

Managing *a* Small Business

Alberta Economic Development and Tourism

Foreword

Managing a Small Business is designed to help you manage your small business effectively.

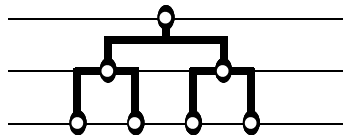
It is one in a series of guides which has been developed and published by Alberta Economic Development and Tourism (ED&T) to assist small business owner/operators in Alberta. The other guides are the following:

- Starting a Small Business
- Starting a Home-Based Business
- Marketing for Small Business
- Financial Planning for Small Business
- Recordkeeping for Small Business

These publications are available at all ED&T offices listed in the back of this publication.

After reading this guide and before implementing a management plan for your small business, you may wish to seek the advice of an accountant, lawyer, business mentor, business management consultant, government agency, educational institution, business or other association suitable to your business needs.

Various federal, provincial and municipal agencies also provide counselling and advice on managing a small business. Please check for services in your area.



This Small Business Series is supported by Western Economic Diversification Canada (WD), the federal department responsible for leading and coordinating federal economic activities in western Canada. The business guides are available through WD's network of business services listed in the back of this publication.

Alberta Treasury Branches has also supported the production of this guide series. The guides are available at any of the Treasury Branch locations listed in the back of this publication.

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Introduction: Managing Your Business

To manage means to plan, to direct, and to control. To manage a successful small business you need to combine reliable information, sound approaches, good business instincts, and previous experience in order to effectively direct and control your business.

You need to start with a clear understanding of all areas of your business operations. In the final analysis, only you can ensure that all tasks are carried out and that areas of strength and weakness are noted. This will enable you to exploit strengths and to reduce or eliminate weaknesses.

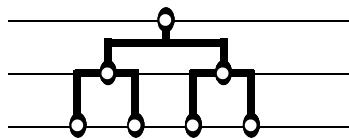
Once your small business reaches a certain size, you will benefit by delegating responsibilities and authority and by working with the suggestions of your management team and employees. You will also have to decide what management functions, such as bookkeeping or marketing, will be contracted to outside resources.

Your management approach will depend on your personal style and the current needs of the business. There are many management books, articles, and training materials available in libraries and bookstores. These can help you assess your own management skills and increase your awareness of successful approaches to managing a small business.

In this business guide, we will cover many important aspects of operating and managing a small business. The guide also includes information on how to stay in business through both good and difficult times.

In most cases, management considerations are the same for small retail, service, and manufacturing businesses. Where there are unique differences, these are outlined in separate chapters.

This publication should not be read in isolation. Key management areas of marketing, recordkeeping, and financial planning are covered in separate guides for small business which are also published and distributed by ED&T.



ONE: Managing your Time

Given that you are responsible for a wide range of responsibilities and activities, learning to effectively manage yourself and your time is an ongoing challenge and one that is critical to your long-term satisfaction running your own business.

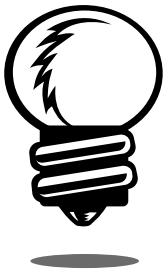
The rewards for effective time management are considerable. These include increased productivity, an increased sense of accomplishment, and reduced stress and pressure.

Learning to treat time as a valuable resource may mean more *delegation* of responsibilities. For example, spending your time on administrative and bookkeeping activities may not be the best use of your talent if they drain you of the time or energy required for key management tasks critical to the success of your business.

Delegating responsibility also helps prepare others to take over key management tasks, when necessary. You should have a plan in place for how the business will be managed if you are unable to be there due to sickness or injury.

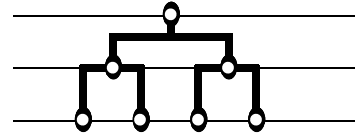
Small business people, like most other people, often have an unreal idea of how they spend their work hours. Before you can use your time more effectively, you must understand how you use time now. Keep a log sheet (for a week or so) to help you establish how much time you spend on different activities. Then decide if you're spending your time the way you want to. If you aren't, decide on a way to allocate your time to match your business priorities.

The following basic time management strategies may help you spend your work time more effectively:



1. Practise setting priorities and working towards them on a daily and a weekly basis. Separate tasks according to these simple categories: Must Be Done; Should Be Done; Could Be Done.
2. Pick one activity or time of day in which you procrastinate, and then work at changing this behavior.
3. Give yourself deadlines, and work at meeting them.
4. Try to develop the habit of handling things once and then moving on to other tasks.
5. Try to do the most difficult or intimidating parts of a job first.
6. Divide your work into blocks that you can realistically finish in the time you have available. This will set you up for success and give you a sense of accomplishment.
7. Don't be paralyzed by your desire for perfection, excellence, or the "right" way of doing something. Get on with the job, and the right way will usually come to you.
8. Set up a new routine, one that clearly contrasts with the one you're trying to change.

9. Take breaks when you've scheduled them. Taking regularly-scheduled breaks can improve your overall productivity.
10. Learn to say no when necessary. Don't waste time feeling guilty or anxious about what you can't do.
11. Don't become too rigid in your approach to time management. A little flexibility will keep you open to opportunities.



Two: Managing Employees

Hiring and keeping good employees is one of the most crucial management tasks for small (and large) businesses. Good employees can be your company's greatest asset.

