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## A. UNDERSTANDING PROFIT

As most retail professionals know, sales are the lifeblood of the store. Like a weekly paycheck, the amount of money the store makes in sales determines how much money it will have to pay its bills. One of the



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most surprising facts about the supermarket business is how many dollars in sales it actually takes to generate a **net profit** (that is, the money left after all expenses are paid). The average supermarket makes only about **one percent** net profit on each dollar of sales. In other words, after it pays all the bills, a store generally gets to keep only about **one penny** of every dollar that comes in. Where does all the money go? To give you an idea, here is a breakdown of how an average store's sales dollars are spent, figured in percentages of total sales.

HOW AVERAGE STORE'S SALES DOLLARS ARE SPENT	
<b>Merchandise</b>	<b>77-80%</b>
<b>Salaries/Benefits</b>	<b>9-13%</b>
<b>Rent/Utilities</b>	<b>3-5%</b>
<b>Advertising/Other Costs</b>	<b>1%</b>
<b>Supplies</b>	<b>1%</b>
<b>Product Shrink</b>	<b>1%</b>

To get a better idea of what it takes to generate a net profit of 1%, let's look at how profit equates to sales.

- ▶ **To make \$1, your store must sell \$100 worth of products.**
- ▶ **To make \$10, your store must sell \$1,000 worth of products.**
- ▶ **To make \$100, your store must sell \$10,000 worth of products.**
- ▶ **To make \$1,000, your store must sell \$100,000 worth of products.**

Looking at this example, we see that to make more profit, the store's average weekly sales, or *sales volume*, must increase. As common sense will tell you, increasing the sales volume means selling each product faster – in other words, generating a high product *turnover*. The whole concept of supermarket profitability is built around the concept of large sales volume and high product turnover. Supermarkets that are successful create:

- ▶ **Large sales volume**
- ▶ **High turnover of products**
- ▶ **Low prices on a wide variety of items**
- ▶ **Aggressive advertising and merchandising**
- ▶ **A large number of customers to the store**



## B. GENERATING PROFITS

Earlier, we looked at the relationship between sales and profit – how many dollars in sales it takes to generate a net profit. In this section, we need to look more closely at how sales *produce* profits. Profit is generated by large sales volume and high product turnover. But how exactly do these two things make more money for your department? First, we will talk about the two most common ways to gauge profits: **mark-up** and **margin**.

### MARK-UP

This is the difference between how much you pay for an item and how much you sell it for, *expressed in dollars and cents*. The formula for figuring the mark-up of an item is:

$$\text{SELLING PRICE} - \text{COST} = \text{MARK-UP}$$

**For example:** If an item sells for \$1.50 and costs \$1.00, the mark-up is \$0.50.  
(\$1.50 - \$1.00 = \$0.50)

### MARGIN

This is also the difference between the selling price and cost, but in this case expressed as a *percentage of the selling price*. The formula for figuring the margin is:

$$\text{MARK-UP} \div \text{SELLING PRICE} = \text{MARGIN}$$

**For example:** Using the same item, if the mark-up is \$0.50 and the selling price is \$1.50, the margin is 33%. (\$0.50 ÷ \$1.50 = 0.33 or 33%)

Mark-up and margin are simply two alternate ways of expressing the same idea – the difference between the selling price and the cost of an item. The two terms are sometimes confused with each other because, in a different “language,” they both tell what the department “makes” on the sale of a given item.

When considering how profitable an item is for the department, many people look first at the margin. After all, common sense tells us that an item with a 40% margin should be more profitable than an item with a 33% margin. In truth, however, this is not always the case. To determine how profitable an item actually is, we must also consider the effect of *turnover* on profit.

## C. HOW TURNOVER AFFECTS PROFIT

There is an old saying among retailers that “you can’t take percentages to the bank, only dollars.” To know how profitable an item really is you need to look first at the *dollars and cents* you make from selling that item and how *many* of the item you actually sell. In other words, you must look at the **mark-up** and at the **turnover** for that item. Here is an example to explain what we mean.

