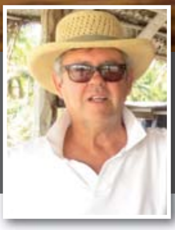
Make more PROFIT without seeing more patients

Purchase right - Improve your GP - Improve your Net



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Chris Faul

"One needs to have a good overall picture of what is available in the market and this demands effort and research."

Pre-amble

A sure way to jeopardise a business is to neglect the gross profit. Likewise, the easiest way to improve your business is to enhance the gross profit. In order to manage the gross profit one must understand the mechanics of the gross profit percentage. Adopting a sound purchasing strategy can do wonders for your bottom line. This is how you can make more profit without seeing more patients.

Mechanics of the gross profit percentage

It is vital to understand the mechanics of the gross profit percentage as a management tool. Firstly, we must distinguish between gross profit and gross profit percentage. Gross profit is simply the difference between the cost we buy our products for and what we sell them for. The final net profit that we take home is arrived at, once we subtract all our expenses from the gross profit.

The Gross Profit formula looks like this:

Gross profit = Turnover – Purchases or Cost of Sales

Note, in optometry, part of our sales is made up of consultations, which do not have a cost of sales. The cost of consultations is the optometrist's salary and is recorded as an expense in the income statement. This means, that the amount coming in from consultations will boost your gross profit.

The valuable tool to manage this relationship between what we pay for goods and how much profit we ultimately make, is the *Gross Profit Percentage*. Mark-ups will of course differ over different product groups; therefore, it is much more effective to use the GP% as a management tool to monitor the actual gross profit we make across the board. It can be seen as the average percentage of gross profit we make.

The gross profit percentage formula:

Gross profit percentage (GP%) = gross profit divided by selling price x 100

Or

The mark-up divided by the selling price

*Buy a frame for **R 70** and mark it up by **R 140** to sell for **R 210***

140/210 x 100 = **GP 67%.**

From a management point of view, we want one number that represents the GP% of all the product we sell.

Note that the GP% is only ever influenced by factors, which can have an influence on the purchase price or selling price of product. It is not affected by your general expenses such as salaries, rent or telephone bills.

Here are the factors, which could influence the GP%:

1. **Purchase price**
2. **Selling price** (mark up)
3. **Discounts received** – a discount from your supplier obviously reduces the cost price.
4. **Discount given** – reduces the selling price
5. **Shrinkage** (stealing)
6. **Re-makes** – using another pair of lenses or frame effectively raises the cost you paid for stock.
7. **Stock losses** – makes your stock (cost price) more expensive
8. **Redundant stock** – same as above.
9. **Undisclosed income** – not declaring all your sales is effectively eroding your sales or selling price. This is obviously done to lighten the tax burden and is illegal. From the SARS point of view, a low GP% will always raise suspicion of undisclosed income.
10. **Product mix** – selling expensive product with a lower mark-up as opposed to product with a higher mark-up.
11. **Consultations** – undercharging or not doing enough consulations, relative to the turnover can decrease the GP%.

Rule of Thumb

An optometric practice should achieve a GP% of 67% in order to make a net profit of at least 20%. If you multiply cost price of a frame by three (mark up by 200%) it will give you a GP% of 67%.

How it impacts net profit

Here is an example of how GP% can impact on your net profit.

Table 1:

GP%	**67%**
Sales	R 250 000 per month
Cost of sales	R 82 500 (what you pay for your frames , lenses etc)
Gross profit	R 167 500
Total expenses	R 117 500
Net Profit	R 50 000 **(20% of turn over)**

Table 2:

GP%	**55%**
Sales	R 250 000
Cost of sales	R 112 500
Gross Profit	R 137 500
Total expenses	R 117 500
Net Profit	R 20 000 **(8% of turn over)**

From the above example it can be seen that the poor GP% can cost the practice R 30 000 per month or R 360 000 net profit over one year of trading. This can be avoided.

Another example, if 10% discount is given on all sales in Table 1, the sales will drop to R 225 000 and result in a Gross profit of R142 500 and a net profit of R 25 000. In this case we reduced our selling price by giving a 10% discount which effectively halved the net profit.