In a small retail or service business, new and repeat sales are directly related to how well your employees look after the needs of your customers. In a small manufacturing business, the quality of your products and the efficiency with which you produce them is directly related to the commitment and competence of your employees. See *Company Image and Customer Relations* in chapter *Three* of *Marketing for Small Business* for further discussion.

Human Resource Planning

To make sure your business is run as efficiently as possible, decide how many employees, with what combination of skills, the business requires. Most small businesses start out with the minimum number of core employees needed to get the business up and running, and then their staff complement expands as demand for their products and services increases.

Take time to plan your current and future human resource requirements. This will ensure that, as your company grows and demand increases, you will have quality, trained staff available to meet the needs of your customers.

When assessing the number of employees you require, consider the following:

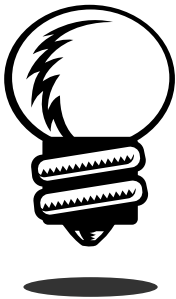
1. Do you require a small core group of full-time employees, plus some part-time workers for peak periods?
2. Are your peak business periods seasonal, and should you hire staff accordingly?
3. Is it more efficient to contract out certain aspects of your business, such as bookkeeping and accounting, rather than hiring employees to do the work or doing the work yourself?



4. Can you fill irregular or unexpected work requirements by hiring occasional workers on contract?
5. In addition to wages, a new employee results in costs related to recruitment advertising and interviewing, benefits, training, expenses, administration, and recordkeeping. Rather than hiring a new employee, is there an alternative, less time-consuming, and less expensive way of getting the job done?
6. Will hiring new employees be of net financial benefit to your business?

Recruiting and Hiring New Employees

Although hiring new employees can be a time-consuming task, it is time well spent if you acquire quality staff. Ways of finding potential new employees include:



- Your current applications file
- Recommendations from current employees, family, and friends
- Trade and industrial associations
- Schools and teachers
- Commercial employment agencies
- Canada Manpower Centres
- Customers and suppliers
- Newspaper (and other forms of) advertising

Whenever possible, tell your present employees about job vacancies first. Good, conscientious workers often have friends of similar character and ability.

Before going outside your business to fill a supervisory post, consider present employees who are capable and deserving of promotion. Promoting from within provides incentive for employees and is good for employee/employer relations.

Newspaper advertising is a common way of recruiting new employees. Display ads are used for specialized jobs, whereas classified help-wanted advertising can be used for recruiting all types of employees.

Employee Relations

Being an employer calls for the use of authority, imagination, tact, and patience. As an employer, you must recognize that people are not all motivated in the same fashion. Some thrive on additional responsibilities; others prefer consistent expectations. Some need constant praise and encouragement; others generate their own sense of accomplishment.

Whatever their differences, when employees are treated with respect, honesty, and courtesy from the start of their employment, their long-term commitment to their jobs and positive attitude about them increases.

There are several measures which contribute to good employee/employer relations. These include:

1. Make sure your employees clearly understand what is expected of them. This can be accomplished through job descriptions and through formal or informal job training. Training is not only good public relations; it also makes your employees more productive.
2. Explain to new employees how their job fits into your overall business operations and how important it is.
3. Whenever possible, promote from within the company. Also, as employees' performance increases, so should their wage rate and responsibilities.
4. Make sure your employees understand their rights and benefits, including regular wage and overtime pay, holiday pay, and holiday time.
5. Establish an open working relationship with your employees. Encourage their input, and be willing to discuss any issues, problems, or concerns they may have.
6. Deal with all complaints or conflicts among employees fairly, openly, and directly.
7. Compliment employees when they do a good job. Correct performance problems constructively (without criticism). Record performance observations, and meet with employees on a regular basis to discuss their performance.
8. Make sure your employees understand company policy on issues such as overtime, holiday scheduling, promotions, and regular wage increases.
9. Do not play favourites. Employee benefits, salary increases, and promotions should be based on merit and on established rules.



For details on an employer's legal responsibilities to employees, refer to ED&T's *Starting a Small Business*.

Job Design and Description

Effective employee management also involves designing and documenting job descriptions for each of your employees. In addition to providing an overview of your company's staff and the work that each one of them does, job descriptions will also assist you in the following:

- Hiring and training new employees
- Preparing employees for promotion
- Describing reporting relationships and expectations
- Providing a basis for performance assessments
- Keeping wages in balance with responsibility and productivity

Sample Job Description:

Vacuum Cleaner Service Repairman

Duties: Call on customers, repair vacuum cleaners, complete work orders, collect payments, keep repair equipment in good working order.

Responsible to: The Service Manager

Job Requirements: Must be bondable and knowledgeable about repairing vacuum cleaners; must have car and driver's licence.

Personal Skills: Must be able to work alone yet relate well to customers; must be punctual and reliable.

Employee Compensation, Incentives, and Benefits

Wages and salaries should be competitive with other companies in the business and should be adjusted to the difficulties and responsibilities of each job within your company.

There are other factors to consider when setting salary levels including:

- Minimum wage
- Salaries for similar jobs in the area
- Applicant's previous salary and experience
- Potential of applicant to add to company profits



You should have a policy, which is clearly communicated to your employees, about how wage increases are determined. Are they determined by length of service, by performance, or by a combination of both?

