Money Matters

How successful operators have realigned their businesses after four years of economic downturn

By Ian Baldwin

The 40-something lady was still there, after 25 or so minutes of looking at the gorgeous 2-gallon perennials in full flower. Picking them up, looking at labels, then price tags (mostly $19.99 or $22.99), she was returning them to the bench and moving on a few feet. She was into a routine; show interest, pick it up, read the information label, look at the price, put it down again.

I lost sight of her until she was loading her car with just a few plants; three big showy Knock Out roses (on sale, buy two at $24.99, get one free) and some nice 4-inch herbs at $3.99 each. There were no obvious tie-ins such as fertilizer, chemicals, soil, support frames, gloves, pruners or pottery — just a few plants for under $50. She wore 'smart casual' clothes, had a $300+ purse over her shoulder, an iPhone and drove a newer car than mine.

This one scene epitomized garden shopping now. Dream big; spend small. From "The sky is falling" uncertainty of 2009 through the too-wet, too-dry years that followed, the consumer is picking their deals, making do with less and NOT investing much in big capital garden items, indoors or out.

The conventional IGC model, with a heavy emphasis on tree and shrub sales and the labor to set up, maintain and service the customers in that area of expertise is seriously challenged by this reality. The math used to be simple. Woody plants were higher margin lines that created enough gross margin dollars to pay employees (often skilled and employed year-round) to run the department and create a fund that "carried" less profitable lines. Now there are simply fewer gross margin dollars to go around, unless products are sold aggressively in a lower-price, higher-volume strategy like other channels, which most IGC owners are not ready to do. But the math of the last two decades isn't working.

Many operators are reacting with discounts and specials (2-gal Knock Out roses for $12.99 anyone?) to drive traffic, which is a nod to reality, but unless they address the cost structure of their businesses, they will get squeezed from both ends.

A DUH MOMENT? At the risk of sounding parental here (who me?), it is worth reminding owners that 60 to 80 percent of all money coming into the

Garden shopping now seems to be about dreaming big, but spending small.

register goes out again pretty rapidly on two things: inventory and labor. So that's a pretty good place to focus – duh!

From clients and Garden Center University participants, we see lots of garden center financial statements each year and it is clear that gross margin as a percent of sales has dropped in the recession, in some cases by several points, although smart buying has offset some of that. Meanwhile, gross margin dollars, the important ones to measure, have not grown as fast as overheads have grown, and selected overheads, mostly labor-related, have not been cut as quickly as gross margin dollars have fallen. So the net result is that less money has found its way to the bottom line. No earth-shattering news there, but now what?

Owners and managers consistently ask me what their labor costs should be as a percentage of sales. Being a slow learner, it finally dawned in me about 20 years ago, a better question is "What can I afford to spend on labor?" Here's how we figure it out. To be able to return a profit worth the effort and risk by the owners, to create money for bonuses, re-investment in improvements and expansion, you need a minimum 26 percent "gap" between two basic metrics: the gross profit margin and labor costs, both as a percentage of sales.

MIND THE GAP! To try this at home (please!), calculate the true actualized gross profit margin percent, after allowing for inventory adjustments (which can cost a few points), subtract 26 percent of sales and the remaining number is all you can spend on labor, including payroll taxes, health insurance and other "burdens."

i.e. True gross margin percent minus 26 percent = maximum labor budget as a percentage of sales.

To put it another way, if at the end of the financial year, you subtract your total retail labor costs,* as a percentage of sales from your actualized gross margin as a percentage of sales and you see less than 26 percent, the gross margin is too low for the labor costs you entail, period.

Percentages are interesting to people like me, but they're dollars that pay the bills so this fundamental calculation has a real life side to it when you use real money!

Because of seasonality, this measurement is best carried out once a year at fiscal year end, and 26 percent is a minimum result, with the better performing IGCs regularly showing a range from 28 to 35 percent. Over percentages in the mid 30s, I get nervous that the prices charged to get a higher gross margin may suggest a service level that doesn't materialize when someone shops there!

WHY A 26 PERCENT GAP? From years of looking at profit and loss accounts, it just seemed that somewhere in the high 20 percents is where the good operators consistently seemed to end up year after year. One year of 23 percent won't kill the business, but when I saw year after year of 'gaps' below 26 percent, I saw retailers struggling to upgrade their businesses from benching to websites, new structures to paving parking lots. There was obviously little spare cash being generated (or if there was, it was not being re-invested which is a whole different story.) Despite increasing competition, there was nothing new, different and exciting. The places just looked tired, as did the owners and staff. It's no fun working harder and harder for less and less at any level of human endeavor!