How to manage your GP%

The only effective way to manage your GP% is by having the right information at the right time. It is a fruitless exercise to try to manage it year on year. You need real time information in order to identify the problem area and then correct it immediately. This means that your management accounts must be ready by the 10th of the month. As soon as you see your GP% had fallen below par, you need to place it under scrutiny and it must be monitored on a weekly basis. If you employ the outdated method of looking at results on an annual basis, the best you can do is to hold a post mortem and perhaps say a prayer, only to repeat the exercise the following year! By getting up to date management accounts, one can immediately see if the GP% is not in line with the target or benchmark and then consider all the factors that can influence it to find the problem. The biggest culprit that erodes a GP% is impulse buying or hand to mouth buying of frames and other products as the need arises.

Impulse buying

Impulse buying occurs when there is no purchasing strategy in place. Buying six frames here and twelve frames there can really mess up the GP% because your discount is likely to be minimal. Emotional buying, based on a friendship with the sales representative, can become very costly. Effective buying requires a well constructed plan which will consider your cash flow and annual buying demand.

Purchasing Strategy

There are only two things that should move the price you pay for frames, lenses and contact lenses. They are:

- **how much you buy and**
- **when can you pay**

How much you buy

For a start, calculate from previous records, how many frames you can sell in a year. Your practice management software should tell you this very quickly. Go to a supplier who has the biggest range of frames that suits your market and negotiate a price for an order of this size if you pay cash on delivery. This will give you an indication of what is achievable. Remember, the discount you get will go straight to your bottom line. It won't be practical to buy all your frames from one supplier but this will give you the inspiration you need. If on your own you can't impress the supplier with the size of your order, you need to team up with colleagues to beef it up. Here are some things to consider to increase the size of your order.

1. **Team up in a group with other optometrists**
2. **Buy in bulk twice a year**
3. **Build stronger relationships with fewer suppliers**
4. **Go big on "safe styles" by buying for two or three years**
5. **Join a buying group**

Buying Groups

Buying groups have been the order of the day in the USA for many decades, but in the past, not so common in South Africa. However, there are some good options available these days. It was really designed to meet the needs of the independent optometrist who will struggle to dictate price with volume buying. As a rule, there is no cost to the optometrist to belong to a buying group and apart from price, there are several other benefits such as training and promotions on offer.

Finding the cash

The saving in bulk buying will be much more than the interest you pay on your over draft, especially at the current rate. Getting an overdraft specifically for your buying programme could be a starting point.

In the first year or two you need to put a repayment plan together to repay the bank. In other words, don't go and spend the extra profit you make in GP% on holidays and golf clubs because you will end up in deep trouble. Remember, you will be using the monthly average you would normally use to pay your frame creditors – the cash flow should be there. Another source of cash is to curtail your own drawings for a year or two to get ahead with a positive cash flow. Once you are able to service your frame purchases on a cash basis you will get an exponential return indefinitely!

Put in the effort and build your reputation

Most frame sellers will find that at least once a year a Rand is better to have than a frame. This is when suppliers will sell-out frame stock, to make space for new models. Opportunities crop up when excellent bulk purchases can be made. It is the buyer with cash in the hand that will be able to take advantage of these opportunities. Frame merchants won't offer these deals to you if you have a reputation as a poor payer. Moreover, a sound purchasing strategy demands time and effort. One needs to have a good overall picture of what is available in the market and this demands effort and research.

What are the risks?

There is risk in bulk buying, but if one sticks to the safe styles, this can be minimised. It is also critical that you keep your accounting up to date. Get professional help if you must and set up your buying game plan on a spreadsheet and monitor the cash flow. Should your turn over implode for whatever reason, your purchasing strategy would go for a loop, but so would everything else in the business.

Conclusion

Cost of product is influenced by how much you buy and how soon you can pay. These are the two factors to focus on in formulating a purchasing strategy. Find the bulk and find the cash. The reward can be as much as 30% saving on purchases by way of discounts. By controlling your GP%, you can make more money without getting more feet through the door, but in the final analysis it can only happen if you have real time financial information available. You need the right information, in the right format, at the right time. Many practitioners fall in to the trap of using their suppliers as bankers by not paying their bills but in the long run they really end up being the losers.