BusinessPlus+ Newsletter

CMA Collins Mellody

INDEX

Issue – November 2020

Our theme for this month is "Setting Charge Out Rates And Retail Pricing To Achieve Targeted Profits"

Setting Charge Out Rates For Tradies' Businesses

It's dangerous to be setting your charge out rates if you're copying what a competitor is charging. How do you know whether the competitor is utilising charge out rates that will achieve a reasonable profit for their business? What correlation does their business investment and costs have to your business? Probably very little!

It's also dangerous to set prices at a certain level and leave your charge out rates at that level for many years. Even in this period of very low interest rates, costs are still increasing.

One of the key activities that accountants can perform for tradies' businesses is to assist you in setting your charge out rates for the forthcoming 12 months and to then monitor your financial performance and analyse your costs and labour productivity figures, to determine whether the charge out rates that have been set are going to assist a business to achieve its profit target.

The first question to be answered is what is the cost of labour? All team members should be included in the labour calculations, including working owners of the business. The first area to tackle is the labour on-costs which relate to:

- annual leave;
- shift worker allowance;
- holiday pay loading;
- statutory holidays;
- personal/carer's leave;
- superannuation;
  and the cost relative to:
- payroll tax if applicable;
- work care;
- training if it is not included as a business overhead expense; and
- training for apprentices and trainees?

The labour budget can then be calculated. This incorporates the gross salary payable to a team member and the productivity percentage that is being budgeted for each individual team member, including working owners.

A budget should be prepared relative to the overhead expenses for 12 months (not including any of the items included as labour on-costs).

The next item to be determined is - what is the estimate of purchases that the business is going to pay for which are then going to be installed for the benefit of a customer. Many businesses charge a mark-up on this expenditure to cover the time and effort taken to secure these purchases on behalf of customers, together with the financial cost involved in purchasing and paying for these items.

The business operator will then be asked to indicate the desired profit, not including working owner's salary, which has been included in the labour budget.

We can then prepare a calculation which reflects:

- Total labour cost including labour on-costs
- Hours worked and targeted productivity of team members and working owner(s)
- Overhead expenses (12 months budget)

- Desired net profit
- The budgeted materials mark-up

Based on the individual working hours and productivity percentages that have been used, calculations can be made to determine the appropriate charge out rates for each team member and working owner.

A proof summary is then prepared to show that, if the individual team members and the working owner achieve the working hours and productivity percentage that has been agreed to, that the business has controlled its overheads and that the mark-up on material purchases is similar to what has been budgeted, the business can achieve its targeted profit for the year.

It's a good idea to have a meeting with us at least four times per annum to monitor the combination of working hours, productivity, wages costs, mark-up on material purchases for customers, overhead costs to see whether the charge out rates are still affective to achieve the targeted profitability for the tradie's business.

A similar approach applies for manufacturing businesses.

This approach can be very beneficial to businesses which are basically selling the labour of their team members to customers.

If you would like to have a discussion with us as to how this type of approach can be undertaken for your business, please do not hesitate to contact the accountant in our organisation with whom you normally deal.

Product Mix And Mark-Ups Affect Retailers' Profitability

A fairly common problem that retailers discuss with accountants is *"Why, if we are selling so much product, aren't we making a profit?"*

To answer this question we need to analyse how a retail business operates. In most instances, retailers purchase a variety of products from various suppliers and they then mark-up those products to a price that they believe will enable them to compete with their competitors.

If the product category that achieves the highest unit sales is a product that you can only achieve a fairly low mark-up on, you'll probably not be generating enough revenue to trade at a profit. Success for a retailer requires an adequate mix of products with variations of mark-ups so that the total of sales generates a gross profit percentage and gross profit that will cover the retailer's overhead expenses and contribute to a profit in the business. (Refer to the next article on Mark-Up Percentages and Gross Profit Percentages).

A retail business analysis to determine whether the stock mix and the mark-ups will generate an adequate profit for the business requires a review that commences with:

- The budget estimate for the employees of the business - wages/salaries, including the cost of labour on-costs (holiday pay, holiday pay loading, personal leave, superannuation etc). This estimate should take into account the manning rosters that the retailer thinks will apply for the year.
- The overhead expense budget for the year would include items such as rent, advertising, accountancy, marketing, cleaning, interest, financing charges, insurance and the other incidental costs of running a business.
- The retailer needs to identify a targeted profit for the year, normally based on the cost of the investment in the business, calculated at a targeted rate of return. For example, if the investment in the business is $500,000 and the targeted rate of return is 20%, the targeted profitability for the year would be $100,000.
- A projected gross profit figure can then be calculated after taking into account the total of:
  - Labour and Labour On-Costs
  - Overhead Expenses
  - Targeted Profit
- The product mix strategy can then be examined to determine whether the products that you intend to purchase and the mark-ups that can be achieved on them will generate sufficient sales to earn the required gross profit that will generate the targeted net profit for the year.

