

BAKERY TOOLKIT

How To Manage Your Business Through A Tough Economy

- 04** CATEGORY MANAGEMENT –
Improving your product mix to match demand is a crucial step on the road to higher profits.
- 10** FINANCE –
Help is on the way. New government programs aim to boost credit access for small businesses.

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Tough Times, Smart Choices

A tough economy can dictate tough choices for your product assortment. Items that are not meeting sales expectations need to be scrutinized—and, if necessary, replaced. Yet don't underestimate the opportunities that lie before you to innovate with new products and new flavor combinations.

“Every two weeks now, we are looking at products that are not moving fast enough,” says Bobbie Merritt, co-owner of Merritt's Bakery in Tulsa, OK. “In our dessert cakes, for example, we have been scrutinizing flavor combinations a lot more.”

Merritt's Bakery, a family-owned bakery with four retail locations and a central bakery/kitchen, is not unlike a lot of retail bakeries today. Bakeries are looking for answers. Solutions are not always obvious. Yet, if you look closely enough and ask a lot of good questions, the path to profitability starts to grow quite a bit brighter.

In this first edition of *Bakery Toolkit*, we offer valuable tools you can use to manage your bakery business through a tough economy, including ideas on how to use category management, price products effectively, and more.

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Assortment: Manage Categories

Identifying and implementing category management principles and tactics at your retail bakery operation can be a critical move toward improving your profitability during tight economic times. The process starts with capturing sales data—as specific as possible—on the front end (or point of sale). For example, it’s not only important to know how many muffins you sell every week, but it’s just as valuable to tabulate your weekly sales of blueberry muffins, banana nut muffins, and so on—for every flavor, size, and package type of muffin that you offer.

At McArthur’s Bakery in St. Louis, customer expenditures in the past three months are down, but customer traffic is up, says David McArthur, vice president of the family-owned bakery. Yet using category management principles, the bakery has adapted to this shift without losing

any sales. In fact, sales during the Christmas period were up 2 percent, and Valentine’s sales were up 4 percent. So how did McArthur’s do it?

“We have keyed on a variety of holidays to have a larger variety of lower-cost items available during these times,” McArthur says. During Valentine’s, for instance, McArthur’s Bakery switched gears from offering a lot of 10-inch fruit tarts and cheesecakes to featuring more 4-inch individual sizes of these items. “By doing that, we were able to keep sales fairly stable, even higher. During Christmas, our average ring a year ago was \$7.25. This year it was \$5.50. But our sales were up because we sold a lot more.”

Vince Termini at Termini Bros. in Philadelphia shares a similar experience. “We make sure the products that are out there are the quality that Termini Bros.

Category Management Primer

Category management begins with the careful review of retail sales records, helping you identify store tactics, such as optimal assortment, appropriate promotion frequency and product display allocation, at key times of the year. The result is specific category plans, which ensure the right products at the right time and the right price are available to the majority of shoppers every day.

Start by arranging all of the bakery products that you sell into core categories: cakes, cookies, muffins, etc. Then, for each core category, list all of the subcategories underneath for which you want to keep track. Create a flow chart. Under cakes, for example, you may want to list the following subcategories: decorated cakes, dessert cakes, wedding cakes, crême cakes, cupcakes, snack cakes, individual desserts (including cake slices), cheesecakes, and ice cream cakes.

Analyzing sales data and recognizing key trends will open the doors for increasing profits within categories and subcategories that are on the rise, as well as identify which categories and subcategories may be on the decline. Knowing this information can be the difference between staying profitable and going into the red.

is known for, but at affordable prices,” he says. “During the holidays, we were slicing cakes and selling slices for \$1.50 apiece. We also offered monster-sized, chocolate-covered strawberries, using fresh strawberries dipped by hand. Where else is a consumer going to find chocolate-covered strawberries that size for just a dollar apiece?”

The good news is that category management principles help you strategize at the most basic level—and provide a valuable framework for managing profitability. Even if you don’t have a point-of-sale computer for capturing sales data, you can keep track of what you produce, what you sell and what you throw away every day. Listen to your customers. Make sure you have a system in place to gather and act on customer feedback. If a product or variety is dropping off in sales, find out why. Then take steps to

tweak the item to meet your customers’ needs or replace it with something they will want even more.

“What we find is that people have gone from eating out at a restaurant two or three times a week to now eating out one night a week,” McArthur says. “People are eating more at home. But, now, at least one meal of the week is planned, and people are stopping by our bakery for a cake for those planned meals. Our layer cake sales are way up. The key thing is to control your stales. You don’t want stales of the high-end, expensive stuff, because that kills you.”

