

## Chapter 1

# Understanding “Profit”



Because this book is all about “how to generate profit” from your coffee business, let’s begin by talking about what profit is, and how it’s made. To put it simply, profit is the money that is left over from sales after you have paid all your bills. Profit is usually calculated over a specific period of time, typically a calendar month. So, at the end of the month, if there is money remaining from your sales after you have paid all your expenses related to that same month, you were profitable ☺. However, if there isn’t enough money to cover all your expenses, and to pay you a livable wage, then you lost money ☹.

To determine how large your profit or loss are, you’ll need to know what your **sales**, **cost of goods**, and **expenses** were for each month.

“Sales” are obviously the revenue you take in from selling your products and services. In a coffee business, product sales are generated from your customers’ purchases of beverages, food, retail merchandise, and whole bean coffees. Income from services isn’t typical to most coffee businesses, but might be generated if you sell WIFI access to the Internet, cater special events, rent out a private room to groups, or perhaps collect a “cover-charge” when you are offering live entertainment.

Next, you must subtract your “cost of goods” (*also known as “cost of sales”*) from your sales. Cost of goods is the dollar value of the items and ingredients that were used to create your sales. When I talk of “items” I’m referring to finished products that you buy and resell, like bottled drinks, pastries and

desserts that you buy from a bakery, etc. “Ingredients” on the other hand, are components of items that you prepare in store, like coffee beans, milk, flavored syrups, bread, sandwich meats and cheeses, etc. Beyond beverage and food items/ingredients, paper products, cleaning chemicals, retail merchandise, and whole bean coffees for retail sale are also a cost of goods. Think about it, if you were serving 1,000 customers per day, would you not use a lot more paper cups, plastic lids, napkins, hand soap, dish detergent, and paper towels than if you were only serving 100 people? Of course you would.

When calculating a cost of goods, it will be helpful if you break down your cost calculations into some subcategories like, beverage cost, food cost, retail merchandise/whole bean coffee cost, and paper & chemical cost. By doing this, when you have a cost-control problem, you’ll have a better idea of where to go looking for it. When you combine all of your cost of goods categories, and divide that by your total sales, your overall cost should typically range between 32% and 38%.

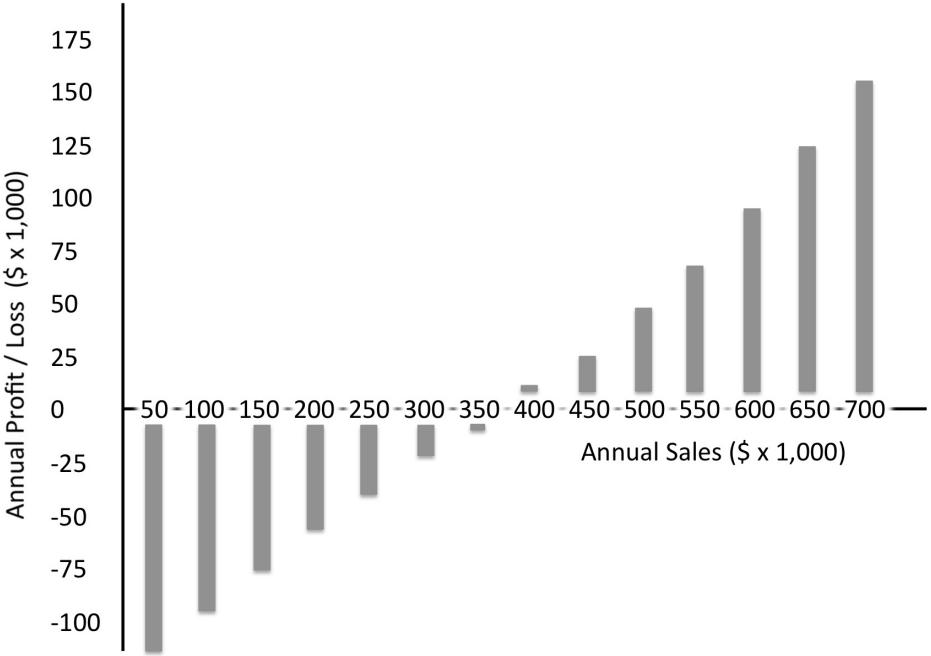
Example: Let’s say you generated \$10,000 in sales last month, and you used \$3,500 in product to produce those sales, then your cost of goods was 35.0% ( $\$3,500 \div \$10,000 = .35$  or 35%). We would also understand that there was \$6,500 left over after subtracting your cost of goods from sales ( $\$10,000 - \$3,500 = \$6,500$ ). This is known as your “Gross Profit from Sales.” So, in this case you made a bunch of money, right? No, sorry, probably not; now you must subtract all your “other expenses” from your gross profit to see what your actual bottom line profit or loss was.