Employee Incentives

There are also several methods of providing special incentives or bonuses to employees. These include:

Profit Sharing - Company profit sharing plans usually provide annual bonuses for all employees and are based on length of service and company performance. Profit sharing can be a strong incentive for employees and a good employee relations tool for your business. However, before instituting a profit sharing arrangement with your employees, check with your accountant on its feasibility and affordability.

Bonuses - Annual bonuses, often paid at Christmas, amount to a less formal kind of profit sharing. These are also based on length of service and company profits for the year.

Employee Discounts - Discounts on merchandise (including food) sold in your place of business are usually 15 to 20 percent. This encourages consumer loyalty on the part of your employees and encourages them to, for example, wear items purchased from your store while they are at work.

Sales Commissions - If your business is based on retail sales, you can offer a variety of sales commissions to your sales staff. *These include the following:*

- A commission instead of a guaranteed salary (where permitted by Alberta Labour Standards)
- A commission paid above a minimum guaranteed salary
- Sales commissions above a minimum monthly sales quota
- A group commission based on total sales, to be divided equally by staff

Incentive Wages - If your small business is in certain types of manufacturing or service, you could consider paying your employees solely or partly on the basis of how much they produce. This is sometimes referred to as piece work or incentive wages. Although a powerful incentive towards increasing employee productivity, incentive wages aren't used by most small businesses because this approach requires more effort to track productivity, calculate compensation, and control costs. Ensuring quality work also becomes more difficult.

As a general rule, incentive wages are more practical and effective in the following situations:

- Quantity is most important
- Units of output are easily measurable
- A clear relationship exists between an employee's effort and output
- The job is standardized, the work flow is regular, and breakdowns are few
- Supervisors do not have sufficient opportunity to evaluate individual performance

For more information on wages and commissions, contact Employment Standards, Alberta Labour. See *Appendix A* of ED&T's *Starting a Small Business* for contact information.

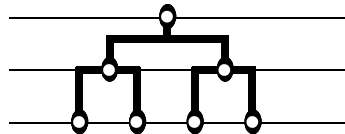
Hiring Employees on Contract

Many small businesses hire workers on contract. Contract workers aren't full-time employees but are contracted for a specific period of time or to complete a specific task. Revenue Canada has strict guidelines for who qualifies as an employee. For more information, contact Revenue Canada. See *Appendix A* of ED&T's *Starting a Small Business* for contact information.

Advantages and Disadvantages of hiring on contract:



Advantages:	Disadvantages:
Can adjust workforce for peaks and valleys of demand-maximize cost return on staff	There are costs of recruitment, training, and severance for each cycle
No CPP and UIC employer contributions to pay	Can be difficult to find qualified people when needed
Simplifies payroll: no deductions to calculate and remit to Revenue Canada	Customer service may lose continuity. Less commitment to the success of your business



Three: Managing for Profit

Determining Costs

Many businesses fail or have poor results because they don't take into account all the costs associated with producing their product or service.

In most businesses, costs can be broken down into two categories:

1. *Fixed costs:* These are overhead costs that don't change, regardless of production levels. They are sometimes referred to as overhead costs or indirect costs.
2. *Variable costs:* These are direct labour and material costs that increase or decrease in direct proportion to the amount of goods or services produced. They are sometimes referred to as direct costs.

Determining the total costs of producing your product or service, and deciding which costs are variable and which are fixed, will have important implications for your overall financial planning and decision making. This will have implications for the price you charge and the volume of product or service you produce.

Sometimes it's difficult to determine if a certain cost is fixed or variable. For example, in most small businesses some employee costs are fixed and others are variable. Direct labour costs associated with the actual production of your product or service are considered variable costs. On the other hand, the wages paid to staff who work in areas such as administration or sales are usually considered fixed overhead costs.

Your accountant or bookkeeper can help you identify which of your costs are fixed and which are variable. For more information on determining and recording costs (expenses), refer to ED&T's *Recordkeeping for Small Business*. For more information on using costs in your business planning decisions, refer to ED&T's *Financial Planning for Small Business*.

Sometimes your total fixed and variable costs do not add up to the true costs of producing your goods and services. This is because intangible costs, such as machine set-up time, idle time, and time for estimating and bidding on jobs, cannot always be calculated. If you cannot accurately calculate these factors, a miscellaneous expense element must be added to your cost calculations.

Estimating

For service businesses such as the construction trades, it is more difficult to determine production costs because each job is different and requires different parts, supplies, and labour. Your having the skill to realistically estimate costs in order to bid on a project is directly linked to the survival of your company.

If you underestimate the costs of a particular job, you will lose money by doing the job. If, on the other hand, you overestimate expenses in your project quote, the job is more likely to be awarded to someone who came in with a lower quote.

In determining costs, successful contractors break the project down into detailed costs of materials and labour (direct costs) and indirect (overhead) costs, such as truck maintenance, administration, bookkeeping, and gross profit margin.

At a minimum, each bid submitted should include cost categories for material costs, labour costs, sub-contracting costs (if applicable), and overhead.

Remember that, in order to make your profit, actual costs must be kept in line with estimated costs. When a project is finished, compare the actual costs of completing the project with the estimated costs contained in your bid. Comparing the two will allow you to make more accurate estimates in the future.

Setting Prices

The price you set for your product or service is one of the key management decisions you will have to make on a regular basis.