As a contrast, garden centers that were re-investing in infrastructure, facilities and equipment, and were following trends, educating themselves, networking and traveling had "gaps" consistently in the 28 to 32 range.

Finding the gap

Year to date sales	$1,000,000	100%
Cost of goods (inventory adjusted)	$520,000	52%
True gross margin	$480,000	48%
Minus 26% of sales	$260,000	26%
Maximum retail labor allowed	$220,000	22%

THOSE FIXED COSTS AREN'T FIXED! My 26 percent target allows money for pre-tax profit (remember that?), marketing, rent or occupational costs, credit card and bank fees, licenses, administration and back office costs, repairs and renewals, equipment, energy and so on. Is 26 percent even enough as most of those so-called overheads have kept rising even in a recession? In my college days, these items were called fixed costs, and for good reason. Most of them are very hard to avoid, slash or re-negotiate. They are the costs of doing business irrespective of how many customers come in the door.

So if they are unable to change the fixed costs in an economic downturn, operators find savings in things they can control such as paint, benches, shopping carts, or sadly, employee training and marketing. Doing this of course just makes the store look even less attractive or relevant to the consumer. Consumers like to shop at a winner, one that looks like it will be there the next time they visit, so economizing on "fix up" is about as bad a decision as you can make in a recession.

Interestingly, a glance through the published accounts of larger retail companies from mass merchants to grocery stores also shows a 24-27 percent gap, albeit based on lower gross margins and labor bills. They also need that magic number to survive, thrive and meet Wall Street expectations.

This gap calculation is down in the wheel house of running a retail company. Operators have little wiggle room in the slab of fixed costs, so they need to be analytical and disciplined about the two big uses of funds they CAN control: inventory and labor.

WIDEN YOUR GAP. Obviously, there only two ways to increase your gap: increase margins and/or reduce wages, both with their own drawbacks, but that is the challenge facing the IGC channel right now. One area of low-hanging fruit for many is to increase gross margin by buying more scientifically which is where the point of sale becomes your best friend. I recently ran a report that showed the bottom performing 1,000 stock keeping units in a large garden center all together only brought in 0.5 percent of all gross margin dollars. No one was buying them, so no one would miss them if they were discontinued, even though some employees pushed back at the news, until the POS was the unbiased decider!

There are many fewer hobbyists now shopping for rare and unusual items, a lot fewer woody plants being sold and a public increasingly wanting you to tell them what they need. Add in the current wave of "decorating" rather than planting and the stage is set for a huge change in an inventory model that has lasted for 30 years. That line of action leads to a smaller nursery footprint that's easier to administer and more convenient for the shopper.

*I don't include back office labor in this total as some of that work can be, or is, subbed-out to others such as a payroll service.

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With a lower demand for plants that were once the foundation of the garden and the whole industry, retailers can carry less SKUs, turn their money around faster and slash those invisible costs of inventory like theft, obsolescence, death and of course that old-time favorite, "shifting up!"

Reduced woody plants means a lower labor bill, with less set-up and care for thousands of trees and shrubs sitting for months or years. Some of those same skilled staff are still needed but for different questions and more hand-holding support for reluctant shoppers. Consumers who simply decorate have fewer long-term expectations and fewer questions, another labor saver. They often just need some strong visual merchandising for grab and go shopping.

IGCs that have not trimmed their labor force to reflect this new reality of today's gardening can probably save several points on their labor bill to increase their gap. Reduced SKUs and buying more quantities of one item can bring better terms. So the act of purchasing can also increase the gap by reducing cost of goods.

GAP-SENSE SUMMARY.

Reduce inventory losses by buying smarter. Trade stagnant woody plants for massed color and trendy veggies. Carry fewer choices, reduce the store footprint, turn products around quicker and reduce labor costs to the level the gross margin dollars can support. Invest regularly in small upgrades and team training that enhances the customer's experience. That, in a nutshell, is how even in a deep economic hole, some IGCs are turning out gaps of 32-35 percent year after year while staying price-competitive. gc

Woody plants are becoming less popular, which could help you cut costs.

Ian has spent his life in the garden industry and has 30 years of experience consulting on business issues with companies large and small helping them make more money with less stress! *(www.ianbaldwin.com)*