### WHEN TRYING TO FIGURE WHICH ITEMS WITHIN A CATEGORY ARE MOST PROFITABLE:

#### 1. COMPARE THE *MARK-UP*

- a. Brand X costs \$1.00 and sells for \$1.50.
- b. Brand Y costs \$0.80 and sells for \$1.30.

The dollar markup for each item is the same, \$0.50.

If you were to compare the margins of these two products, the margin on Brand X is only 33%, while the margin on Brand Y is 38%. Based on this information, Brand Y appears more profitable. Yet the amount of money made on each sale is the same.

#### 2. COMPARE THE *TURNOVER*:

- a. Brand X sells an average of 30 units a week.
  - b. Brand Y sells an average of 20 units a week.
- Brand X sells an average of 10 units more a week.

#### 3. CALCULATE *DOLLAR PROFIT*:

- a. Brand X provides \$15 of profit a week (30 units @ \$0.50 each).
- b. Brand Y provides \$10 of profit a week (20 units @ \$0.50 each).

Brand X is more profitable than Brand Y.

As this example shows, turnover is an important factor to consider when comparing the profitability of items within the same category.

For instance, if you are trying to determine which deli meats or cheeses actually make the most money for the department, figure each item’s dollar mark-up and rate of turnover. If the expenses required to make and display items are the same, items with a high turnover can have a *lower margin* and still generate more *profit dollars* than similar items with slower *turnover* and *higher margins*.



## D. DETERMINING GROSS PROFITS

Now that you know what the terms *mark-up* and *margin* mean and you have an understanding of how profit is generated for individual items, the next step is learning about **gross profit** and **gross margin**.

### GROSS PROFIT

This is the total amount of profit you make on any item or group of items you sell, expressed in *dollars and cents*. The formula for figuring gross profit is:

$$\text{DOLLAR SALES} - \text{COST} = \text{GROSS PROFIT}$$

**Gross profit can be figured for one item, one product category, or the entire deli department.**

**For example:** If the weekly sales of cooked ham are \$155 and the cost of the ham you sold is \$93, the gross profit generated from cooked ham sales is \$62 for the week. ( $\$155 - \$93 = \$62$ )

### GROSS MARGIN

This is the total amount of profit you make on any item or group of items you sell, expressed as a *percentage of sales*. The formula for figuring the gross margin is:

$$\text{GROSS PROFIT} \div \text{DOLLAR SALES} = \text{GROSS MARGIN}$$

**Gross profit can be figured for one item, one product category, or the entire deli department.**

**For example:** Using the same numbers from above, we can calculate the gross margin for cooked ham for the week.

$$\text{\$62 gross profit} \div \text{\$155 sales} = \text{0.40 or 40\%}$$

The gross margin for cooked ham is 40%.

Understanding how gross profit and gross margin are figured is crucial to managing a deli department successfully. Gross profit tells you exactly how much money you made from your sales. Calculating the gross margin gives you a “shorthand” way of analyzing your gross profit each period and comparing one period to the next. These two numbers are the basic yardsticks for measuring the deli department’s profitability.

## E. CALCULATING DEPARTMENT PROFITABILITY

Now that you know how gross profit is calculated, let's see how these numbers are used in figuring the overall profitability of the department.

Most companies generate a periodic recap of sales, profit, and operating expenses for the deli, either on a weekly, monthly, or quarterly basis. This recap is usually called an **Operating Report or a Profit & Loss Statement – P & L for short.**

The Operating Report is a valuable document, much like the department's report card. The report usually shows: department sales, department gross profit, department labor costs, department expenses, and net profit. Operating Report terminology is defined as follows:

OPERATING REPORT TERMINOLOGY	
<b>Sales</b>	Total department sales for the quarter. Percent of sales the deli contributed to total store sales.
<b>Cost of Goods Sold</b>	The total cost of the merchandise sold during the quarter in dollars and as a percent of sales.
<b>Total Gross Profit</b>	Total dollars generated from sales during the quarter. Percent of profit generated from sales.
<b>Direct Controllable Expenses</b>	The total amount spent on wages and supplies.
<b>Direct Non-Controllable Expenses</b>	The total amount spent on freight, trucking, etc.
<b>Contribution to Overhead</b>	Profit before indirect store expenses are deducted.
<b>Allocable Expenses</b>	Indirect expenses like payroll taxes, group insurance, etc.
<b>Total Operating Expenses</b>	The total amount of all expenses charged to the deli.
<b>Net Operating Profit</b>	The total amount of profit the deli made after all expenses are deducted.



