profitable

adjective \ prä-fə-tə-bəl \

1. yielding profit or financial gain:
2. yielding advantageous returns or results

How To Run A Profitable Bike Shop

By David Dekeyser

NBDA national bicycle dealers association
P2 THE NBDA PROFITABILITY PROJECT

Running a profitable retail store is the goal. It's also difficult—just consider the churn today in retail outlets. Many try; many fail. Somewhere in the middle are a majority who get by and a smaller percentage who generate solid profits. Even the definition of what's profitable can be up for debate. Partnerships, business structures, salaries, and where to apply the profits play into the profitability equation.

There's a term the NBDA uses in its *Cost Of Doing Business* Studies. It's "owners compensation and profits to total revenues." It sounds bland, but dig deeper and the calculation trends downward as the business becomes larger even as actual dollars become much higher. That calculation could be zero or even a negative number, but could also climb in some cases into the high 20% range.

It's a quick calculation: Take your tax returns and find your total income before deductions. Divide that number by gross sales. It's simple math: $1 million in sales equals $200,000 in owner's compensation and profits compared to total revenue or profits of 20 percent.

Defining profitability is difficult. Some IBDs continually invest with store remodels, upgraded tools, and many carry too much inventory by choice. Some have large payrolls due to long-tenured employees or family members. Some pay high rents or mortgages, but believe that location defines their store.

For stores grossing under $300,000, profitability is much different than a multi-location, multi-million-dollar operation. Still, basic principles remain the same. My goal is to help you improve your bottom line. I cannot stress enough that even at your current level of profitability, becoming more profitable is always possible. But sometimes maximizing profits isn't the sole goal. I make no judgment on how you define profitability, but I do want to demonstrate what's possible and how to get there. Someday you will exit the business and past profits could be a major factor in that exit. It could determine the life you live in retirement.

In this booklet I want to start first with the basics: Evaluating a location and how much space you will need. This is aimed at first-timers who may want to open a new store. But it also offers a solid review for current IBDs as they evaluate their ongoing operations. I will then discuss the following:

- **Evaluating Location**
- **Evaluating Space**
- **Margins and Pricing**
- **Vendor and Product Selection**
- **Evaluating and Experimenting With Product Mix**
- **Always Negotiate in Your Best Interest**
- **Eliminate Emotion When Purchasing Products**
- **Inventory Part I: The Right Amount and the Math**
- **Inventory Part II: Inventory Optimization and Purchasing**
- **Hidden Hurdles to Avoid**

Evaluating Location

The second most significant expense behind payroll is often occupancy. As a percentage of gross sales, the target for occupancy expense is generally around 10%, preferably less. But a percentage point or two adds up. For example, if you have an "average" size store with $1 million in annual sales, a 2% occupancy expense reduction, invested monthly in a mutual fund over ten years, could add up to $300,000 based upon an 8% return rate. That 2% could also buy inventory, pay down debt, and a host of other things. A mistake many make is too large a location or one too expensive. Or both. Commercial property prices tend to rise over time, so if you find a spot to purchase, you permanently lock in the expense and build equity. If you can afford to buy, it usually makes sense. If not, then be careful negotiating a lease.

Evaluating Space

Determine square footage by extrapolating a number based on estimated sales per square foot of selling space. This number can vary, but in your projections try to aim for something close to $400 per selling-square-foot. That should pay for overall square footage. So, what is "selling-square-feet?" It's simply retail floor space, excluding restrooms, storage, repair area, and most office space. Somewhere around 30% to 35% of your square footage will be dedicated to supporting space. Let's look at an average size store with $1 million in sales with an average sales per square foot of $325. How much space would you need? About 3,100 square feet of selling space or roughly 5,000 total square feet overall.

A caution: There are so many variables based on regional rents that some areas allow for more space and others far less; that adds significant variance to the sales-per-square foot equation. Still, having too much space—even if relatively inexpensive—creates a tendency to fill that space. And that could wreak havoc on inventory dollars you must carry and subsequent turns. On the other hand, in areas with high rent, you tend to go small, focus on turns, become creative with selling space and look for less expensive ways to store inventory.

