

HMAVIEWPOINT

The importance of bookkeeping



Rick DeFavero
Vice-President,
Atlantis Toy
and Hobby

We've all walked into a hobby shop sometime in our life and were amazed at what we saw. Our eyes opened wide and our hearts were thumping.

It's a great feeling that stays with you. Equally surprising was when you asked the person behind the counter where something was, and they knew exactly where to point – "Third aisle halfway down on the left above the Tamiya paint rack." That's when you thought, "How does anyone keep track of all this?" They may know where everything was in the store, but did they know how much all that inventory was worth?

Every business owner should be able to answer the question, "Am I actually making money?" If there's money in your bank account and the bills are being paid, you're able to take a salary or cover your expenses, then all is well. Many people work like that for years without looking any deeper. This may work for you, but I'm a numbers guy. There are many questions that can help you be more successful.

For example: What is my overall profit margin? What sector do I sell most? What are my top 10 items and what's the markup on those items? What are my most profitable and least profitable items, and are they worth carrying? Should I run a sale or promotion, and for how much off? Inventory valuation is also very important for insurance purposes.

Of course, this does involve some extra work. Finding the right accounting software is the first step. There are many programs on the market like Quickbooks, Xero, Netsuite and FreshBooks, and they range in prices from low to very high. Look at all of them and test them before buying one. You will be inputting your purchases and sales. Some of this can be automated, but setting up all of the items you carry into the program is the big step. Take inventory in your shop, one sector or shelf at a time. Hopefully, you saved your invoices so you will have the cost of these items and the SKU.

Once everything is entered into your bookkeeping program, you can run reports that give you some answers. One of the most useful features is tracking expenses. Entering all the checks you write, balancing the bank account, and logging in all those credit card charges starts to paint a picture of your business. Categorizing expenses is the key, and your program can arrange them in ways to make this easier. The reports you run will help you understand your cash flow and show you where the money is going. "Do we really spend \$400 a month on lunch?" These are the little things that can be tightened up once you are made aware, such as moving to a monthly utility billing plan.

Drafting a monthly budget will help you do this. Once you have several months of data, you can see your typical monthly expenses: rent, labor, insurance, utilities, advertising (and yes, lunch!). Now you know how much it costs to run your business. Based on your gross profit margin, you know how much you need to sell to break even.

It doesn't take that much time, especially if you stay on top of it. Think of this as continuing your education, or dare I say it, another hobby!

Here are two helpful formulas:

1) The gross profit margin is calculated by taking total revenue minus the cost of goods sold (COGS) and dividing the difference by total revenue. The gross margin result is multiplied by 100 to show the figure as a percentage.

Example: You had a sale of \$250 (total revenue) that cost \$150 (COGS), so your gross profit is \$100, divide that by \$250 (total revenue) = .40 To see the percentage you multiply that by 100 = 40 % gross profit margin.

2) Markup refers to the difference between the selling price of goods or services and its cost. It is expressed as a percentage above the cost. In other words, it is the added price over the total cost of the good or service.

For example, if a product costs \$10 and the sells for \$15, the markup percentage would be selling price \$15 – cost \$10 = \$5. Then, divide by cost \$10 = 0.50 x 100 = 50% markup.

Remember, the more knowledge you have regarding your finances, the more efficiently you can run your business. **HM**



Hobby Manufacturers Association

1410 East Erie Avenue, Philadelphia, PA 19124 • Phone: 267-341-1604
E-mail: heather.stoltzfus@hmahobby.org • Web: www.hmahobby.org