These other expenses will include such things as employee and management labor, payroll taxes, repair and maintenance, small wares & china, utilities, trash pick-up, rent, office supplies, bank & credit card fees, insurance, licenses & permits, cash over/short, bank loan payments, dues & subscriptions, promos & comps, professional services, etc., etc. *(We’ll explore cost of goods calculations in much greater detail a little later on in this book.)*

Even if you keep no books and have no numbers to look at, you’ll probably still know whether or not you were profitable. If you haven’t been able to pay all of your bills each month, and the unpaid balances are getting larger, and there’s no money left to pay yourself, I don’t have to tell you that you aren’t profitable; you’ve probably already figured that out. ☹

So, why is profit eluding you? Absence of profitability can be attributed to a lack of sales, a lack of control over costs and expenses, or a combination of both. While there is always room to tighten controls to reduce costs and expenses, lack of sales is the culprit that prevents most coffee businesses from realizing a profit. Insufficient sales might be the result of a poor location, a lack of marketing, a limited menu, unappealing products, slow or unfriendly service, or uninviting ambiance.

A certain level of sales will be required to make money. What that level is, will be determined by the unique conditions of your business, (*your average transaction amount, the number of people who visit each month, and your total expenses*). The truth is, even a very inexperienced operator, who is making some mistakes, may find it impossible to not make a profit if their sales are extremely vibrant. And conversely, a seasoned veteran manager, with years of experience, may find it impossible to generate a profit if sales aren't great enough. If you own a typical sit-down café, the graph below shows the approximate profit/loss that you can expect at different levels of annual sales.



Understand that as your sales increase, your cost of goods should remain about the same as a percentage of sales. So, from our earlier example, if you used \$3,500 of ingredients to generate \$10,000 in sales, (*making you cost of goods 35%*), then you could expect that if you generate \$100,000 in sales, your product usage should still remain about 35%, or \$35,000. What obviously also

increases as sales increase, is the gross profit that's left after you subtract your cost of goods. You would go from \$6,500 of gross profit generated from \$10,000 of sales, to \$65,000 of gross profit from \$100,000 of sales. This will give you a lot more money with which to pay bills, yourself, and a lot more will be left over as profit. I'm not suggesting that if your current sales are \$10K a month, that you should expect to be able to increase them to \$100K, but it illustrates the impact that increasing sales will have on your profitability.

What's even more exciting is that as sales increase, bottom line profit will increase exponentially! In other words, profit will increase at a faster rate than sales. So, if your sales double, your profit might increase by 2 ½ or 3 times. This happens because most of your expenses won't increase by the same percentage that your sales increase, and some won't increase at all. Expenses such as labor, payroll taxes, employee meals, and credit card fees will grow slightly as sales increase. But, your fixed expenses, such as, rent, insurance, utilities, office supplies, bank loan payment, licenses & permits, professional services, etc., won't increase at all. To put it simply, build sales and profit will blossom! *(A good portion of the upcoming chapters in this book will deal with how to increase your sales.)*

The example on the following page is 3-monthly income statements for a drive-thru coffee business, each reflecting a different level of sales. It illustrates how profit increases at a higher percentage than sales. Note that the increase in sales between the left hand column and middle column, (200 & 300 transactions per day), is 150%, ( $\$29,250 \div 19,500 = 1.5$  or 150%). However, the profit increased by 222%, ( $\$3,652 \div \$1,642 = 2.22$  or 222%). Likewise with the difference between 300 and 400 transactions per day, sales increase by 133%, ( $\$39,000 \div \$29,250 = 1.33$  or 133%), and profit by about 216%, ( $\$7,883 \div \$3,652 = 2.158$  or 216%). It's also interesting to note, that these increases in profit occurred even as monthly expenses increased. *(Remember, some expenses would be expected to rise as sale increase.)*