Think about your position in the marketplace. What sets you apart, and how do you stack up against the competition? If you sell the best cakes in town, make sure you are not the lowest price in town, or not even close.

Cookies: Fill The Need

Cookies are well positioned to serve the changing needs of today's consumers. On one hand, more are craving indulgent, hand-held sweet goods for holidays, parties and other occasions. Others are seeking out more healthful options. Cookies afford you the flexibility to target these trends or any number of demand shifts that show up in your local marketplace. The key is to stay knowledgeable about consumer consumption habits and watch closely how customers spend their dollars at your bakery.

Veteran bakery owners like Kirk Rossberg of Torrance Bakery in Southern California, for example, are witnessing an upswing in demand for decorated cookies. One driving force is the economy. "Rather than treat yourself to a fancy dinner, you're going to treat yourself to a \$2 cookie," he says. "So far, it seems like people around here are

treating themselves to bakery, and cookies keep getting more popular."

At Torrance Bakery, a two-store operation based in Torrance, CA, the bakery maximizes cookie promotions for holidays using a colorful monthly flier, which is available to customers on several counters inside the bakery. The bakery's March 2009 flier not only lists monthly specials like shortbread cookies for \$1.50 apiece, but includes suggestive selling lines: "Purchase a dozen Egg or Chick Cookies for \$16.50!" or "Purchase a dozen Bunny Head Cookies for \$21.45!" This gets customers thinking about upcoming Easter parties and boosts impulse sales.

One critical piece to planning holiday or weekly promotions is to think big. Then think bigger. At Torrance Bakery, the bakery runs a special every Wednesday—buy two dozen cookies and a get a third dozen

free. “We’ve been doing this for a couple of years, and it’s been really great for drawing in customers,” Rossberg says. “Wednesdays are a lot busier days now. Even at that price, it’s very profitable. We sell cookies for \$7.50 a pound (retail), and our food cost is about \$1.10 a pound.”

> CONSUMER SPECIFIC

Other bakery owners like Kurt Schmitt of Deerfields Bakery in Deerfield, IL, are experiencing more demand for healthful options or items that address specific dietary needs like gluten-free.

As healthy eating started to go mainstream a number of years ago, Miriam Diamond, president and owner of Nana’s Cookie Co., was creating alternative baked foods made with natural ingredients. “Seventeen years ago, there wasn’t much tasty in what was then known as the natural foods arena,” Diamond says. Nana’s Cookie Co., San Diego, CA, manufactures whole-grain cookies and cookie bars and bites free of “Nana’s No’s.” The No’s include preservatives, chemicals, cane and beet sugars, refined sugars, dairy, cholesterol, hydrogenated oils, eggs and trans fats. “As the population ages and allergy problems grow, shoppers become more selective,” she says.

> COOKIES ANYTIME

Breakfast cookies may just prove that the childhood request of cookies for breakfast isn’t as bad as mom might have once thought. The desire to create a shelf-stable “portable bowl of oatmeal” was the catalyst behind the first breakfast



cookie created 17 years ago by then-23-year-old entrepreneur Erin Baker. She observed the need for a healthy product that could be eaten on-the-go at any time of the day.

Erin Baker’s Wholesome Baked Goods, Bellingham, WA, offers breakfast cookies that are free of cholesterol, trans fats, refined sugars and high-fructose corn syrup. “We are a grab-and-go society, and people are missing out on the benefits of eating breakfast,” Baker says. “The breakfast cookie is not just a snack; it’s truly an on-the-go meal that can fill you up.”

> PERSONAL TOUCH

Mintel, a Chicago, IL-based research organization, reported the health-oriented cookie segment is experiencing robust product activity with opportunities for manufacturers using whole grains, quality ingredients, upscale products with organic certification and antioxidant-rich fruits and nuts. “One reason why cookies may be seeing such success in a difficult climate is their unusual flexibility,” according to Mintel analysts.

Graduation Season: Plan Ahead

Graduation season can be like Christmas for bakeries. Average weekly sales of cakes and cookies will climb as much as 50 percent higher from mid-May through June at bakeries such as McArthur's Bakery in St. Louis and Torrance Bakery in Southern California.

For starters, put out signs inside your bakery about graduation specials in April, or sooner. Find out if you can distribute fliers or newsletters at area schools, and check into electronic notices that you can send to schools for posting on their websites.