Before setting prices, these factors should be considered:

- What does it cost to produce your product or service?
- What is your break-even price?
- What are your profit goals?
- What are your marketing goals?
- What prices are your competitors charging?
- Is there a high or low demand for your product or service?



Based on these factors, there are two main methods of setting prices: *market pricing* and *cost pricing*. In most cases, prices are based on a combination of the two methods.

Market Approach to Pricing

Market pricing is based on how much your customers and potential customers are willing to pay for your product or service. The price your competitors charge can serve as a general guideline, but your market price also depends on your target market and your marketing strategy. For example, is your target market more concerned with low costs or with high quality?

Once you've set your base market price, be aware that it will have a direct impact on your sales volume and revenue, your market share and competitive position, and your company image.

Using the market approach to pricing can be a tricky business, particularly if you are in a service business (for example consulting or editing) where there are no established fees for services. Charging too much will price your company out of the market. On the other hand, charging too little may lead potential customers to think that the quality of work you do might be inferior.

If customers react negatively (or positively) to your pricing decision, you can adjust it accordingly. You may also adjust your price to accomplish marketing goals such as these:

- Attracting new clients
- Encouraging volume sales or off-season sales

Remember that the market approach to pricing has nothing to do with the actual cost of producing your product or service. To make sure that your market-determined price covers all costs, you must consider the cost approach to pricing.

Cost Approach to Pricing

The true total cost of producing your product or service is also your break-even selling price. In other words, if you sold your product or service at this price, you would cover all costs but not make any profit.

The final step, therefore, in the cost approach to pricing is to decide on a reasonable rate of return (profit) and to add this amount to the break-even selling price. The following case is a simple example of how to use the cost approach to calculate your selling price.

Barbara's Bowls:

Barbara produces and sells 100 clay bowls per month. She calculates her variable costs in labour, supplies, and material to be \$30 per unit (per bowl).

She then calculates her fixed costs per month (regardless of how many bowls she produces). Her fixed costs in utilities, rent, and equipment total \$900 or \$9 per bowl (\$900 divided by 100 bowls). She also includes a miscellaneous cost of \$1 per bowl.

She then calculates that her total cost of producing each bowl is \$40 (\$30 variable costs plus \$9 fixed overhead costs plus \$1 miscellaneous costs). This \$40 also represents her break-even selling price.

Now, let's assume she wants to make a profit of 10% on each bowl she sells. Her profit per bowl would be \$4 (10% of \$40).

Her selling price, including total costs of \$40 and a profit of \$4 would be \$44 per bowl.

Break-even Point and Break-even Price

Many small business owner/operators confuse their break-even point (discussed in ED&T's *Financial Planning for Small Business*) and their break-even price. Here's the difference:



Break-even point	Break-even price
Calculate your fixed and variable costs	Calculate your fixed and variable costs
Decide on the price for your product or service	Decide (or estimate) your sales volume
Calculate the volume of sales you need to break even at this pre-determined price	Calculate the price you must charge to break even at this pre-determined sales volume

Both of these break-even calculations provide information to help you in your management decisions and business planning. These calculations should, however, never be looked at in isolation. In most cases, for example, the price you charge will directly affect your sales volume.

Your accountant or business advisor can help you with these calculations and advise you on their appropriate uses.

Retail Pricing

If you are in the retail business, markups, margins, and discounts (markdowns) will form the basis of your pricing policy.

Markups, Gross Margin, and Discounts (markdowns)

- **Markups:** the difference between the selling price and the cost *as a percentage of the cost*
- **Gross Margin:** the difference between the selling price and the cost *as a percentage of the selling price*
- **Discounts (markdowns):** the difference between the selling price and the reduced price *as a percentage of the selling price*

Example:

Markup	Gross Margin	Discount
Cost: \$100	Cost: \$100	Selling Price: \$150
Selling Price: \$150	Selling Price: \$150	Sales Price: \$125
Markup: 50% ($\$50/\100)	Gross Margin: 30% ($50/150$)	Discount: 17% ($\$25/150$)

Markups

Methods of arriving at a profitable markup vary, but there are industry norms for many businesses. The selling price must cover these three basic elements:

- Cost of the merchandise
- Overhead costs, including the salary of the owner/manager
- Net profit

Remember that your actual final markup on any particular product line will likely be less than your initial markup target. In the example above, the initial markup is 50%. However, after the sales discount, the net markup is 25%.

Different product lines and different situations call for flexible pricing. When deciding on markups, consider the following:

- Higher risk items (such as the latest fashions) may require above average markups
- Items that have a low stock turnover or require more service might also require a higher markup
- Staple, low risk merchandise may require a lower markup
- Items with high consumer demand can usually sustain a higher markup

When setting markups, remember that consumer pricing is very sensitive. If you overprice, your business may go to your competitors; if you underprice, you will be operating a profitless business.

Sample industry norms (Statistics Canada, Alberta sample 1991)

	Markup	Margin
Independent Grocery	28%	22%
Drug Store	47%	31.8%
Women's Clothing Stores	53%	34.8%
Furniture Store	65%	39.5%
Gift & Souvenirs	60%	37%

Note: these norms reflect averaging of all sales during a year and will incorporate all sales and discounts. Initial markups and margins may be higher.

Discounts (Markdowns)

Discounts to clear slow moving items are the biggest single drain on a retail store's profits. Generally, the last 25% of each product line determines its overall profitability. If the last 25% can be sold at the regular price, markups and profits are maintained. If, the last 25% of the product line needs to be marked down substantially to clear, profits for that line disappear.