## F. INCREASING GROSS PROFIT MARGINS

We have seen how sales drive the overall profitability of the deli department. We have also looked at how merchandising can increase sales and profits. In this section, we will look at another way to increase profitability – by adjusting *gross margins* (or gross profit percentages) so that you generate more profit from your sales.

As you recall, the gross margin is determined from gross profits – it is the difference between the retail price and the cost of an item or group of items, expressed as a percent of sales. The greater the difference between the cost and retail price, the greater your *profit margin*.

**Basically, there are three things you can control to increase your gross profit margin in the deli. You can:**

- ▶ **Raise prices**
- ▶ **Change the margin “mix”**
- ▶ **Reduce shrink**

Let's look first at the pros and cons of raising prices as a way of improving your margins and generating more gross profit. Even though pricing may be controlled by others in your organization, it is important to understand the factors involved.

**How raising prices affects gross margins** One seemingly easy way to increase your overall margin in the deli is to raise your prices. If the cost of a product remains the same and you sell it for more money, you have generated more profit dollars and improved your profit margin.

The problem is that when prices go up, sales tend to go down. The question is, if you are making more money on each item, by *how much* can sales go down before you lose all the extra profit you generated from the price increase? To answer that question, let's look at an example:

- ▶ **If you have an item that costs \$1.00 and sells for \$1.50, the mark-up is \$0.50. If sales are 60 units a week, the gross profit from this item is \$30.00 per week.**
- ▶ **If the price is raised to \$1.60 (an increase of over 6%), the mark-up will be \$0.60 per unit.**

- ▶ At \$0.60 mark-up per unit, you now have to sell only 50 units a week to make the same \$30.00 of gross profit.
- ▶ Thus, with an over 6% price increase, sales could decline almost 17% and you would still make the same amount of gross profit.

From this example, it may seem that raising prices is a great way to improve profits!  
However, there are two important factors to be taken into account:

- ▶ **Consumers' price awareness** Many customers follow prices enough to notice increases, especially increases on popular items. Although they may not know exactly how much the increases are, they will consider the relative value of the products compared to similar products elsewhere. If they decide that too many items are out of line, they may switch to another store.
- ▶ **Competition** The intense level of competition among retail stores makes it easier than ever for consumers to switch stores when they feel prices are too high.

In areas with several stores close at hand, customers may decide to use your deli for specials only, while shopping another store for most of their purchases. This can set up an ongoing cycle of raising prices to cover shrinking sales – a practice that is usually ruinous to a successful deli operation.

As you see, price increases may not always be the best alternative for increasing gross profit. Before any price change is made, it must be carefully considered in light of consumer awareness and competitive pricing.

Perhaps a more effective way to increase profit margins is to *change your "product mix"* so that you are selling a larger percentage of high profit items. We will look at that strategy next.





**How product mix affects the gross margin** As we have already seen, the gross margin for the entire deli department is made up of the margins on all the individual items you sell. This means that your department's gross margin will increase or decrease in relation to the *type of products* you sell.

In other words, if you sell more high-profit merchandise, you generate more profit dollars, which makes your profit margin go up. If you sell more low-profit merchandise, you generate fewer profit dollars, which makes your gross margin go down.

So, how can this information help you generate more profit in your department? To answer that question, we need to consider the concept of **contribution to margin**.

#### **CONTRIBUTION TO MARGIN**

This is the percent of profit that any item (or group of items) contributes to the gross margin. The formula for calculating contribution to margin is:

$$\% \text{ OF TOTAL DOLLAR SALES } \times \% \text{ OF MARGIN } = \text{CONTRIBUTION TO MARGIN}$$

Contribution to margin can be calculated for items within a product category or for product categories within the department. To find the percent of total dollar sales for a category, simply add the sales of the individual items in the category, then divide by the total category sales. To find the percent of margin for the category, just average the margins for the individual items in the category.