Make sure to contact local and regional media outlets (newspapers, radio stations, etc.), and think of clever ways to promote your bakery. A giveaway contest is one great idea; contact your city's top radio stations and ask if you can participate in a free giveaway of a gradua-

tion cake from your bakery. Make a list of schools in your area or state (don't forget public and private schools) and build your graduation chart using a spreadsheet. Under each school, list the respective school colors, graduation dates, mascots and other special graduation events in your surrounding communities. Educate your sales and customer service staff with this information weeks in advance.

> MANAGE TO MAXIMIZE

Another important step is to treat graduation season as a defined category of your business. Bakeries are able to maximize sales opportunities during graduation season, through the knowledge of knowing which subcategories (decorated cakes, cupcakes, message cookies, etc.) offer the greatest potential for sales opportunities during this important time frame. To help bakeries better understand these opportunities, the

first 2009 Dawn Bakery White Paper, titled “Plan to Graduate to Head of the Class,” offers many insightful ideas for bakeries looking to boost their graduation sales. This report is based on 2008 sales at U.S. supermarkets.

Across the total U.S. during graduation season last year, cakes averaged \$3,030 per week per store, which is 16.5 percent more than the total year average of \$2,601. All cake subcategories averaged higher dollar sales during graduation season than during the total year. Representing the largest lifts at graduation time are snack cakes (including pound cakes, angel food cakes and shortcakes) at 36.6 percent, decorated cakes at 24.6 percent and ice cream cakes at 23.6 percent.

In the cookie category, message cookies (32.2 percent higher), everyday cookies (7.2 percent higher) and mini cookies (0.2 percent higher) all averaged higher dollar sales during graduation season.

Regionally, cakes captured 37.4 percent of bakery department dollar sales in the South during graduation season, over 5 points above the national average. At 12 percent contribution during graduation season, the Central region had the largest cookie contribution and was 3 points greater than the national average. More than 4 million graduations take place every spring and summer at American colleges and high schools. Bakeries that plan ahead can capitalize on this opportunity to maximize sales.

Licensing 101

When it comes to putting licensed characters on cakes, the baker doesn't have much leeway. It's important to understand the federal laws that protect trademarked and registered characters.

The “TM” mark used with a word, phrase, symbol or design alerts the public to a prior claim. The federal registration symbol, ®, is only used after the United States Patent and Trademark Office has received an application and registers the mark.

Licensing occurs when a brand owner extends its trademarks to consumer products manufactured and distributed by others.

The key is profit. It is illegal for retail bakeries to sell a free-hand drawn trademark character on a cake; it is illegal for a supermarket bakery, as well as the woman down the street who sells decorated cakes to families on her block.

You cannot make a profit on a character that does not belong to you. You also cannot alter the appearance of a famous character by a certain percentage and be safe.

Copyright issues also come into play when putting photos on your cakes. Professional pictures often belong to the studio that took them.

A simple phone call asking for permission will often be enough to allow you to scan and print an edible copy of a senior or team photo for one cake.

Some suppliers have agreements with many local photo studios, so be sure to check.

Finance: Explore Your Options

If you are feeling in a financial slump because of the economy, help is on the way. As part of the government's Financial Stability Plan (FSP), President Obama and Secretary Geithner on March 16 announced plans to take immediate action to help ensure that credit gets flowing again to entrepreneurs and small business owners.

The Obama Administration announced that economic recovery will be driven in large part by America's small businesses, which have generated about 70 percent of net new jobs annually over the past decade. Still, businesses with strong credit histories have seen loan applications denied due to conditions that have nothing to do with their own actions and are now struggling to expand their businesses, make their payments or even keep workers on their payrolls. As a result, while the U.S. Small

Business Administration (SBA) typically guarantees about \$20 billion in loans annually, new lending is trending below \$10 billion this year.

The Obama Administration has taken several positive steps to ensure that small businesses have access to the credit they need to support an economic recovery. The American Recovery and Reinvestment Act, signed by the President, provides for increased guarantees and reduced fees for certain Small Business Administration loans.

Further, the IRS will issue guidance for a provision in the Recovery Act that allows businesses with gross receipts of up to \$15 million to "carry back" their losses for up to five years, effectively allowing them a rebate on taxes paid in previous years. The carryback provision is only one of several measures in the Recovery Act that



will improve liquidity for small businesses by lowering their taxes, including:

Incentives to Invest in Plant and Equipment by Allowing Small Businesses to Write Off Up to \$250,000 of Investment:

The Recovery Act allows small businesses to immediately write off up to \$250,000 of qualified investment in 2009, providing an immediate tax incentive to invest and create jobs.