At the same time, markdowns may be a normal and necessary part of your pricing policy. You should plan on a certain markdown percentage on your retail items. This percentage should be included in sales and profit estimates right from the beginning.

Used effectively, markdowns do the following:

- Reduce inventory and free up working capital for other uses
- Clear out poor-selling, out-of-fashion, or out-of-season items
- Reduce carrying charges on money borrowed to purchase the inventory
- Free up capital to purchase more profitable inventory

Many small or new retailers are reluctant to markdown slow sellers. When marking down items, be decisive. The first markdown should be soon enough and big enough to move the merchandise. Remember, the longer the merchandise stays on the shelves, the more it costs and the less it is worth.

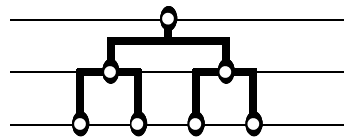
Markdowns are usually cleared through strongly-advertised post season sales or clearance sales. Some stores set aside a special section of the store for marked-down merchandise.

Other Retail Pricing Considerations

In addition to markups and markdowns, there are many other factors and options to consider when setting prices. These include:



1. Do you charge the same price to every customer or do you negotiate price?
2. Will odd ending prices, such as \$39.95, attract customers, or will they see them as an unwanted sales gimmick?
3. Will multiple pricing, such as “three for \$5”, increase sales?
4. Can you attract customers to your store through the use of “loss leaders”? Your loss leader products should be bought frequently by large numbers of people, have a familiar regular price, and be relatively inexpensive.



FOUR: Managing Your Assets

Many small businesses have considerable amounts of money tied up in inventory (stock). Having the right amount of inventory on hand is a crucial part of managing your business.

Too much inventory on hand means you will have excessive amounts of capital tied up in stock, therefore reducing the amount of working capital you have available for day-to-day operations. Too little inventory means either not having enough items to sell to customers or not having the materials to provide your service or manufacture your product. This represents a lost opportunity to serve your customers and a potential loss in profits.

Before you can effectively manage your inventory, you must have an effective method of tracking and recording how much stock you have on hand. For more information on stocktaking, refer to ED&T's *Recordkeeping for Small Business*.

Minimizing Service Business Inventory

If you are in a small service business, it is generally advisable to keep inventory to a minimum. For example,

1. If you are a contractor in the construction trades, it is usually advisable to purchase the specific construction materials you need for each job. This is preferable to tying up working capital by keeping a wide variety of construction materials in stock.
2. If you own and operate a restaurant, it is important to plan your food supplies carefully. Having too much food on hand results in a significant amount of spoilage, thus reducing your profits.
3. If you operate a general car repair shop, it is too expensive to stock a wide range of parts for all the major makes of cars on the road. It is much more cost-effective to establish good relationships with suppliers so you can get parts quickly as you need them.

Controlling Manufacturing Inventory

If you are in a small manufacturing business, it is also advisable to keep inventories as low as possible without affecting sales or production efficiency. Raw materials and partially or fully finished products tie up cash that could be put to better use.

The key is to develop an inventory control system to meet customer orders while minimizing inventory costs. Four steps to effective inventory control for small manufacturers are:



Step 1 Keep accurate records of how much inventory (raw materials, finished and partially finished products) you have on hand.

Step 2 Estimate future sales of your product over a certain time period (could be a year).

Step 3 Base the amount of product you produce per month on projected sales and existing inventory. Production requirements will only be higher if you plan to increase product inventory.

Step 4 Production requirements and the amount of raw material on hand will determine the amount of raw material you need to order on a monthly basis.

Purchasing and Controlling Retail Inventory

If you are in the retail business, effective inventory control and decision making is one of the most important factors determining your success or failure. A small retail business can't afford to make serious mistakes with its inventory.

Stock Turnover

The speed at which stock turns over (usually measured as the number of turns per year) has a direct influence on the quantity and balance of your inventory. Slow stock turnover is a drag on your inventory. It ties up cash in slow-moving items and will probably mean that you will be forced to markdown (discount) the selling price of these items in order to clear them out.

On the other hand, you can maximize the stock turnover rate of a particular item simply by stocking very little of it. If this item is a popular or hot seller, however, this will mean that you will lose sales and customers if the stock runs out.

Optimum stock turns vary, depending on the type of product you are selling. Here are some industry norms:

- Women's Clothing Store: 6.8 times per year
- Grocery Store: 20 times per year
- Furniture and Appliance Store: 5 times per year

You should set up objectives for your stock turns. Subdivide merchandise into logical classifications or departments and establish a realistic average for turn rates on each classification. This will help determine which products are fast and slow sellers, how much you should reorder, and whether you should continue or discontinue selling certain product lines.

For further information on calculating stock turns, refer to chapter *One* of EDT's *Financial Planning for a Small Business*.

Buying Inventory

Your inventory, its size, quality, variety, and balance, is a direct result of your buying decisions. You should plan your inventory purchases in advance, and your inventory budget should be based on actual and projected monthly sales.

When setting your inventory budget, it is advisable to set aside a portion to buy additional items as the season progresses. This approach is called “open to buy”, and it provides built-in inventory purchasing flexibility in order to do the following:

1. Take advantage of purchasing deals offered by your suppliers (provided you have a market for these extra units).
2. Purchase items for a sales promotion.
3. Stock fast-selling new items or increase the stock of current items that are unexpectedly in high demand.

