

COST OF GOODS SOLD

Michael Ahern, Ahern's Inc. Florists, Fairlawn, Ohio

"Cost Of Goods Sold" is a subject that often brings on an immediate yawn! While this may not seem like an exciting area, the potential of making profits is exciting. I feel it is essential to learn how to make a profit while giving great customer service.

Here's what I will cover in this article.

1. Definition of terms.
2. What makes real vs. apparent Cost of Goods.
3. What is necessary to control Cost of Goods.
4. To determine what a target Cost of Goods should be, I'll explain pricing and some of the factors to be considered.
5. Everything depends on the collection of data. I'll discuss just how much data collection makes sense.
6. Different product lines will contribute differently to profitability. I'll discuss how to evaluate what to handle and when.
7. Finally, I will show some examples and develop some suggestions of target Cost of Goods on certain product types.

Definitions

First, let me define some basic concepts.

Sales you would normally see at the top of your operating statement. It includes all sales of merchandise, wire in sales, equipment rentals, etc., but it does not include wire out sales, delivery charges, service charges, rebilling charges, or any other charges customers pay that do not involve merchandise.

Cost Of Good Sold (COG) is the cost of all materials used in a product sold to the customer. This includes all the foil, ribbon, pot covers, foam, wire, etc. These are called supply items. This does not include order forms, labor, stationery, or items used in the sale but not part of the sale.

Gross Profit is the amount left after Cost of Goods is subtracted from the sale price.

Gross Cost Of Sales (COS) is the sum of the Cost of Goods plus the labor to design, plant, assemble, or package a product. It does not include the cost of labor for marketing, sales, or delivery.

Gross Margin is a term I use to show the amount left after Gross Cost of Sales has been deducted.

Operating Profit is what's left after all expenses, labor, and Cost of Goods associated with operating the business have been paid. This does not include income from service charges or expenses for interest payments.

Net Profit is what's left after everything and everyone has been paid, including the tax collector.

Actual Vs. Apparent Cost of Goods

When we compute our Cost of Goods, regardless of how often we do it, we can be fooling ourselves. How do we account for shrinkage or the effect of clearance sales in our determination of COG calculations? The real use of any records is to help us make good decisions. Misleading data can cause us to make decisions that are not profitable, or to continue to do things that no longer make economic sense.

Discounts. At Christmas, we offer a 10 percent discount for early order and delivery of poinsettias. We sell approximately 50 percent of the plants this way. The apparent Cost of Goods on a \$15.95 plant is \$5.42 (plant + pot cover + plant sleeve) or 34 percent. If we consider that half the plants are sold at less than full value, the actual COG is 36 percent, or 2 percent high. If my target COG is 33 percent, then I must either charge \$16.95 for this plant or reduce the cost by \$0.32.

Clearance Sales. At Christmas, we also sell many of the leftover ornaments and permanent arrangements on sales later in the holiday season. The sale discounts have been as much as 75 percent. In the case of ornaments, the original markup is 2.5x, giving a 40 percent Cost of Goods. If 25 percent of the ornaments are sold at 50 percent off, the actual COG is 46 percent - a full 6 percent higher. Knowing this, we are going to be like the department stores and build money into the markup to cover the season-end discounts. If our markup is raised to 2.86x in this example, the actual COG will be back to 40 percent.

Factors in Controlling Cost of Goods

Differing Margins. Many of the products we sell are composites of different types of merchandise. Each item has its own markup for pricing and Cost of Goods purposes. The best example of this is an arrangement, which contains cut flowers, cut greens, containers, supply items, picks, and labor. If all the rules are followed, the COG will vary depending on the quantity of each item used.

Examples 3 and 5 illustrate what happened to COG on two arrangements in which the individual components have the same markup, the second one uses a cheaper container and more cut flowers. The net effect is that because the markup for cut flowers is higher than it is for the container,

the actual cost (COG) of producing the second arrangement is reduced by 3.2 percent.

