Goltz On Business

by Jay Goltz

Supplier Price Increase… Are They Nuts?

I just received the newest round of supplier price increases. Given the state of the economy and the fact that we are at war, price increases might seem inappropriate or even un-American. Au contraire! It's totally American. There is nothing more American than capitalism. And there is no more important part of capitalism than being profitable.

You may say that your suppliers' profitability is not your problem. Given that it's good for a supplier to raise its prices, why is it good for you? The answer is: Price increases from suppliers are not only good for you, but they are critical for you to maintain *your* profitability.

You might be thinking, "Huh?" That doesn't make any "cents" to you, and certainly not dollars. Well, let's do the math. There are two kinds of expenses in business: fixed and variable. When you sell a framing job, whatever is left after you subtract your variable expenses (materials and labor) leaves you with a gross profit which covers your fixed expenses (rent, insurance, manager's salary, etc.). Hopefully, it is large enough to leave you with a profit.

> *Assuming that your costs have increased, how do you cover them without taking directly from your bottom line?*

Let's look at what happens over time—war or no war, bad economy or good economy. Some costs go up. For instance, real estate taxes go up, and most leases have provisions in them that the rent goes up annually based on CPI (consumer price index) or some predetermined amount. Have you gotten your insurance bill yet? Brace yourself. You are probably going to see as large of increase as you have ever seen. And utilities? Forget about it!

How about employee wages? If you think you can keep your employee wages from going up by singing the blues, think again. You'll change your tune when either your employees start to quit or they are generally disgruntled because their rent went up. I don't think this is a good strategy for keeping your workforce happy, productive, and still working for you.

Assuming that your costs have gone up, how are you going to cover them without taking them directly out of your bottom line? Simple.

It's something that should happen every year. You raise your prices. And when do you raise your prices? When your suppliers' prices go up. Voila! It's the white rabbit out of the hat. There's a nice rhythm to all of this. When you raise your prices because your suppliers' prices go up, you don't worry about your competition's prices because you know they are doing the same thing.

If the suppliers' prices haven't gone up and you just arbitrarily decide to raise your prices because your expenses have gone up, you would have to raise your margin percentages without the comfort of knowing that everyone else's prices are going up.

This could lead to depression and even hospitalization. It would be like dressing up for Halloween on October 1st. When everyone else is doing it, it's OK; when you do it by yourself, you're losing your mind. (Except, of course, if you're dressing up like Elvis; that's acceptable 365 days a year.)

As those of you who have been to my pricing classes have heard, pricing in this industry has been haphazard. A good pricing strategy is based on good cost accounting. Good cost accounting takes into account materials and direct labor costs. Unfortunately, many people in the framing industry just mark up materials without taking into account how much the labor costs.

For those of you who have been in business a long time, you might remember there was a long period where mat board prices hadn't gone up. Unfortunately, many framers put themselves in a losing situation by keeping their costs the same. They forgot that their other costs were going up.

Let me illustrate: To make things simple, let's assume that your store grosses $200,000 a year, and that your material costs are 30% (or $60,000), leaving you $140,000 to pay for all of your labor, a "framer's wage" to yourself, rent, and other expenses. At the end, you're left with a $20,000 profit, in addition to your framer's wage.

Let's assume that one year, your suppliers "held the line" on prices and didn't raise them, and you forgot about your other increased costs. Let's also assume that those costs went up 4%. Four percent times $120,000 ($140,000 less the $20,000 profit) is $4,800. Now subtract that from your next year's profit. Instead of having a $20,000 profit, you have a $15,2000 doing the exact same volume.

Did you take the loss because business is down? No, business was calculated on the exact same amount. You took the loss because you failed to stay current on your cost accounting. Whether it's the rent or moulding, most costs go up about the same percentage. When your material costs go up more, you actually end up making more money if you stick with the same mark up. The problem is when your material cost goes up less than your other costs, i.e labor, rent, etc. In that case, your fixed costs go up, but your gross profit does not. That problem usually doesn't happen though.

Over time, subtle changes in your product mix, variations in inflation, and fluctuations in labor costs can wreak havoc on your bottom line. The secret is to have a well thought out budget for the year and to monitor it on a regular basis to make sure your costs are falling according to plan.

As in a lot of areas, the difference between your personal life and your business life are drastically different. A personal budget was probably designed to help control your spending. A business budget is more of a plan. It estimates your sales volume and what your costs should be. You don't do one just to control your spending. You do it to make sure you stay on course to make money.

Making money is a good thing. Plan for it. Adjust for it. Work for it. Just don't live for it. ■