When ordering or reordering merchandise, consider the following:

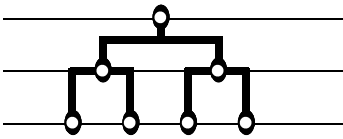
1. Because of the rapid turnover of styles in today's markets and the unpredictability of consumer demand, the trend is toward smaller and more frequent orders.
2. Inventory stocks should peak just before major periods of customer demand and diminish as demand falls off. Failure to increase or decrease stocks based on customer demand can seriously affect sales, cash flows, and profits.
3. Make sure you purchase enough stock to back up your advertising and promotional campaigns.
4. Beware of investing too many inventory dollars in similar styles or product lines. This practice ties up capital in merchandise that may take a long time to turn over.
5. Maintain ample stocks of your best selling items. Running out of these items could result in a significant loss in sales and regular customers going away unhappy.
6. Concentrate your inventory according to the sizes, lines, and styles that are most common and most frequently in demand. This is where your turnover and profits are, as well as where your markdowns should be minimal.
7. Don't overstock fringe sizes or merchandise with limited appeal. Fringe sizes and items slow down stock turnover and frequently end up as markdowns. Accept the fact that you will lose an occasional fringe-size customer.



Selecting Suppliers

It is not advisable to buy your merchandise from too many suppliers. This will spread your buying too thin and limit your purchasing power. Most suppliers will think of your business as a fringe account and not give it the attention, service, or special deals given to larger accounts. Purchasing from many different suppliers can also result in

- Mixed up inventory that is hard to track, manage, and sell
- Additional and costly bookkeeping
- Too much time spent with salespeople
- Overlapping or duplicated lines



When choosing suppliers, consider what services they provide in addition to providing merchandise. Ask if they have any retailer assistance programs. For example, do they provide marketing, sales or promotional aids, merchandising guidance, national or cooperative advertising, or ideas for better store management?

FIVE: Managing the Production Process

If you are in the manufacturing business, a key management responsibility is to ensure that your manufacturing plant produces quality products at a cost-effective price. (If you are not in the manufacturing business, you may want to skip this chapter.)

Depending on the size and nature of their manufacturing operation, some small business owners manage the production process themselves, while others hire an experienced production or plant manager.

There are four main elements to consider in planning and managing the production process. These are labour, production materials, equipment, and plant layout.

Labour

The first step in deciding on the size and makeup of your labour force is to prepare a list of all the basic operations required to produce your product and the estimated time to perform each task. For example, cutting, welding, assembling, gluing, and painting may be required.

When hiring labour, consider the following:

1. Are there special skills required to perform certain tasks? Do these tasks require licenced tradespeople? If so, where can this skilled labour force be found?
2. What labour training programs are necessary? Are any of these training programs eligible for government-subsidized wages?



For more information on recruiting and hiring employees, including employee incentives, see chapter *Two* of this guide.

Production Materials

Materials are a significant part of the cost of your production process. Careful planning is required. If you don't keep enough material on hand (including any component parts used), your production process may be interrupted. Conversely, too much raw material on hand means that you have unnecessarily large amounts of capital tied up in raw materials.

Because the quality of raw materials and component parts will affect the quality of your finished product, it is important to find the highest quality materials at the lowest price.

When planning your material purchases, consider the following:

1. What quantities of each raw material are needed to produce your product over the next month? Over the next year?
2. Where will the raw materials come from? List your main sources and include price, delivery time, any special features, such as quality. Make notes regarding whether they meet all your specifications and if they provide credit.
3. Are there alternative sources of supply available if your regular suppliers cannot meet your demand?
4. Would it be cheaper to make certain materials or component parts used in your production process rather than buying them?
5. Are there volume discounts available from suppliers, and do they have minimum purchase requirements?
6. If you are using a depleting resource, are there specific government regulations to consider?
7. What environmental regulations must be met for processing waste products resulting from the use of raw materials?
8. What other regulations must be met, such as the storage of explosive materials or toxic chemicals?



9. Do you have on hand miscellaneous shop materials used directly or indirectly in the production process, and are they accounted for in your costing calculations?
10. Are any of your raw materials perishable, or do they have special storage requirements?
11. Is shipping included in the cost of raw materials? If not, what will it cost to ship them to the plant?

Equipment

Examine the production process and determine your equipment and machinery needs. Determine the total cost of this equipment, including taxes, freight, installation charges, and training required. It may not always be necessary to purchase a brand new top-of-the-line model, if a less costly or used model will perform the same function.

In order to free up capital for day-to-day business operations, many small manufacturing businesses are leasing rather than purchasing equipment. For more information on this topic, refer to ED&T's *Financial Planning for Small Business*.

Plant Layout

Designing or redesigning the layout of your manufacturing plant is a major undertaking which requires time and considerable preparation. There are three approaches you can use when designing or redesigning your plant layout:

- Hire a plant or production manager to develop a plant layout plan
- Hire an outside production or efficiency expert to develop the plan
- Develop the plan yourself

The more complicated the production process, the more you should rely on outside experts to help you. If you decide to develop the plan yourself, visit other production plants to observe what works and what doesn't work in their plant design. Make sure you get critical feedback on your plan before you implement it. It is far easier to change a poor plan than it is to change a poor production process once it is up and running, and the machines are bolted to the floor.