If you currently aren't making any money from your coffee business, don't feel bad. The truth is 95%+ of coffee businesses don't make any money in their first 6 to 12 months of operation, and sadly, many never turn a profit. I'm not saying that sometimes people don't just get lucky. I've had past clients who opened, and hoards of consumers came in from the very first day, and their operation generated a profit in the first month, and never looked back. This is wonderful when it happens, but it's not typical. Like most things in life that are worth having, you'll probably have to work hard to attain profitability in your

business. But, the good news is, if you're not allergic to hard work, the following chapters will provide you with a "road map" to move your business to profitability.

	A	B	C	D	E	F	G	H	I
1	<i>(Average Transactions per 10 Hour Day)</i>	<b>200</b>			<b>300</b>			<b>400</b>	
2	<i>(Average Transactions per Hour)</i>	(20 per hr.)			(30 per hr.)			(40 per hr.)	
3	<i>(Average Sales per Day @ \$3.25 per transaction)</i>	\$650			\$975			\$1,300	
4		(X 30 day mnth)			(X 30 day mnth)			(X 30 day mnth)	
5	<b>SALES</b>								
6	Beverage Sales	\$15,600	80.0		\$23,400	80.0		\$31,200	80.0
7	Food Sales	\$3,315	17.0		\$4,973	17.0		\$6,630	17.0
8	Retail Merchandise Sales	\$585	3.0		\$877	3.0		\$1,170	3.0
9	<b>Total Sales</b>	<b>\$19,500</b>	100		<b>\$29,250</b>	100		<b>\$39,000</b>	100
10									
11	<b>COST of SALES</b>								
12	Beverage Cost	\$3,588	23.0		\$5,382	23.0		\$7,176	23.0
13	Food Cost	\$1,823	55.0		\$2,735	55.0		\$3,647	55.0
14	Retail Merchandise Cost	\$351	60.0		\$526	60.0		\$702	60.0
15	Paper & Chemical Cost	\$878	4.5		\$1,316	4.5		\$1,755	4.5
16	<b>Total Cost of Sales</b>	<b>\$6,640</b>	34.1		<b>\$9,959</b>	34.1		<b>\$13,280</b>	34.1
17									
18	<b>Gross Profit on Sales (Gross Income)</b>	<b>\$12,860</b>	65.9		<b>\$19,291</b>	65.9		<b>\$25,720</b>	65.9
19									
20	<b>EXPENSES</b>								
21	Owner/Manager's Salary	(from profits)			(from profits)			(from profits)	
22	Employee Labor (@ \$10 per hr.)	\$7,500			\$11,250			\$13,050	
23	Payroll Taxes & Workman's Comp.	\$1,050			\$1,575			\$1,827	
24	<b>Total Labor Expense</b>	<b>\$8,550</b>	43.8		<b>\$12,825</b>	43.8		<b>\$14,877</b>	38.1
25									
26	Small Wares	\$25			\$25			\$25	
27	Laundry & Uniform	\$100			\$100			\$100	
28	Office Supplies	\$25			\$25			\$25	
29	Repair & Maintenance	\$50			\$50			\$50	
30	Phone / Internet	\$100			\$100			\$100	
31	Utilities	\$500			\$500			\$500	
32	Waste Disposal	\$100			\$100			\$100	
33	Advertising / Promos / Comps.	\$250			\$250			\$250	
34	Cash Over / Short	\$90			\$90			\$90	
35	Rent (triple net)	\$750			\$750			\$750	
36	Licenses & Permits	\$10			\$10			\$10	
37	Insurance	\$200			\$200			\$200	
38	Professional Services	\$125			\$125			\$125	
39	Bank & Credit Card Fees	\$343			\$489			\$635	
40	Loan Payment (Principal & Interest)	?			?			?	
41	<b>Total Expenses</b>	<b>\$11,218</b>	57.5		<b>\$15,639</b>	53.4		<b>\$17,837</b>	45.7
42									
43	<b>PROFIT/LOSS (Monthly)</b>	<b>\$1,642</b>	8.4		<b>\$3,652</b>	12.5		<b>\$7,883</b>	20.2
44									
45									