



# Double your profit

by Sidney Burton

**I**n 2004, APRO commissioned Trenholm Research to conduct an image survey for the rent-to-own industry. This survey revealed that we are doing business with only 6 percent of our potential customer base. During the past 12 months, I have given seminars exploring the nature of the elusive 94 percent of our potential customers. In this article, I want to address how many more customers you need to...

### ...double your profit

Let's assume that your store netted 6 percent pre-tax profit on total revenue last year. You may think you made 6 cents out of every dollar of revenue. This is a misconception. If you believe this, then you probably conclude that you need to double your revenue in order to double your profit. (I *do* think that it's possible to double your revenue, but I realize that I may be alone in this belief!) Some think it might be impossible to double revenue, so they conclude that it is impossible to double their profit and fail to do anything to improve their profitability. That's unfortunate, because most dealers need only increase revenue between 10 percent and 15 percent to double their profit.

### First, the expenses

Understanding the difference between fixed and variable expenses is the key to understanding the doubling of profit with only a small increase in revenue. Variable expenses are those that vary directly with revenue. As revenues increase, so do these expenses. Advertising, selling and delivery are variable expenses in a rent-to-own store. Total variable expenses should be between 8 percent and 12 percent of revenue.

Let's throw around some numbers. If your cost of rentals is 33 percent, then your gross margin is 67 percent. By adding 12 percent variable expenses to your 33 percent "cost of rentals," we arrive at a total "cost of rentals" of 45 percent. This leaves 55 percent as your "contribution margin." It's called contribution margin

allocated expenses. These are support costs that are necessary for the operation of a rent-to-own store, but the costs of which may be shared by more than one store. Some examples are home office costs, distribution costs and service costs. For our example, we will use 11 percent of revenue as our allocated expense amount and, to simplify matters, we'll add this in with our fixed expenses.

### The break-even point

Your break-even point equals fixed expenses divided by your contribution margin. In the example below, I've used an average monthly sales figure that might be higher than what is typical just to make the math easier. Let's take a look:

Average monthly revenue	...\$100,000 (100 percent)
Cost of rentals	.....\$33,000 (33 percent)
Gross margin	.....\$67,000 (67 percent)
Variable expenses	.....\$12,000 (12 percent)
Fixed expenses	.....\$49,000 (49 percent)
Net profit before tax	.....\$6,000 (6 percent)
Break-even revenue	.....\$89,091 (fixed expenses/contribution margin)

In other words, it takes \$89,091 of sales at a 55 percent contribution margin to cover the fixed expenses of \$49,000. Incremental revenue (revenue received after you've passed your break-even point) equal average monthly revenue minus break-even revenue. (\$100,000 - \$89,091 = \$10,909). Net profit = incremental revenue times contribution margin. (\$10,909 x 55 percent = \$6,000)

Consequently, we can see that the last \$10,909 of revenue produces all the profit! The rest of the revenue went to pay the fixed expenses. The good news is that in this situation, it will take an increase in revenue of only \$10,909—or a little more than 10 percent—to double the profit to \$21,818. At an average yield per customer per month of \$150, the \$10,909 amount represents about 73 new customers. Just think of it: 73 new customers to double your profit! That's all it takes!

Do you know where you're going to get these 73 new customers or how you're going to convince them to rent something? Well, I have some ideas on this subject. If you want to find out what they are, come to APRO's 2006 Convention and Buying Show, September 20-23, in Orlando. We'll be addressing these ideas in a seminar entitled *RTO Strategies: Pricing, Marketing and Keep Rates*. I hope to see you there! ■

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## Understanding the difference between fixed and variable expenses is the key to understanding the doubling of profit.

because it is that portion of every revenue dollar that contributes to covering fixed expenses. Once your fixed expenses have been covered and you are past your break-even point, this 55 percent is then contributing to profit. In other words, a rent-to-own store that nets 6 percent of revenue doesn't make 6 percent out of every dollar. The store is losing money until the fixed costs are covered and the break-even point is passed. Once past the break-even point, they don't make 6 percent from every subsequent revenue dollar—they make 55 percent!

Now let's take a look at fixed expenses, such as occupancy costs, insurance and property taxes. Of course, all expenses are variable in the long term, but fixed expenses are either static over a range of revenue or they vary based on some other factor, such as inventory levels.

If you have more than one store, you may also have

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