Whether starting or expanding your plant, you must know your present and future space requirements. When planning your layout, make sure you consider the following:

1. Which elements of the layout (such as heavy equipment) will be the most expensive to change?
2. Does the location of the heavy equipment limit the direction of expansion, and is there room for the expansion of each element of production?



3. Are the locations of the basic raw material input areas and product output areas functional and convenient, and is the overall flow of the raw materials fast and efficient?

Types of Production Layout

There are essentially two types of production layout models: production line and job lot production.

Production Line - In this production arrangement, the processes and machines are arranged in sequence according to their use in the production process. The simplest way of visualizing this is that the raw materials come in at one end of the production line (although in reality many are added along the way), and the finished product comes out at the other end.

The production line has many advantages, particularly for small plants producing only one or two products. The advantages of a production line include reduced production time, lower handling costs, tighter control and monitoring of operations, better control over raw materials, and lower overall production costs per unit.

Possible drawbacks include the fact that a new product may require another complete production line, and a breakdown of any one machine may shut down the whole production process.

Job Lot Production - Job lot production arranges the machines according to the tasks that they perform. For example, in a large manufacturing plant, all the metal presses may be grouped together. This type of production is flexible and can easily accommodate the production of a new product. Possible drawbacks are that cost control is more difficult, and handling costs and overall unit production costs are generally higher.

Benefits of an Effective Plant Design

The results that can be achieved through a superior layout can be considerable. The benefits include:

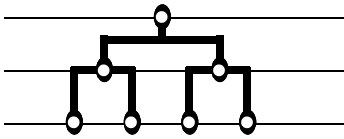
- Less down time in the production process
- Less time and money spent handling and moving materials
- More convenient and efficient work spaces
- More productive and less frustrated workforce
- Plant expansion with a minimum amount of disruption to current production



Costs of Changing Production Layout

If you decide that you must change your plant design, either because it is inefficient or because you're introducing new product lines, make sure you have budgeted for the costs. These costs include:

- Planning costs and cost of hiring an outside consultant
- New equipment costs, including delivery, installation and training
- Structural changes to the building or new construction costs
- Changes in utility costs
- Labour costs and the costs of moving machines
- Indirect costs, such as shutting down your production while the changes are made



SIX: Managing Retail Merchandising

If you sell products and have a display area, how you design your retail space will greatly influence sales. How merchandise is displayed also contributes to your store's overall image. The most effective store layout makes maximum use of the retail space available, while also presenting your merchandise in a way that is attractive, uncluttered, accessible, and convenient for your customers.

There are three approaches you can use when designing or redesigning your store layout:



1. Design or redesign it yourself. Make sure you visit similar types of retail outlets and observe their store layout. Get critical feedback and professional advice (as necessary) before making any changes.
2. Hire a retail manager and ask them to develop a store layout plan.
3. Hire an outside merchandising or retail store design expert, preferably one specializing in your type of merchandise.

Merchandise Fixtures

The most effective and efficient store fixtures display merchandise in a logical, orderly fashion, with maximum exposure to customers. Remember that a well-designed fixture that gives maximum exposure to goods is less expensive in the long run than a lower-priced fixture which doesn't allow for effective display.

If you are selling small, expensive items, such as jewellery or watches, security can be a major concern. This type of merchandise should be kept under lock and key, although it should still be clearly visible to the customer.

Wherever practical, the merchandise should be displayed so that customers can handle it. Self-service fixtures not only save money, they also enhance the display and sale of stock. Self-service fixtures allow customers to shop without having to ask a salesperson to show them the merchandise, and there is no barrier between the customers and the goods.

Fixtures should be designed, if possible, with upper and lower tiers to make maximum use of vertical space. Goods should not be put out of reach or out of sight of customers. The best selling space is from waist to eye level.

Suppliers may provide fixtures at nominal cost to display their products. If you use their fixtures, make sure they fit into the overall layout and display plan for your store. Often suppliers will advise on display needs and techniques, especially when they are doing promotions or installing displays in your store.

Floor Display

The overall floor design of your retail store will determine how attractive and accessible your merchandise appears to customers, and this will have a major effect on how much they purchase. Floor display and design will also determine how pleasant and convenient your customers' shopping experience is, and this will influence their decision to return to your store or become regular patrons.

Effective retail floor designs vary, depending on the size of the store and the type of merchandise being sold. In a grocery store, for example, bread and milk should be kept at the back of the store. When buying these staples, customers will be exposed to as many store items as possible. In a clothing store, sale items should be placed near the entrance to attract customers, and more expensive items should be kept near the back of the store.

When designing your floor space, consider the following:

1. Determine what your traffic pattern will be, and make sure related items are adjacent to one another.
2. Ensure that your aisles are wide enough for the anticipated customer traffic.
3. Try to create a circular traffic pattern through your store, so that customers are exposed to as large an assortment of merchandise as possible.
4. Decide the best locations for the various departments.
5. Customers should pass by items which they may buy on impulse on the way to inspect items that are continually in demand.
6. Cash registers should be located for easy access by customers and salesclerks, and to ensure security throughout the selling floor.
7. Non-selling and office activities should be kept out of valuable selling space.





