before you cannot cover your overheads. It can be calculated on a yearly basis by reviewing your financial statements from you accountants, or monthly if you generate your own monthly profit and loss statement.

Calculation

$\$ \text{ Net Profit (Before Owners Salary)} / \$ \text{ Gross Profit} \times 100$

To illustrate how the margin of safety is calculated and interpreted let us use a case study of a retailer's yearly result.

Sales	\$2,000,000
Cost of Sales	\$1,600,000
Gross Profit	\$ 400,000
Expenses not including owner's salary	\$ 300,000

Net Profit (B.O.S) \$ 100,000

(B.O.S) = Before Owners Salary

In this case study the Margin of safety is:

$\$100,000 \text{ divided by } \$400,000 \times 100 = 25\%$

This means that this store can afford to lose 25% of its sales before it cannot cover its expenses before owner's salary and therefore not

making a profit nor provide a return on effort to the owner through payment of a salary. Obviously the higher the percentage the better

A sample of retail Margin of Safety percentages for a variety of retail sectors are detailed below.

Bakery & Hot Bread shops

Butchers

Florist Shops

Hardware Stores

Jewellery Retailers

Newsagencies

Pharmacies

Take Away Food

Travel Agencies

***From CCH Benchmarking Business Benchmarks on Disc.**

The Margin of Safety is of crucial importance to you in the actions you undertake to the entry of new competition to your area and the pricing policies of your competition. By calculating your margin of safety you will know quickly what you can afford to lose in sales to them. If the result is low (say anything less than 15%) you are at high risk to increased price competition or new players in the marketplace.

If price is being used to compete and you are cutting the gross profit margin, your margin of safety will fall. It is therefore important that whilst competing on price, you also ensure that your margin is improved in other areas such as

Minimizing Damages

Checking in all stock in correctly

Ensure all sales are rung up or booked out

Check your freight charges

Minimise theft

Negotiate early settlement discounts with suppliers

This is not the complete list there are another 15 factors that affect your Gross Profit result and none of them relate to neither your pricing policies nor your competitors.

Put simply, it is a fact that the store with the lowest Margin of Safety in your suburb, town or district will probably be the first to close its doors due to increased competition in the retail marketplace. How well are you performing?