

Factors to Consider in Management of Nursery Profitability[®]

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The theory behind managing a business is very simple – it's implementing that theory that can become as complex or as simple as you like. In basic terms, business owners and managers have four key aspects they must focus on, and these are sales, profit, assets, and cash, and to focus on these you need to know your "numbers," in other words you need data on what is happening in your business.

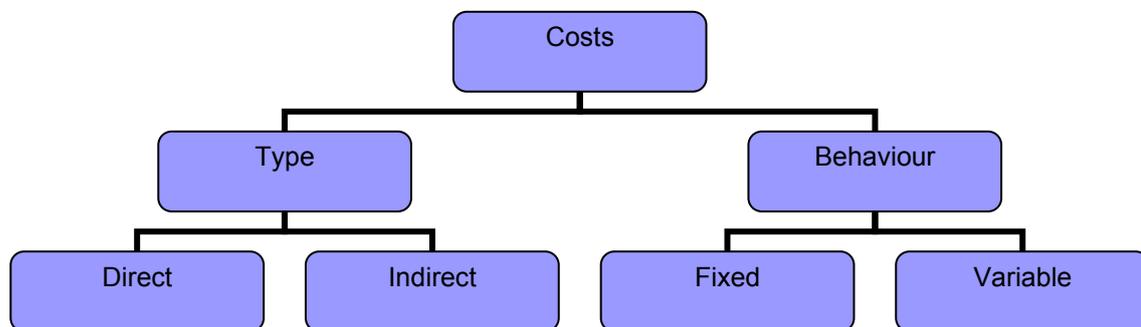
Let's start with "profit," in my view the most important of them all. The respected management thinker Peter Drucker famously said that "the purpose of a business is to create a profit" – fairly obvious you might think, but how often do you think of "profit" in your business in terms of clear figures and targets? Profits are vital and without them a business cannot develop and prosper. Depending upon how you have structured your business, your profits might form the basis of how much you earn from the enterprise, but irrespective of that, profits can be a just reward for your hard work and the risks that you have taken.

Profits also give you options. In addition to rewarding the major stakeholders in an enterprise (owners, shareholders, employees, etc.) profits can also be used to reinvest back into the business whether that be in a new potting machine, a new delivery vehicle, or a long term capital project such as building new propagation facilities. The greater your profits, the more options you have and of course the less need there is to finance capital projects through bank borrowings. The cheapest way to finance a development is from re-investing profits back into the business, particularly now that stock market returns are poor and interest rates on deposit accounts are pitifully low.

What should your level of profits be? This is a difficult question to answer but perhaps the best way to identify if your profit is acceptable is to benchmark your financial performance against other similar enterprises. In my view if you are a small business owner you should be making enough profit to reward yourself in excess of the rewards offered by a conventional job – simply because you are probably working longer hours, under greater stress, and taking more risks.

COSTS

To maximise profit we need to first understand our costs. They can be classified by "type" and by "behaviour" (see diagram).



On a nursery, a direct cost is any that is directly incurred in the production of plants whereas an indirect cost is an expense incurred which does not form part of the direct cost

of producing plants – typically this would be insurance, rent, rates, and so on and these costs are referred to as “overheads”.

Costs can also be classified as “fixed” or “variable.” Fixed costs are those paid irrespective of the amount of plants you produce (such as rent) and would typically be an overhead cost. Variable costs, on the other hand, do vary with the level of activity. For example fuel for the delivery vehicle would be a variable cost because the greater your sales are, the more deliveries you make and therefore you incur more fuel costs.

If we want to make more money we need to identify all our costs, measure them and monitor them.

PROFITABILITY

Once we understand costs we can think about gross profit – which is the difference between your sales income (excluding VAT) and the cost of the goods sold. On a nursery the “cost of goods” figure includes all the direct costs involved in producing plants (young plants, pots, compost) and may include some variable costs (water, fuel).

Net profit however is the profit you have left after you have deducted all your overheads (typically these are fixed costs), operating costs, bank and interest charges, and depreciation from your gross profit figure. These simple definitions can be complicated further by considering other terms such as “operating profits,” but gross and net profit are the most important figures to track and control.

Armed with an understanding of the difference between gross and net profit figures, the most important question is how can you increase your profits?

It’s a bit like going on a weight-loss programme. There, the first thing you do is to measure and weigh yourself and then set a target for weight loss. It’s the same principle with a business. You will make more money when you implement some measurements and then monitor and manage those measurements.

What should you measure? The potential list is endless and for details you should take advice from your accountant. You can however start simple, and typically this means measuring sales and all your direct inputs. If you run a nursery this means direct labour, pots, compost, and so on. Once you measure your sales and your inputs you can then derive a gross profit figure – which again should be measured against the figure for previous years or months and, if possible, against other businesses regarded as good performers in your particular sector. Overheads should also be measured, as by calculating these you can then calculate your net profit, and try to focus on your largest overheads if you are aiming for reductions.

To really see an increase in net profit, however, my suggestion is to focus on your gross profit – because the larger this is the larger will be your net profit.

How then can you increase your gross profit? There are five ways to achieve an increase in gross profit:

- 1) Increase your total sales. However this means growing more plants. Your inputs or cost of goods purchased will therefore also increase, but the increase in the cash amount of gross profit will be larger.
- 2) Increase your prices. However you will need to make sure that by doing so you do not make yourself uncompetitive. If your inputs remain at the same price and you increase your selling price, the increase will go straight on the bottom line.
- 3) Decrease how much you pay for your inputs. Any discount you negotiate off your inputs will again go straight on to the bottom line.
- 4) Reduce your wastage. On a nursery this means increasing crop yields, using labour more efficiently, reducing water use, etc.
- 5) Reduce production of your under-performers. This means identifying and decreasing production or sales of those product lines that are very slow or less profitable sellers – particularly if you have limited resources which should be focused on your better performers.

ASSETS

Airline companies know that their expensive aeroplanes only make money when they are flying. It's the same with your assets such as glasshouses or delivery vehicles – greenhouses are only making money when full of growing crops; delivery vehicles only earn their keep when on the road and full of stock for your customers. Your assets have to be managed well and they have to be used. Maintain them, invest in them, and use them.

CASH CONTROL

Having maximised sales, profits, and assets you should be left with a healthy amount of cash in your bank. Sadly this is not always so. Poor cash and credit control has led to the collapse of a surprising number of businesses. Money in the bank is the life blood of a business, without it any business will fail no matter how good sales and gross profits are, so knowing and monitoring how much you owe and are owed is vitally important as is implementing cash flow forecasts. How many business owners know their bank balance on a daily or even weekly basis? In today's world of internet banking there really is no excuse not to.

CONCLUSION

Focusing on profit, sales, assets, and cash evidently then requires measurements and monitoring, so you need to establish a method for recording those measurements on a regular basis. A minimum recommendation is to have monthly reporting – any less frequent than this and it will be too long before you know if anything is going wrong and then it will be too late to take evasive action. Having agreed on the reporting time, the next stage is to set targets for these measurements. Sensible targets do work, that's why top athletes use targets to improve their performance.

Targets and figures also have another positive effect. They can help us see the wider picture and make us step outside the day to day running of a business in order to focus on its financial performance.