Additional Liquidity Support By Reducing Estimated Tax Payments:

Normally, small businesses have to pay 110 percent of their previous year's taxes in estimated taxes. But with incomes down for many small businesses this requirement is too burdensome—and causing a cash crunch. The Recovery Act allows small businesses to reduce their estimated payments to 90 percent of the previous year's taxes, helping to boost their li-

quidity and better align their estimated taxes with their actual taxes in a year of severe economic contraction.

Extension of Bonus Depreciation Deductions Through 2009:

The Recovery Act also extends through 2009 bonus depreciation, allowing businesses to take a larger tax deduction within the first year of a property's purchase.

The Small Business Administration has centers located in all 50 states called Small Business Development Centers (SBDC) that will give your business free or very low cost counseling. Your local SBDC can be found on the Association of SBDC's (<http://www.asbdc-us.org/>). SBDC counselors are experienced and their assistance can be invaluable. Many SBDCs conduct regular classes to help small business owners learn valuable new business skills that help them succeed.

Pricing: Know Your Numbers

Pricing for profit can be one of the most important decisions you make nowadays. So don't forget to add skilled labor hours into your pricing equations, according to retail baker Christian Merritt of Merritt's Bakery in Tulsa, OK.

Merritt, who majored in engineering physics in college and is the oldest son of Merritt's Bakery owners Larry and Bobbie Merritt, is studying a different set of equations lately for his family's four-store retail bakery operation.

Gone are the days when you can afford to apply the old "five times material costs" equation to pricing your products, bakery experts agree. Bakers need to apply activity-based costing, a process of evaluating all related costs in producing each and every item individually.

Variables that need to be factored into

pricing, Merritt says, include how much supplies cost, how much you are paying your staff, what skill set is required to produce each cake, and how efficient is your staff's production.

Merritt offers a formula that can help you determine the cost to produce any custom cake: Labor cost equals wage multiplied by time, divided by decorator's percentage, minus the base price of cake.

For bakeries that decorate a lot of cakes, it's important to calculate decorator's percentage, or the time it takes each decorator to complete one cake. Merritt offers this formula: The decorator's wage multiplied by time, divided by the sum of the cakes done by this decorator. That's the decorator's percentage.

For example, say a decorator whose sal-

ary is \$14 per hour and has a 12 percent decorator's percentage can complete a custom order of a cake with a base price of \$30, the labor cost of the custom order is \$86.67, using his formula. "The percentages should remain between 10-20 percent," he says. "You can decide the threshold of where your decorator's percentages should be."

Once the math is done, chart out your base cake prices, chart out all the prices of extras, and chart out your labor rates. Merritt's Bakery has charted out basic skill levels for drawings, cutouts and sculptures. As a result, the bakery's employees can quickly price out a custom cake order based on whether it will include a cutout, a drawing or sculpture, or any extras like licensed characters (refer to page 9 for licensing guidelines). "You can have anyone price almost anything if they simply know how long it will take," Merritt says. "All these things can be done without a great deal of technology."

The next step is to better understand what factors, beyond price, will most influence your customers' purchasing decisions. Malcolm Gladwell, best-selling author of "The Tipping Point," says it's never been more complicated for the American consumer to make a decision than right now. Factors like store design and merchandising layout play a huge role in whether consumers buy more or walk away from a stressful environment. Communicate the value to the shopper with simple, clear messages.

Manage Costs by Taking Out the Guesswork

In this tricky environment, it is imperative that retail bakery owners and managers maximize their profitability through strategic planning, cost and pricing analysis, and staff scheduling, among other factors. And one valuable tool that can help take the guesswork out of the equation is probably staring you right in the face on many days—your computer.

The right computer software programs can help you manage costs by giving you a more accurate and immediate read on true profitability. You may think you're making money on a particular baked good, especially one that you've been selling for a long time. But until you run the numbers, you don't really know.

One strategy involves calculating your operating costs per square foot, a feature that is available on computer programs like BakeSmart software. Owner Ray Clements says their software has made it possible for any bakery to input their total sales, total square footage and total hours they operate to determine their operating cost per square foot.

Bakers can use this software to figure out how much it costs their bakery to make any product or operate just about any piece of equipment—down to the penny. "If you can't track your costs, you can't control your profit," Clements says. "And the tougher times get, the sharper you have to be."

Benefits: Engage Employees

It's no secret that health-care costs for bakery businesses continue to rise. What is less understood is how to manage these costs, while at the same time ensure that your people are getting the right coverage for their needs.