8. Receiving, labelling, and pricing merchandise should not be done on the selling floor, as this will negatively affect both your store's appearance and atmosphere and your customers' access to merchandise.
9. More colourful merchandise and national and private brands should be highlighted in your floor arrangement and window display.
10. Items that reflect the store's image or sense of fashion should be prominently displayed.
11. Place advertised and non-advertised specials at the end of counters, as well as in their regular shelf space.
12. Depending on the type of store, each merchandise category should be grouped under a separate sign.
13. Arrange merchandise in each category according to its most significant characteristic - colour, style, size, or price.
14. Do not overcrowd counters and aisle tables, and keep trash bins out of sight.

Colour and Interior Signs

Colour helps set a buying mood. Generally, strong contrasts and loud colours should be avoided. Although they get attention, they also overpower the merchandise and distract the customer. Background colours, however, tend to blend in with or highlight the display merchandise.

In experimenting with colour, keep in mind that high priced merchandise and high fashion items are best displayed in more refined colour arrangements, such as blues, greys, greens, and blacks. If you are handling lower priced items and are trying to encourage impulse buying, brighter colours can attract customers.

Interior signs answer basic customer questions about location, size, price, and other features. They should always look professional and up-to-date. Make your signs informative, concise, straightforward, and easy to read. In larger retail stores, overhead signs can help customers quickly locate the specific items they are looking for.

Lighting

Well-designed lighting systems can have a major impact on retail sales. They are the most effective means of highlighting merchandise and can influence shoppers to move from one department to another.

Good lighting highlights product features by giving texture and depth. It also strengthens colour. The three key elements of lighting design are the following:

- levels of brightness (measured in foot candles)
- "colour" of light (measured in Kelvin temperature)
- ability of light sources to render colours naturally (measured by the colour rendering index- CRI)

Lighting needs to match the intended image of the store and to fit the product line. For example, fashion boutiques prefer bright pools of more natural light on displays with lower light levels in aisles to add energy to the display areas. Discount stores prefer more uniform, cooler light to match the corporate image of low-cost, no frills.

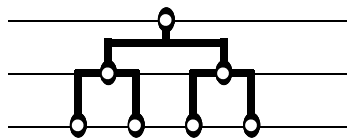
Lighting systems can be combinations of fluorescent, incandescent and halogen.

Aromas, Sound, and Moving Displays

There has been recent research on innovative techniques which encourage customers to stay longer in your retail space (and therefore buy more). Just as it is important to have attractive display fixtures and window displays, appropriate lighting, carefully selected *aromas*, and background *music* which is appropriate to your customers' profile create a pleasant, appealing ambiance.

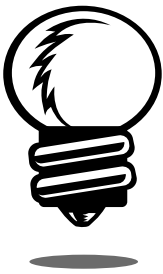
At the same time, some consumers express concerns about being “manipulated” and if, for example, the choice of scent or music is offensive to some, there is a risk of losing them as customers.

Moving displays have been used in store windows, especially at Christmas time. Carefully chosen, moving displays at any time of year might help your retail space stand out among other retailers who rely on passive displays.



Appendix A: Staying in Business Tips

Despite the best of intentions, many small businesses run into serious difficulties, and many of them are forced to go out of business. Many successful businesspeople have previously experienced business failures. However, they learned from their experience and ultimately established a winning formula. The following is a list of tips to help you avoid potential problems and to stay in business through both the good and tough times:



1. Keep *good business records*. These records tell you where your company stands at all times and form the basis for good business planning and decision-making.
2. Make a *realistic budget* and stick to it. Make *realistic projections* of how much revenue your business will generate, and keep expenses in line with those revenues.
3. Make *realistic cash flow projections*. Plan carefully for how the money will flow into (revenue) and out of (expenses) your company.
4. Keep *debt load manageable*. Borrow only the amount of money you need to keep the business running.
5. Protect your *cash* by renting or leasing such things as property, machines, equipment and vehicles.
6. Cultivate and maintain *long-term customers*. In tough times, these are the customers you will depend on to keep your business viable.
7. At the same time, *diversify your customer base* as much as possible. Avoid staking your future success on the viability and loyalty of a few customers.
8. *Customer service* is key to business success. Establish high *product and service quality* standards and guard them fiercely, even as sales increase and you are scrambling to meet new demand.
9. Keep a close watch on your *competition*, including their pricing, service, and marketing policies. Learn to anticipate and to respond, if necessary, to the moves of your competitors.
10. Keep a close watch on the overall *market* for your product or service. How can you adapt your product or service to the changing demands of the market?
11. Keep a close watch on your *inventory*. Poor inventory control will result in too much capital being tied up in inventory.
12. Keep a close watch on both *accounts receivable* and your credit policy. Bad lending decisions will result in too many overdue or delinquent accounts receivable.

13. Look for innovative and inexpensive ways to *promote* and to *advertise* your product or service.
14. Regularly reassess the number and quality of your *employees*. Do you have the right number of staff with the right skills and attitudes?
15. As your business grows, *delegate* more. Use your employees' skills and protect your own time for key decisions and activities.
16. Have a clear *succession plan* in place. Be prepared for the eventuality that one of your partners or key personnel will leave the business.
17. Develop a positive working relationship with your *lenders and investors*. If your business runs into financial difficulty, a good working relationship with your lender will assist renegotiation of the terms of a loan and the repayment schedule.