To see how calculating contribution to margin can be helpful, let's look at the following example comparing product categories in the deli department.

Let's assume there are five product categories in this deli:

CATEGORY	% OF TOTAL DOLLAR SALES	X AVG. MARGIN % FOR CATEGORY	= CONTRIBUTION TO MARGIN %
Salads	24%	30%	7.2%
Cheeses	15%	50%	7.5%
Sandwiches	20%	55%	11.0%
Sliced meats	30%	50%	15.0%
Prepared foods	11%	55%	6.1%
<b>TOTAL DEPARTMENT</b>	<b>100%</b>		<b>46.8%</b>

In this example, we see that this deli is making a 46.8% profit margin this period—the sum of the margins for the five product categories. If your target profit margin for the deli is 48%, your profits are below expectations.

Let's see how you might improve your profit margin by changing your product mix.

Notice that salads have the second highest sales (24%), but the lowest average margin (30%). That means that although you sell a lot of salads, they contribute fairly low percent of profit to the deli.

Notice also that prepared foods have one of the highest profit margins (55%) but the lowest percent of sales in the department (11%).

Now look what happens if you increase the sales of your prepared foods and decrease your salad sales a bit.



CATEGORY	% OF TOTAL DOLLAR SALES	X AVG. MARGIN % FOR CATEGORY	= CONTRIBUTION TO MARGIN %
Salads	20%	30%	6.0%
Cheeses	15%	50%	7.5%
Sandwiches	20%	55%	11.0%
Sliced meats	30%	50%	15.0%
Prepared foods	15%	55%	8.25%
<b>TOTAL DEPARTMENT</b>	<b>100%</b>		<b>47.75%</b>

By changing the mix of products you are selling, your gross margin has jumped 0.95% (almost 1%). As you can see, calculating your contribution to margin can be an important way to analyze what you are selling.

But how can you actually change what you are selling? As we learned earlier, one significant way is through **effective merchandising**:

- ▶ **Placing high-margin impulse items in highly visible locations.**
- ▶ **Tying in high-profit merchandise with low-profit items.**
- ▶ **Promoting popular high-profit items using in-store promotions.**
- ▶ **Creating effective signs to promote high-profit items, and so on.**

While merchandising is one crucial way to change the mix of products you are selling, another important way to improve your mix is through *multiple-tiering* — that is, offering several different brands of the same type of products.

Consider how this works with a popular item like sliced ham. By offering a range of styles—for example, cooked ham, smoked ham, honey cured ham, and prosciutto—you offer four different choices and four different price ranges for the customer to choose from.

The odds are that at least a portion of your customers will choose a ham with a higher profit margin, especially if you use suggestive selling and sampling to show them new alternatives.

Carrying a wider selection of different priced brands gives your deli greater appeal to a broader cross-section of customers, and improves your gross margin in the process.



## G. REDUCING & MANAGING SHRINK

Shrink represents the loss or waste of any product you purchase that cannot be sold. It may be the trimmed ends of deli meats or cheeses, products that spoil prematurely, or products whose freshness dates expired. Product shrink is one of the leading causes of lost revenues and drives down profits. Understanding how to reduce and manage shrink can significantly help improve profit margins in your deli.

**Reducing Shrink** Product shrink can't be eliminated, but, it can be significantly reduced by following proper guidelines for sanitation, food safety, and product handling. These guidelines are detailed in previous sections of the manual. Review them again and follow them carefully. Together, the guidelines are a roadmap for reducing shrink and increasing profit margins in your deli.

**Managing Shrink** Certain aspects of shrink are unavoidable. For example, if there is mold on a piece of cheese it must be trimmed. The important thing to do is to record and report the amount of product that is lost. By doing this, you end up knowing the true cost of your products. When you know that, prices can be adjusted accordingly to maintain proper margins or mark-ups.



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### *Get One Step Closer to Getting Your Certificate of Completion*

Now that you have completed this section and reviewed the corresponding portion of the video, you are ready to take the “**Section 5: Deli Profitability**” test. Please refer to Section 6 of this manual for more information on how to test out. **Good Luck!**

