Warren Buffett — What You Should Know About the Jewelry Business

April 26, 2011

A Message from Warren E. Buffett

Chairman, Berkshire Hathaway Inc.

What You Should Know About the Jewelry Business

You don't need to understand the economics of a generating plant in order to intelligently buy electricity. If your neighbor is an expert on that subject and you are a neophyte, your electric rates will be identical.

But jewelry purchases are different. What you pay for an item vs. what your neighbor pays for a comparable item can be, and often is, widely different. Understanding the economics of the business will tell you why.

To begin with, all jewelers turn their inventory very slowly, and that ties up a lot of capital. A once-a-year turn is par for the course. The reason is simple: People buy jewelry infrequently, and when they do, they are making both a major and very individual purchase. Therefore, they want to view a wide selection of pieces before zeroing in on a single item.

Given that their turnover is low, a jeweler must obtain a relatively wide profit margin on sales in order to achieve even a mediocre return on their investment. In this respect, the jewelry business is just the opposite of the grocery business, in which rapid turnover of inventory allows good returns on investment though profit margins are low.

In order to establish a selling price for their merchandise, a jeweler must add to the price they pay for that merchandise, both their operating costs and desired profit margin. Operating costs seldom run less than 40% of sales and often exceed that level. This fact requires most jewelers to price their merchandise at double its cost to them or even more. The math is simple: Jewelers charge $1 for merchandise that has cost them 50 cents. Then, from their gross profit of 50 cents they typically pay 40 cents for operating costs, which leaves 10 cents of pre-tax earnings for every $1 of sales. Taking into account the massive investment in inventory, the 10-cent profit is adequate but far from exciting.

At Borsheim's the equation is far different from what I have just described. Because of our single location and the huge volume we generate, our operating expense ratio is usually around 20% of sales. As a percentage of sales, our rent costs alone are fully five points below those of our typical competitor. Therefore, we can, and do, price our goods far below the prices charged by other jewelers. In fact, if they priced to match us, they would operate at very substantial losses. Moreover, in a virtuous circle, our low prices generate ever increasing sales, further driving down our expense ratio, which allows us to reduce prices still more.

How much difference does our cost advantage make? It varies by competitor but, by my calculation, what costs you $1,000 at Borsheim's will, on average, cost you about $1,350 elsewhere. This is called the “Borsheim’s Price.” There are very few instances where we are unable to offer you those great savings due to restrictions, but you will always know upfront if an item is non-discountable.

Of course, price means nothing unless you are sure of the quality of what you are getting. When products are branded, such as watches and chinaware are, comparisons are simple. But jewelry is usually a "blind" item — and that puts virtually all purchasers at the mercy of the seller.

I can remember well how helpless I used to feel in a Fifth Avenue or Rodeo Drive jewelry store, where the only thing I knew for sure was that the operator had extraordinarily high overhead — and that they had to cover it in their sales price. I was also wary of the "upstairs" solo operator who operated on consignment merchandise, since that would have cost them more than merchandise bought outright, and would necessarily have inflated their retail price. And, finally, I always worried about the quality of what I was getting. I couldn't tell the difference between an emerald or a diamond worth $10,000 and one whose value was $100,000. (I still can't.)

My sense of helplessness led me to an obvious conclusion: "If you don't know jewelry, know your jeweler." For that reason, I made all of my jewelry purchases at Borsheim's for many years before Berkshire Hathaway bought the company. I didn't know stones, but I did know Ike Friedman, the retailing genius who had built the business from nothing into one of the nation’s largest independent jewelry stores. When I purchased Ike's business, I did it without an audit but with full confidence that I was getting value received. And that's just what I got — precisely as I had when I purchased a single piece of jewelry from him.

The main point of this letter is to tell you that you don't have to live near Omaha to benefit from Borsheim's. Our “shop-at-home” program brings Borsheim’s to our qualified customers. Simply contact Borsheim’s to describe what you’re looking for — to any degree of detail. We will assemble selections that best reflect your wishes and send them to you. Then, in the comfort of your own home or office, you can conveniently and leisurely select the item(s) you most prefer, or return the entire selection.

Our results from this "shop-at-home" program have been amazing. Customers have loved it and keep coming back for more. Each year, we send out several thousand packages, ranging in value from $100 to $500,000. Call us at 800-642-GIFT (4438) to learn how to qualify for Borsheim's "shop-at-home" program.

At Borsheim's the service will be exemplary, the price will be exceptional and the merchandise will always be what you are told that it is. You have my word.

Warren E. Buffett

Chairman of the Board