It seems more prudent to me to burst at the seam and outgrow a location versus trying to grow into it, which is a significant risk. Remember, my example of 5,000 square feet is a middle of the road number. Go bigger and you risk adding too much inventory; go smaller and you must focus on more turns and storage issues.

In real estate, it's "Location, Location, Location." Everyone, of course, wants an "A" location. But it's expensive. Perhaps a "B" location is good enough. Bicycle stores are generally destination businesses and seldom require an "A" location. In fact, it may be a hindrance to be in major shopping area and become lost in the retail crowd. Test rides is also a significant consideration, along with the ability to rent bikes if you wish to tap into that market.

In real estate, it's "Location, Location, Location." Everyone, of course, wants an "A" location. But it's expensive. Perhaps a "B" location is good enough. Bicycle stores are generally destination businesses and seldom require an "A" location.

Having managed or owned retail bicycle businesses in at least seven locations during my career, I can say without hesitation that being where people ride is a huge benefit. It's tough to quantify, but when we moved our shop from a strip mall to a freestanding store on a bike path, sales quickly increased.

So, what to do? Big store for the wow factor in an "A" location? It could work, but I urge caution in going too big or too pricey. It could be better to build up to that, particularly if starting a new business. On the other hand, you could go small. But too small and too conservative may hurt potential sales and future growth. The answer often lies in finding a balance. I offered a formula for 5,000 square feet as an example. Calculate local variables in expenses metered against your risk assessment, and then analyze local demographics to get the best possible location, then add in the potential to ride nearby.

Margins And Pricing

Margin. One of the most used words when discussing retail. Margins are generally regarded as too low, getting lower, hard to maintain, and that retailers are at the mercy of suppliers. Then there's issues with internet and MAP pricing. However, some retailers seem to thrive because they negotiate for the best pricing, while others selling the same products struggle.

While margins are critical, the reality is that so many other things can weigh on profitability like controlling expenses, avoiding discounting and increasing turns. But let's get back to margins. Evaluating product margins must happen from the standpoint of what you pocket once a product is sold, or what is referred to as "realized margin." This concept is often overlooked if you fail to use financial tools to make these evaluations. Two products with different wholesale margins may, for many reasons, have flip-flopped "realized margins." Things like color, quality, sales staff buy-in, and other factors can affect whether an item is sold quickly at full price/margin. An underperforming item is never a good buy if it ends up languishing on shelves and later discounted at a lower "realized margin."

Margins at successful stores goes hand-in-hand with pricing. There's an art to pricing items and services. There are many price-sensitive items that you can generally price at the retail price a supplier sets. These items most likely are bikes and other high-profile items. However, be careful and avoid falling into the trap of thinking that items with acceptable margins on paper are profoundly affected by what it sells for online.

You can always find items that sell at or below wholesale prices if you search the internet for the best price. But you can still sell that item at full margin. I know from personal experience that items susceptible to discounting online can sell at full price in your store. This is a conversation about psychology—yours and your customers—that can derail profits if you fail to experiment with pricing and fail to manage your own biases.

Never blindly assume you are unable to command full margin for an item until you try. The same is true for your service center where you can regain margin lost from elsewhere. If you are struggling with uncovering hidden margin opportunities, please visit my P2 consulting page to learn how I can help. A few easy examples show how to charge for services that customers seldom expect to get free.

When selling a bike, should you charge to install additional accessories or component swaps? The answer is "yes." Yet many store owners and staff argue that it's impossible. However, the store across town is quietly doing just that with no problems. You won't know if something works until you try it, but try it with conviction.

Running a profitable shop is not as simple as it may appear on the surface. When it comes to margins and pricing, analyze your business and dig deeper into your potential profitability. Never assume that margins are too low. You have ultimate say in margin maintenance and pricing strategies. Margins and pricing are a critical part of success. Still, these are not simple issues and some think they are. With serious attention to details, you will soon realize how much control you have over your business.

Now let's discuss inventory issues—how to determine a vendor and the correct amount of inventory, and how to optimize that inventory. Later, I will dive into other topics related to store operation, effect on profits, and adjustments for financial gain. I also want to install guardrails on certain expenses and maximize profits regarding service and pricing. I will also cover some basic best practices that every retailer should follow. Get out your calculator and sharpen your pencils!