Dawn Foods learned several important lessons during a recent health-insurance switchover to BlueCross BlueShield for its 2,300 U.S. employees. Dawn's new medical benefits' plan took effect on Jan. 1. One of the key elements to a successful transition, according to Dawn executives, is that communication with your employees—and their families—is crucial to the process.

Tom Harmon, Dawn's President of Human Resources, says they began investigating options more than 1½ years ago, as the economy began to worsen and as they evaluated the benefits' needs of their

people. "At Dawn, we follow the principle of what we call the Circle of Excellence, and our people are at the top of that circle," Harmon says.

The challenge, though, arose when Dawn opted to pursue a rapid upgrade of "team member" benefits for 2009, giving them just three months to accomplish what normally would be a nine-month process of examining options and implementing a switch to a new medical benefits plan. Yet the need was pressing enough to forge ahead. "We were optimistic that it was possible, even though we knew there would be difficult pieces to accomplish," Harmon says.

It was already late June, and all communications about the benefits' upgrade would have to be out in front of all employees by October, so that Dawn team members could make their choices in November.

“We had a hard date in the sand for October,” Harmon says. “We did a review with our executive team and ownership and told them, ‘Here’s our plan, and we need your support. We think the overall gain will be big enough that we need to go after it.’ Our executive team and ownership gave their full support.”

Dawn also sought out a vendor-partner that would work with them toward this goal. They were up front with vendors about the expectations of what they needed—and when they needed it by. BlueCross BlueShield was able to give Dawn “a dedicated response to move the whole team forward,” Harmon says.

Dawn accelerated communications with its thousands of U.S. employees, sending out 24 different types of messages—including emails, newsletters, benefits meetings and paycheck stuffers. BlueCross BlueShield offered a wide range of attractive benefits, such as 24-7 customer call-in phone lines, web-based support service, multiple language service, and more. Dawn employees gained improved access to doctors and the ability to follow up on claims any time of day, including evenings and weekends.

“The whole focus of the rapid upgrade was service, service, service,” Harmon says. “Part of the Dawn culture is getting a little bit better every day. What we learned is, don’t let perfection be the enemy of the better. When you clearly know where you are going will be a significant upgrade from where you are, then hurry up and get there.”

New Option to Address Health-Coverage Problem

Health care represents an increasingly important issue for small and medium-sized bakeries.

Nearly 90 million Americans, or one of three people under 65 years of age, were uninsured at some point during 2007-2008, according to a report released in March by the health consumer organization Families USA.

Five years ago, seven in 10 American businesses offered their employees health insurance. In 2009, the number is six out of 10. The biggest barrier is high costs. The National Restaurant Association reports their members—many of which are small businesses—say health care costs are up an average 14 percent per year.

To help bakeries address this growing problem, the Retail Bakers of America recently announced a new partnership with Association Health Programs (RBA/AHP) to help reduce the rising cost of health insurance.

The following benefits are nationwide and are offered to RBA members: health insurance, life insurance, long-term care insurance, cancer coverage, accident insurance, disability income, critical illness, dental insurance, and vision.

These benefits will allow RBA members to take advantage of better insurance coverage at the lowest possible rates with its new comprehensive health insurance program for individuals, families, groups, and businesses.

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Another article looks at health care benefits, and the importance of communicating with your employees to ensure their needs are being met. Overall, we hope *Bakery Toolkit* serves as an important resource to make smarter and more profitable decisions.

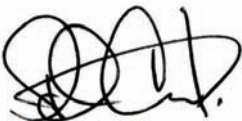
Producing great-tasting bakery goods remains as important as ever. But now, says Merritt, the analytical side of the bakery business is increasing in importance.

Merritt's Bakery recognizes that small ideas can add up to bigger profits. For example, the Tulsa, OK, bakery recently re-introduced a mocha cake with a new whipped cream icing and a caramel filling that they already had in stock. "It's selling better now," Merritt says. "Sometimes, you can just tweak the icing or tweak the filling. We started experimenting with flavor combinations to use up stuff that we already have faster."

Merritt points out that you can't just count floor time in your bakery when assessing inventory turns. "You've got to count time on the floor in the warehouse," she says. "Anything that makes your SKUs move faster for the distributor is also better for the baker."

Bakeries like Merritt's draw on their vast experience as bakers to make the right choices every day about what to sell and what to promote. But you can't rely on gut instinct alone. It takes a scientific approach to managing your business if you hope to turn a profit—and especially so during a tough economy.

"It's kind of like fishing," Merritt says. "The experienced fishermen go to the spot where they know they're going to get a bite."



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