

Do The Math!



Working All the Angles

By Jay Goltz

Cutting costs has become the new focus for many companies as both the economy and the production framing industry have been beaten up. If that weren't enough, the banks have made it harder to borrow money. This situation has caused both suppliers and art and framing to reconsider how they buy and sell.

Some suppliers are offering cash discounts for quick payment. Is it worth paying in 10 days if you get a 2 percent discount? Let's do the math!

If you normally would pay in 40 days, you would be effectively borrowing the money for 30 days and giving up 2 percent to do so. To figure the true cost of that money, you have to divide the 30 days into 365 to determine what the annualized cost is. In this case, it would be $365/30 = 12$ (approx). You then have to multiply this by 2 percent, giving you an annualized cost of 24 percent. Most people would not want to pay charge card interest of 24 percent, but routinely pass up a 2 percent discount. That is expensive money. If you have \$20,000 of payables every month that offer a 2 percent discount that you pass on, it will cost you $\$20,000 \times 2 \text{ percent} = \$400 \times 12 \text{ months} = \$4,800$ per year. That's some real money.

Now, if you don't have the cash to pay the invoices in 10 days, you might still be able to borrow some money or even put it on a lower percentage credit card. If you could borrow the \$20,000 at 12 percent, you would still be able to save \$2,400.

2% discount x 12 months	24 % annualized discount
\$20,000/month x 2 %/month	\$400 savings/month
\$400/month x 12 months	\$4,800 savings/year
<hr/>	
Borrow \$20,000 at 12%	\$2400/year interest
\$4,800 savings - \$2,400 interest	\$2,400 savings when borrowing

There is another opportunity you have to squeeze some more profit out of the business. It is always worth looking into buying in larger quantities to get a bigger discount and to also save freight. The freight bill for getting one 1,000-pound shipment from an out-of-state supplier does not cost twice as much as a 500-pound shipment. It costs marginally more, say \$300 compared to \$200. Getting another 5 percent discount might make it well worth sitting on the added inventory for another month.

Let's do the math on that! If the cost of money is 6 percent, a "month's worth" will only cost 0.5 percent. If you saved 5 percent on the total order, you are well ahead of the game.

Cost of 2-month order	\$10,000
Added inventory cost/month	$\$5,000 \times 0.5\% (6\%/year) = \25
Freight cost savings	$\$300 \text{ vs. } 2 \times \$200 = \$100$
Order discount ($\$10,000 \times 5\%$)	\$500
Savings ($\$100 + \500)	\$600
Minus added inventory cost	\$25/month
Yearly savings on 6 larger orders	\$575/order or \$3,450/year

Here is why it's worth looking into. Suppliers are looking at all of their costs, are struggling for market share, and are also concerned about cash flow. Their view on discounts that they might have been willing to give two years ago could be very different today. Between cash discounts, freight savings, and product discounts, you might be able to save \$10,000 per year.

And every \$10,000 counts! ■

Jay Goltz owns Artists' Frame Service in Chicago, IL, which employs over 50 people at its main framing operation. He has received many business honors and is known for his straight talk on succeeding in business.