Changing Sales Analysis. As with the contents of a package, the Cost Of Goods of my company is made up of parts generated by the products we sell. The amount of each type of merchandise sold each season will vary because of intentional marketing and changing customer preferences. In addition, the costs of supply items are charged directly to COG at the time of purchase, adding as much as an extra 2 percent to the company's COG. It is also common for my company to focus its marketing efforts on a particular item or buying occasion for a month or group of months and then move to another target area for the next campaign. Paying attention to what the effective COG of each merchandise type is should play a large part in the choices we make on which items or occasions we will promote. The COG targets listed at the end of this article show that I am much more likely to promote a fresh arrangement than giftware.

Handling Of Shrinkage (Breakage And Dump). The most difficult problem with Cost Of Goods is the control of what we throw away. The accounting problem is easy. If the item is gone or unusable, it is charged to COG. We take a physical count of all perishable products every month. Even though we keep track of everything thrown out, comparing the beginning and ending perishable inventory ensures that all perishable merchandise expenses are charged to COG. Broken or missing hard goods are charged directly to Hard Goods Cost Of Goods. Estimated hard goods usage is charged to Hard Goods Cost Of Goods each month.

It is difficult to control the dump on cut flowers without putting it into customers' arrangements. For an example of the seriousness of this problem, consider this. If my dump is 3.5 percent of sales; my COG is 35 percent, and cut flower products represent 65 percent of total sales, then I am actually throwing out almost 15 percent of everything I purchase in cut flowers. Reducing the dump to 1.5 percent of sales will save \$2,000 per each \$100,000 in yearly sales.

The following are some ways to manage dump:

- A. Rotation Of Stock
- B. Care And Handling
- C. Managing Just-In-Time Inventory
- D. Managing Customer Expectations

Pricing

Many things are involved in pricing decisions. I start the process with the profit I need to make for my efforts. Given the profit needed and the projected sales (a very conservative guess), the target for Cost Of Goods for the entire

company is made. The trick then becomes how to maximize our strengths and allow me to reach the targets I set. Pricing pressures may cause us to accept higher COG on some items, but will not necessarily prevent more lucrative margins on others.

I have developed some examples of how to plan and manage packages in order to predict the COG. Examples 1 through 5 show the effect of various pricing policies and the hardgoods content of package COG. Progressively more of the hidden costs are accounted for in the latter examples.

Some of the factors to be considered in pricing are:

- A. The customer perceived value.
- B. The labor contribution necessary.
- C. The competitive factors including but not limited to price.
- D. Marketing strategies driving special pricing.
- E. Your company's position in the market.

All these factors will help determine a price, and price will determine the allowable markup and COG. Planning will help you make your target COG.

Fafard, Inc.

Open House 1995

You've seen our old plant,
Now come and see
our **new plant!**

Come and join us on June 15, 1995 from 8:00 am until 5:00 pm for our open house. Get a tour of our new manufacturing facility. See the plant you helped create. Have a taste of good food and dessert while you're here. Our house is always open, so if you cannot make it for the open house, just call for a personal tour. Hope to see you soon.

**For directions, please call:
1-800-722-7645 or 706-224-7989.
Fafard, Inc. 1417 Amity Rd.
Anderson, SC. 29621**

Data Collection

It is important to periodically do pricing and cost studies, especially during sales and discounts, to see if we are meeting our planned COG. A few items derived from daily sales will be enough to gain basic control. More detailed information will allow for fine tuning, but basic numbers periodically can do great things.

Evaluation Of Product Lines

We can improve our company Cost of Goods by choosing what we sell. Our marketing can then emphasize those products with the best COG. At the very least we can predict the effects of sales analysis changes on the COG.

However, I evaluate products on the basis of both COG and the labor required to make the product to sell. Again, the terms Gross Cost Of Sales is used to represent the cost of both merchandise and production labor. This is the best means of evaluation.

In Example 6, the COG shows that the most profitable type of sales by far is corsages. We all know that corsages are extremely labor intensive and the profitability is not our best. Looking at the COS, the pictured is somewhat different. Corsages are slightly better than average, but only when done as a group at one time. If the COS of all products can be managed to a target of 40 percent (or less), then it will make no difference what we sell. Just sell as much as we can of anything.