Vendor And Product Selection

Why are you selling specific products and brands? Were they simply the brands available, brands you chose because you endorse them personally, or brands that offer a competitive product that returns sustainable margins? Whatever the reason, always try to optimize product selection. While it may seem impossible if you are in a strong partnership with a primary supplier, you should regularly look at other options if for no other reason than to validate your current lines.

Merely looking at price lists is not the only criteria to judge one vendor over another. It's critical to look at payment terms and product availability when you need to replenish. Also examine freight minimums and the ability to receive products from several warehouses to attain freight discounts. On a somewhat subjective scale, consider whether you can sell a product at the same or better sell-through velocity as your current choices. But before making a change, gather as much intel as possible and avoid unnecessary surprises. Call a few dealers out of your area to get a sampling of opinions. It's also essential to know what else is available so you can benefit from that information when negotiating buys. And you should continually be negotiating.

Why are you selling specific products and brands? Were they simply the brands available, brands you chose because you endorse them personally, or brands that offer a competitive product that returns sustainable margins?

Evaluating and Experimenting With Product Mix

Constant evaluation and experimentation with the product mix are vital. Always tinker with product mix to validate choices and to avoid becoming stale. What was hot a few years ago may have cooled. You also may have missed how sales of that product have slowed. An example is cycle computers. Carrying that item was always a no brainer, but they have slowly lost traction to cell phone holders and GPS devices. Retailers may add other items to their product mix without realizing that these new products are replacing older products or, at the least, lessening obsolescent inventory.

You also want to experiment with pricing on some items to verify the products' worth. Too often retailers settle for MSRP or MAP pricing on items that are not price-sensitive and could be sold at higher margins. Again, experiment continuously. We slowly replaced our best-selling bottle cages with a very competitive and incredibly similar model that delivered twice the profit, which on high-volume items can add up quickly.

You may want to pare down color selections on certain items until finding a happy medium. Now go deeper on fewer SKUs while maintaining sales. Apply this to product selection as well. You may not need an array of choices when a good, better, best approach may work well enough. Or even try "this is the only model we carry" approach which, for the right item, can be best. The "right" amount of selection can vary from store to store, so fiddle to find the right balance.

Always Negotiate In Your Best Interest

Sadly, many IBDs are defined solely on the product and brands they carry. As a result, they may overlook or avoid opportunities that could be profitable. While I am well aware of the "quotas" many retailers must contend with due to supplier programs and demands, always negotiate in your best interest. You will want to use your sales data to back up your negotiations. If nothing else, never become complacent with vendors and with product selections.

Vendor and product mix can impact supply, turns, and profits.

When you pick the right products and mix, it's good for the vendor and it makes the experience for you and your customers much better. Many retailers, even successful ones, can become complacent. There are many ways to work on your store's profitability, operational efficiencies, staff training, and other aspects, but inferior product and vendor selection makes for an uphill battle. Things change over time; make sure you do too.

With product selection, be careful to avoid knee jerk decisions based on emotion.

Eliminate Emotion When Buying Products

With product selection, be careful to avoid knee jerk decisions based on emotion. I can think of several products where we made excellent margins and experienced fast sell-through. These brands were also sold through online channels at or below wholesale pricing. The obvious decision, at the time, was to kick these bad actors to the curb. Next season, we struggled with replacements that lacked the brand name, quality, and sometimes availability of past bestsellers. Somewhat begrudgingly, to see how customers reacted, we went back to those products, always fearful that we would be called out for overpricing them.

In the dark recesses of internet forums and Facebook pages, the word is you could suffer the wrath of showrooming customers within minutes of those products hitting the floor. And worse yet, supporting these brands did not help us. While this may be the case with certain products, I can think of two examples of selling these products at full margin with no blowback and, even better, selling far more of those products than their replacements.

The moral of the story with vendor and product selection is to validate your decisions on the sales floor. Would you rather be right or profitable? Developing strong vendor relationships can be an incredible help to your success, but trust requires verification. Of course, it may be necessary to sell some products to stay in your vendor's good graces, but only if they deliver tremendous value across a wide swath of your business.

