IDEAS

ASK ALAN | BY ALAN FRIEDMAN

COMPENSATING A RETAIL SALES STAFF

Alan,
I just received the latest copy of *Music Inc.* and promptly began reading it cover to cover. I got to the article by Sara Farr ("How to Fix Your Business," June 2007), and somewhere in the middle, there were some financial indicators of what rent, advertising and salaries should be as a percentage of sales. I was mortified to find that our sales salaries are at a way higher percentage of sales than what was reported in the article.

Please tell me I should be including something else in my sales number (maybe rental or repair income?). And if an owner spends a fair amount of time generating sales, should officer compensation be included in sales salaries? Is there something I'm missing, or do I should I start lowering salaries by firing myself?

Kris Kjeldgaard
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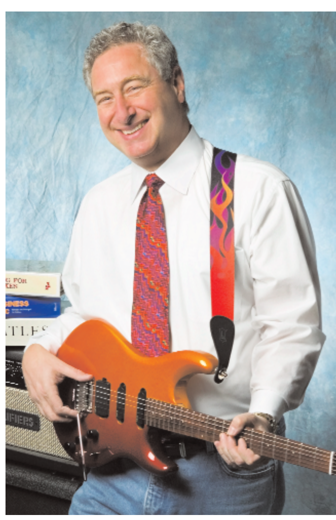

Sales staff compensation is a factor of a dealer's type, profitability and the way sales contribute to revenue

Hi Kris,
I don't think you'll need to fire yourself, as long as you figure out why your sales staff salaries, measured as a percent of net sales, are higher than the norm and do something to correct it. Let's see if we can get to the bottom of this issue before you write yourself a pink slip.

There's an old saying in the accounting profession — ask any accountant any question, and you'll always get this answer: "It depends." So, is your sales staff compensation higher than it should be? Well, it depends. It depends on your type of dealership (combo/MI, school music, keyboard, print music, full-line), how you're reporting revenue earned by your store on financial statements and whether your store is ultimately profitable on the bottom line. Let's talk about each of these issues.

COMPENSATION & DEALER TYPE

According to trends found in NAMM's annual Cost of Doing Business Survey and the many financial statements we prepare for our music retailing clients, we've found sales salaries generally fall between 8–22 percent of sales, depending on the type of dealership. Standard figures are: keyboard, 8–13 percent; combo/MI/pro audio, 9–15 percent; school music 14–22 percent; and full-line, 11–15 percent. These ranges vary depending on whether sales are the predominant revenue generator for the given retailer and depending on the average price of items sold by that retailer.

For most keyboard stores, sales are the predominant revenue-generating activity, and these retailers tend to sell pricey goods like acoustic pianos. So, sales salaries as a percentage of sales tend to be at the lower end of the range because a keyboard dealer's sales volume is typically the largest number on its income statement.

For most school music stores, sales are often a secondary revenue-generating activity. These dealerships also focus on generating rental, repair and lesson income. Furthermore, the sales they do make are often comprised of smaller-priced goods like student-line instruments, band accessories and method books. So, sales salaries as a percentage of sales tend to be at the higher end of the range because a school music dealer's

sales volume is typically one of a few large revenue sources on its income statement.

WHAT COUNTS AS SALES REVENUE?

The second issue has to do with the other revenue items a retailer includes in the sales revenue they're comparing salaries to. A properly formatted income statement for all music retailers should begin by reporting "sales" — and nothing more — followed by "cost of goods sold" and "gross profit."

Sales should not include rental, repairs, lessons, deliveries or any other material source of revenue. These items should be reported as "Other Operating Income" after gross profit but before overhead expenses. When done correctly, overhead expenses, such as sales salaries, will be consistently compared to "sales only." If you include other operating revenues in sales, you'll erroneously report much higher gross profit and much lower operating expenses as a percent of sales.

And, by the way, do not include officer salaries in sales staff compensation, even if officers are involved in selling activities. Segregating these two types of compensation lets you properly measure both sales compensation and store profitability for the owner; think about how distorted sales compensation would be by including an officer's salary of $300,000.

Once you're using the right numbers to calculate sales salaries as a percent of sales for your type of store, you can determine if those salaries are too high, too low or just right. If your sales salaries still appear to be too higher than the norm, don't beat yourself up just yet. Take a look at your officer's salaries and bottom-line net income. If they're both healthy, your sales staff compensation may still be OK because your staff sold product profitably, as opposed to just churning sales with little profit. But if, in the end, you're not profitable after a reasonable officer salary, then perhaps we can conclude you're sales staff is being paid too much — either individually, in the aggregate, or both — for the volume they're generating.

'Sales should not include rental, repairs, lessons, deliveries or any other material source of revenue.'

Kris, I hope this guides you in your analysis of sales staff compensation. If if turns out you do in fact have a compensation problem and want to know what to do next, well, the answer is … it depends. **MI**

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