In addition to evaluating costs in choosing product lines, you must consider several other factors. They are:

A. Potential market. What are the likely number of sales that can reasonably be expected once people know you have the product? Is it worth the effort?

B. Difficulty of sale. What special expertise is needed to sell the product, and can the product be sold in your store rather than in the home?

C. Critical volume. Is a certain product difficult to sell, and how much of it will you really sell? Maintaining a large inventory or making a number of special trips for supply may be necessary (e.g. fruit baskets). Is the product profitable enough to be worth your effort?

D. Perishability. Are the sales rapid enough to prevent unacceptable amounts of dump?

E. Fit with focus and product. Is this item something your customers are likely to think belongs in your store?

Conclusions

The evaluation of your business in terms of profit required, fixed costs of facilities and personnel, and the expectations of the near future will determine what your Cost Of Goods

needs to be. An honest evaluation of your design productivity will also show you what COG you can afford and still make a profit.

I, like many of you, have struggled for years to make a minimal profit. I believe these types of planning will identify the things I must do to make things change. Using these processes, I am beginning to see more control in the COG. There are many ways to increase margins in some areas. These will work if I can apply them and attack dump.

My Cost Of Goods Targets:

- A. Fresh arrangements -- 30%
- B. Giftware -- 40%
- C. Hard goods - utility -- 33%
- D. Specialty Silks - loose -- 33%
- E. Silk arrangements - 35%
- F. Dried or silk and dried arrangements -- 33%

Labor markup -- 3X

Labor on arrangements -- 20%

Labor on silk arrangements --27%

Please See Tables On Pages 43 and 44

Reprinted with permission from the Ohio Florists' Association Bulletin No. 779, September, 1994.

**Ready to Upgrade your Software?
..or just starting to think about computers?**

The choice is clear for the GREENHOUSE AND NURSERY INDUSTRIES

*Designed for the Green Industry and first installed in 1981...Continuing to be enhanced through the 90's

*The PC computer software of choice by cost-oriented owners/ managers. It has a nationwide customer base.

***NOT just accounting, but the *best* accounting PLUS daily operating programs that let you schedule, plan and control your nursery/greenhouse business.**

*We help you select the *Argos* (tm) nursery programs & features you need for YOUR operation and combine them with popular *Windows* (tm) programs to give a complete, custom tailored, "business wide" solution.

*We come to your office, install the programs on your PC or network and train you how to use them.

*Through the famous *Argos* subscription service you get proven superior support and all program updates.

We are with you for the long haul!

for a brochure call:


ARGOS
SOFTWARE
Since 1979

SOFTWARE SOLUTIONS

1(800) 553-4414

Example 1. Arrangement sells for \$49.95.

Item	Wholesale Cost	Markup	Retail Price	% of Total
Container	\$10.00	2X	\$20.00	40%
Cut Flowers	\$9.62	3X	\$28.87	58%
Greens	\$0.36	3X	\$1.08	2%
Supplies	\$0.37	-	-	-
Labor (memo)	\$1.78	-	-	-
Labor (basic)	\$0.80	-	-	-
TOTAL (merch.)	\$20.35		\$49.95	100%
COG	40.7%			
COS	45.9%			

Example 2. Arrangement sells for \$49.95.

Item	Wholesale Cost	Markup	Retail Price	% of Total
Container	\$10.00	2X	\$20.00	40%
Cut Flowers	\$8.64	3X	\$25.92	52%
Greens	\$0.36	3X	\$1.08	2%
Supplies	\$0.37	1X	\$0.37	1%
Labor (memo)	\$1.78	1X	\$1.78	4%
Labor (basic)	\$0.80	1X	\$0.80	2%
TOTAL (merch.)	\$19.37		\$49.95	100%
COG	38.8%			
COS	43.9%			

Example 3. Arrangement sells for \$49.95.