Inventory–Part 1

Every retailer needs inventory, but very few have the right amount or the right mix. And it's difficult to get this essential parameter of a successful business right. In my experience, here's some reasons why.

- **Fear of lost sales.**
- **A desire to have something for everybody.**
- **Vendor requirements.**
- **Lure of long dating in hope of selling products before bills come due.**
- **Many IBDs are cyclists who relish cool inventory.**
- **Some store can't sell some brands profitably.**
- **Ego may dictate certain purchases, especially bicycles.**

Be aware of your ego. It's hard to admit that you may be incapable of selling a certain category or price point for bikes or accessories—at least profitably. This often leads to discounting and an enormous amount of time spent on unprofitable areas of the business just to maintain a certain appearance. If you want to know one of the secrets of a profitable shop, look at its inventory. The owner will have the right amount, in the right categories.

The Right Amount

So how do you unravel the seemingly dark mystery of how much inventory is the right amount? It's simple. You want enough so you can turn that inventory multiple times. Based on my own experience and that of retailers I admire, plus reviewing the financials from shops performing either well or badly, there are some dead giveaways. First, our industry loves the idea of two turns yet many shops fail to do even that. I believe that IBDs need a target goal of 3- to 3.5-turns. Some do better, some don't. But that's a realistic number to aim for.

The Math

This is where being careful is important. I've spoken with some longtime retailers who pay their bills on time and seem to know their business, but end up stumbling here. First, let's look at gross sales. I like to use $1 million as a round number for examples of gross sales. It also seems to be a number for what "average" stores do annually. Most retailers don't enter a cost for labor, which is correct. Your cost for labor is an expense and is already accounted for. Let's also assume that labor accounts for 10% of gross sales. Remove this amount from the equation.

This means we now have $900,000 in gross sales and we need inventory to produce that amount. Let's then assume that sales of inventoried products return a 38% margin which, sadly, is oftentimes to high of an assumption. If you know your gross margin, and you should, use that otherwise 38% —it's a sound generalized number once labor is removed. If your margin is higher, then you get a number that will deliver more turns—a good thing. I use a free app called iMargin. These numbers will look like this:

Cost equals inventory cost for the year, then divide by the number of turns desired.

Divide the "cost" by three. That equals $186,000 at three turns; $159,428 at 3.5; and so on. There are retailers achieving 4 and 5 turns and some, unfortunately, fewer than one. Plug in your numbers and see what you're doing. Most likely you're carrying a bit too much inventory. If carrying more than advised, you could be struggling with cash flow issues. This is one of the first key performance indicators I dig into when consulting with a client.

Inventory—Part 2

In Inventory—Part I, I presented a straightforward way of determining how much inventory you should carry. Now I will cover how to better manage cash flow and how to enjoy the benefits of profitability. This can be tedious. I will fine-tune the dollar amounts of those 3-to-3.5 turns and how to get more granular with that number. If this seems basic, that's good. If this is confusing, then pay attention—it's critical to success, which is another word for profitability!

First, I assume that your point-of-sale system is accurate. If not, then you have some work to do. Garbage in, garbage out. With confidence in your data, and assuming that you most likely have more than 100 categories and subcategories, let's begin some detailed analysis.

The trick with inventory optimization is to treat each category as unique. Some items allow an incredible number of turns. Parts and accessories lend themselves to this. Most shops place one or two parts orders weekly and this is where diligence pays off. Why carry several months inventories for items that turn weekly or bi-weekly? More turns allow you to hit freight allowance discounts and keep more dollars in categories that naturally have fewer turns. When I talk about turns, some items may turn less than goal, while others may turn 10 or 15 times.

From a cash-flow standpoint, "just in time" is always the goal. I know some disagree with high turns since inventory arrives constantly. Still, to become inventoried correctly, it's safer in my opinion. As you develop better inventory controls, you can more confidently increase ordered quantities, always staying within your budget of inventory dollars.