  If the initial product mix selected does not generate the required gross profit and therefore the targeted net profit, there needs to be a re-examination of the product mix and potentially the mark-ups to see whether a changed product mix within the business will generate the targeted gross profit which will then flow through to the targeted net profit.
- This analysis enables accountants to assist retailers to set targets on the product mix within the retail business and the mark-ups to ensure that the overall profit target is achieved.
- We do not recommend that you set this strategy once in a year and then wait to the end of the year to see if it worked out. Big businesses continually review the strategies throughout the year and we believe the same applies for SMEs. At least on a quarterly basis the process should be reviewed by examining the recent performance and then reviewing the revised product mix to try to achieve the targeted results.

We can assist retailers in these types of analysis if you would like to have a discussion with the accountant in our organisation with whom you normally deal.

Mark-Up Percentage And Gross Profit Percentage

In a retail business, a mark-up percentage is applied to the purchase price of the product to determine the selling price, whilst the gross profit percentage is calculated on sales, less product cost, equals gross profit. The gross profit percentage is calculated:

$$\frac{\text{Gross Profit}}{\text{Sales}} \quad x \quad \frac{100}{1}$$

For example, if a product was purchased for $100. Mark-up was 60%. The selling price would be $160.

The gross profit would be calculated:

Sales Price	$160
Less: Cost of Product	$100
Gross Profit	$ 60

The gross profit percentage would be calculated:

$$\frac{\$60}{\$160} \quad x \quad \frac{100}{1} \quad = \quad 37.5\%$$

The mark-up was 60% and the gross profit percentage in that same transaction was 37.5%.

Unfortunately, there have been instances where the mark-up percentage and gross profit percentage are confused which can lead to significant problems where the amount of mark-up was based on the expected gross profit percentage and not the mark-up percentage. This is illustrated in the Gross Profit/Mark-Up Chart:

Gross Profit/Mark-Up Chart (Sample)

Do you understand the difference between mark-up and gross profit percentage? The following chart sets out a comparison between various mark-up percentages and their equivalent gross profit percentage.

Equivalent Price Mark-Up/Gross Profit Chart

Mark-up % on Purchases	Equivalent Gross Profit % on Sales
5%	4.8%
10%	9.1%
15%	13.0%
20%	16.7%
25%	20.0%
30%	23.1%
35%	25.9%
40%	28.6%
45%	31.0%
50%	33.3%
75%	42.9%
100%	50.0%
120%	54.5%
130%	56.5%
140%	58.3%
150%	60.0%
175%	63.6%
200%	66.7%

Export Market Development Grant Closes Soon

A reminder that, if you are an exporter and in the year ended 30th June 2020 your business spent more than $15,000 on export market activities, then you're entitled to lodge a Export Market Development Grant Application.

The closing date for the grant applications is 30th November 2020.

If you would like our assistance with the preparation of an, Export Market Development Grant Application please contact us as soon as possible.

Win For Small Business - "Loaded Contracts" Crackdown

The Federal government has announced that big business will face new fines and penalties for entering into unfair contracts with consumers and small businesses, under a crackdown agreed to by the Federal and State governments.

This shakeup is aimed at stopping big business squeezing small business partners, such as through changing supply contracts without approvals, suddenly terminating contracts and the auto-renewal of contracts without an agreement and enforcing long lead times to cancel.

The government originally extended an unfair contract term protections for consumers to small business in 2016.

However, the law only allows big businesses to be taken to court to have the relevant terms declared unfair and void. Even if the contract term is proven to be unfair, it is not illegal and there is no penalty to big business.

The Small Business Ombudsman, Kate Carnell, has pressed the government to make unfair contract terms between big and small businesses illegal and subject to penalties. The governments have agreed to strengthen unfair contract term protections.

The shakeup will include making unfair terms unlawful and giving courts the power to impose a civil penalty.

The definition of small business will be expanded from less than 20 employees to less than 100 employees, with an annual turnover test of less than $10 million.

The government's Small Business Ombudsman has indicated that the new small business thresholds would ensure 99% of businesses were covered by the tougher unfair contract rules.

COVID-19 Grants To Be Income Tax Free

In a major change to government policies the Federal government has introduced legislation into parliament that provides for small and medium size business grants, announced on or after 13th September 2020, to be non-assessable, non-exempt income.

Normally, income received by a taxpayer from a government grant is included as assessable income for the recipient.

This change will apply to certain grant programs administered by a State or Territory governments where payments will be treated as non-assessable, non-exempt income so that these payments are not subject to income tax levied by the Commonwealth government.

This grant exemption will only apply to entities with aggregated turnover of less than $50 million per annum.

To be eligible, a business must have received a payment that was made under a Grant program, that is declared by the responsible Cabinet Minister to be eligible for this dispensation and is, in effect, responding to the economic impacts of the COVID-19 coronavirus pandemic.

To be eligible the grant program, from which the payment is made, must first be publicly announced on or after 13th September 2020 and directed at supporting businesses, subject to certain restrictions regarding their operations.

The legislation has been introduced to the House of Representatives but has not yet been passed by both Houses of Parliament.

If you have any questions regarding the proposed legislation, please do not hesitate to contact the accountant in our organisation with whom you normally deal.

Contact us:

CMA Collins Mellody

P: 03 9836 1533

F: 03 9836 3025

E: admin@colmel.com.au

W: http://www.cmagroup.com.au
Ground Floor 1 Chapel Street, Blackburn, VIC, 3130