Item	Wholesale Cost	Markup	Retail Price	% of Total
Container	\$8.00	2.5X	\$20.00	40%
Cut Flowers	\$8.09	3X	\$20.20	40%
Greens	\$0.36	3X	\$1.08	2%
Supplies	\$0.37	2.5X	\$0.93	2%
Labor (memo)	\$1.78	3X	\$5.34	11%
Labor (basic)	\$0.80	3X	\$2.40	5%
TOTAL (merch.)	\$15.46		\$49.95	100%
COG	31.0%			
COS	36.1%			

Example 4. Arrangement sells for \$49.95.

Item	Wholesale Cost	Markup	Retail Price	% of Total
Container	\$6.00	2.5X	\$15.00	30%
Cut Flowers	\$8.09	3X	\$24.28	49%
Greens	\$0.36	3X	\$1.08	2%
Supplies	\$0.37	2.5X	\$0.93	2%
Labor (memo)	\$2.09	3X	\$6.26	13%
Labor (basic)	\$0.80	3X	\$2.40	5%
TOTAL (merch.)	\$14.82		\$49.95	100%
COG	29.7%			
COS	35.5%			

1995 Southeast Greenhouse Conference and Trade Show Program

1995 Welcoming Reception and Breaks Sponsored by:

Armin Plastics, Bouldin & Lawson, Inc., Bruce's Greenhouse, Carolina Nurseries, Inc., Cassco/Southern Growers, Dillon Seed & Supply Co. Inc., Dixie Green, Inc. Duke Power Company, Fafard, Inc., Florists' Mutual Insurance Co., Landmark Plastic Corp., Metrolina Greenhouses, Henry F. Michell Company, Mid-Atlantic Plant Co., M&R Specialty Sales, Rockwell Farms, Inc., Rough Brothers, Inc., Total Gro/SDT Industries, Vaughans Seed Company, Verlite Company, and V-J Growers.

Thanks For Your Support!

Example 5. Arrangement sells for \$49.95.

Item	Wholesale Cost	Markup	Retail Price	% of Total
Container	\$3.00	2.5X	\$7.50	15%
Cut Flowers	\$10.13	3X	\$30.40	61%
Greens	\$0.36	3X	\$1.08	2%
Supplies	\$0.37	2.5X	\$0.93	2%
Labor (memo)	\$2.55	3X	\$7.64	15%
Labor (basic)	\$0.80	3X	\$2.40	5%
TOTAL (merch.)	\$13.86		\$49.95	100%
COG	27.8%			
COS	34.5%			

Watch your mail for special member-discounted publication package offers!

- *Identification Of Insects And Related Pests Of Horticultural Plants – Pictorial Guide and Tips On The Use Of Pesticides On Floriculture Crops: A Guide To Insecticide, Miticide, Fungicide, Growth Regulator And Herbicide Application* for \$21 plus postage and handling.
- *Tips On Growing Poinsettias, Tips On The Use Of Chemical Growth Regulators On Floriculture Crops, and Tips On The Use Of Pesticides On Floriculture Crops: A Guide To Insecticide, Miticide, Fungicide, Growth Regulator And Herbicide Application* for \$28 plus postage and handling.

Example 6

Product Category	Cost of Goods	Design Labor Cost	Cost of Sales	Local Sales	Contribution to Company's Total COG
Arrangement Sales	30%	6.7%	36.7%	38%	11.4%
Blooming Plants & Blooming Basket Sales (purchased complete)	40%	–	40%	1%	0.4%
Green Plant & Planter Sales (purchased complete)	40%	–	40%	4%	1.6%
Blooming Baskets & Planters (produced in-house)	35%	5.8%	40.8%	6%	2.1%
Loose Cut Flowers	33%	6.2%	39.2%	24%	7.9%
Special Bunched Flowers	50%	5.8%	55.8%	1%	0.5%
Giftware Sales	40%	–	40%	3%	1.2%
Silk, Dried, & Permanent Arrangements	37%	8.3%	45%	13%	4.8%
Rental of Equipment, Arrangements, & Plants	–	33%	33%	5%	–
Corsages, Bouquets, & Body Flowers	25%	11.7%	36.7%	5%	1.3%
Total Product Line Cost of Goods	31.1%			100%	31.1%

All figures indicate a % of the company's total sales.