As you become more knowledgeable about inventory, some vendors and sales reps may object to your use of data in decision making. Use data to disarm them. Negotiate from the position that improving your metrics is the goal and that it can enhance the vendor relationship. On the other hand, if based on your data, a vendor can't fulfill your needs, then you will need to look elsewhere. Sales reps have a job that, at times, can be at odds with your business health. Being data-aware is a fine line, but you want partners who trust that you're doing what is best for your business and theirs.

Buying inventory is a personal process for many retailers. Certain brands, product categories, and even colors can play a major role in what ends up on a shop's sales floor. The constant use of data to drive decisions will also disarm staff from making costly mistakes. One critical thought to remember is that data is just another way of listening to what your customers want. It's evident when products sit until discounted, while others turn circles around slow movers. When you fail to act on data, that's a serious problem. The reality is many shops make the same mistakes year after year, while the data tells them another story.

Inventory purchasing need not be a mystical process. Using the formula I outlined in Part One applied across all categories, ensures that you have the correct amount. Apply some artful foresight when you feel a specific category needs attention. Perhaps it needs bulking up to increase sales. Or maybe a product shortage looms. Conversely, a category may need to be cutback due to infrequent turns. Data, and knowing any personal bias, improves profits and loosens cash flow. I'm sure many of you have stood on the sales floor and wished you could convert slow-moving merchandise to cash. While discounting is generally frowned upon, when an item appears stale or can't be sold without an incentive, decide quickly and convert them to cash. You don't want to operate a museum!

Running a profitable shop is not rocket science. However, it's challenging if you fail to budget inventory purchases at the category level, especially after extracting sound sales data. Interpreting data accurately helps decide future buys, and continually analyzing whether products on the floor are selling through, is the best option for profits.

Hidden Hurdles To Avoid

Sometimes the biggest hidden hurdle in your business is you and the beliefs you have about how your business operates and what your customers perceive your business to be. Always work toward the goal of becoming more profitable, even if that means acknowledging when your preconceived notions are wrong. This is a major problem for many struggling IBDs.

Does your store align with customer demographics?

This is quite common in my experience with struggling stores. Simply put, owners are trying to become the store they aspire to be in the face of contradictory evidence. This is most common when owners believe they can sell higher-end products than their market or customers want, or selling a category that appeals to them personally but customers reject them.

Do you avoid personal bias when choosing inventory?

This is straightforward. You like things you use, yet they fail to sell for various reasons. You may like certain brands, models or categories of products, yet your customers are not buying. Still, you persist in a cycle of ordering and then discounting these items.

Do customers reject higher prices or service charges?

I've heard "we can't" so many times when it comes to pricing. It's an IBD's perception of what the market will bear. The shop owner who feels this way may be right, but I will go out on a limb and say they seldom if ever experiment with different pricing strategies to see if there is pushback. If there is pushback, determining how much is crucial. Humans seem to be averse to criticism and even one negative experience may produce enough ammo to revert, even in the face of sales transactions that garner no reaction to higher pricing.

Will a percentage sales increase solve financial strains?

This is a difficult thought process to overcome. I've heard many retailers describe the perfect percentage sales increase that will free them from stress. The problem is that unless a concerted effort is made to reduce expenses and increase margins, the extra costs associated with more sales is seldom a panacea. Often an immediate expense reduction is what's needed to right the ship. That's why one of the first reactions to stagnant or slowing sales is to reduce payroll. It's an immediate change to the financials. Less extreme measures include pricing strategy solutions and a more intense analysis of key metrics. There are many quick and healthy solutions to tight cashflow than simply raising sales volume.

These issues can be resolved by diligent best practices in the reporting of inventory and sales; that along with margin maintenance and stocking items that turn quickly. Also use financial reports to verify data-driven decisions versus emotional or ego-based decisions.

Please review the NBDA's programs such as P2 Consult with myself or the peer to peer, P2 groups. You can learn from excellent retailers how to elevate your business and increase profits following best practices. Some retailers argue that some of these practices will suck the soul out of their business by becoming too business-like. On the other hand, I would counter that nothing could be better than being more profitable since you get to choose what to do with those profits. Profits should drive your decisions. You can operate a worthwhile business that delivers the lifestyle you desire and still benefit the greater community as well.