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SHRINKAGE - IT CAN BE CONTROLLED!

I touched on this subject last month but feel it is important enough for more dialogue. A survey done by the National Retail Security Survey for 2006 reports that the breakdown of shrinkage causes are:

- 47% employee theft
- 32% shoplifting
- 14% administrative error (paperwork errors in your office and store)
- 4% vendor fraud

Did you know that inventory shrinkage remains the single largest category of larceny in the United States, more than motor vehicle theft, bank robbery **and** household burglary **combined**?

If your fiscal year ended in December, January or February it is too late to do anything about last year's shrinkage. However, **everyone** can take steps so shrinkage for the current year will be less.

Too many times retailers do not get the most value from the information available from the physical inventory count. They either do not know how to analyze the results or do not take the time to do so. Due to this they fail to make the changes in their operation that will help them to reduce future losses due to shrinkage. Of course, there are costs involved in instituting tighter internal controls. However, in most cases these costs are not significant and can provide other benefits for the company because a well-run and controlled business is a more profitable business.

Was your shrinkage as low as you expected, and wanted, it to be? If not, following is a procedure to help you determine the probable cause of shrinkage for each individual classification (you will need unit information in addition to retail data to do this):

1. Calculate the average retail of inventory shrinkage.
(retail shrinkage dollars divided shrinkage units)
2. Calculate the average retail of merchandise sold for the past year.
(sales dollars divided by units sold)
3. Calculate the average retail of merchandise in ending inventory.
(retail dollars divided by units)
4. Compare the average retail of inventory shrinkage to the averages of merchandise in inventory and sold.

Using a spreadsheet makes the calculations easy and less time consuming.

If the average unit retail of inventory shrinkage for a class is considerably higher than the average unit retail of ending inventory and units sold, the probable cause of shrinkage is due to unrecorded markdowns and missing merchandise. This is the most common source of discrepancy we see.

If the average unit retail of inventory shrinkage is considerably lower than the average unit retail of ending inventory and units sold, then a partial cause of shrinkage is due to one or both of the following reasons: misclassified merchandise (wrong class number used when entering receipts, sales, markdowns, transfers or physical counts) or employee fraud.

If the average unit retail of inventory shrinkage is very close to the average unit retail of ending inventory and sold merchandise (add together and then average the two), the cause of shrinkage is most likely missing merchandise.

Review the data carefully. It can tell you a lot if you know what to look for. Common causes of shrinkage are: misclassified merchandise, un-recorded transactions such as un-recorded markdowns, employee fraud and shoplifting. For example, did Long Sleeve Sport Shirts have a shortage while Long Sleeve Dress Shirts showed an overage? This could mean that a merchandise receipt was recorded using the wrong class number. In a multi-store company, if Mens Blazers is 'short' in Store 1 but 'over' in Store 2 the most likely cause was a merchandise transfer that was not recorded.

There are numerous things, other than missing merchandise, unrecorded markdowns or employee fraud that can cause shrinkage. If the physical count is poorly done and some merchandise is not counted, it will show up as missing merchandise, even though it is actually not missing. Or if some merchandise is counted using the wrong class number or incorrect price the physical count will be distorted.

Many times, paperwork errors show up as *overage* when the physical count is compared to the book inventory. Overage is bad because it hides or distorts actual shrinkage. It also distorts Gross Profit for a classification, making it appear higher than it actually is.

If you want to reduce shrinkage and increase the accuracy of your inventory records, the first step is to make it a high priority in your store. Employees must be educated in what to look for so they can detect shoplifters. Use physical deterrents to discourage shoplifters, such as keeping small expensive items behind the counter and eliminating any blind spots. You must communicate to your employees the importance of paying attention to the details and making sure that all paperwork is completed in an accurate and timely manner.

Let your employees know that any employee caught stealing from the company in any manner will be immediately terminated and a police report will be filed. Some situations are more conducive to theft than others. The opportunity to commit fraud is more convenient when people have access to financial accounts, when no one audits them, and when they think it is unlikely they will be caught or prosecuted or punished. **Fraud is easier when companies have poor internal accounting controls and when they fail to follow them.** Occasionally, fraud is so convenient that even honest people are seduced by the opportunity presented to them even though they had no intention of being dishonest.

You must set up procedures that include good internal controls. Shortages can and will occur at every point where merchandise changes hands or paperwork is created or processed, from the time it comes in the back door until it is sold and leaves the store. Every step of this process involves both people and the forms on which the transactions are recorded. The receiving/marking person records the receipt of merchandise, checks it and attaches the price tags. This person also handles merchandise that is returned to the vendor. The sales staff handles sheet (or bulk) markdowns and records sales,

including any POS markdowns. And of course the office is responsible for accurately recording in the books all the information from all the forms that come into the office. The process can break down at any of these points.

Shrinkage can be controlled. Management must give it a high priority, employees must be trained, and internal controls must be put in place and monitored.

If your Net Profit is 5% of sales, it takes an additional \$20 of sales to make up for each \$1 of shrinkage. If shrinkage is \$1,000 it will take an additional \$20,000 in sales. It is just good business sense to initiate action to reduce your shrinkage figure as much as possible. For small independent retailers that provide good personal service, shrinkage should be no more than 0.50% to 0.75% of sales. If your store is in a mall, the shrinkage is likely to be a little higher, perhaps as much as 1.25% of sales. If your shrinkage was more than this, you have a problem that you need to attend to now so the next physical inventory count will be much better!

QUOTE OF THE MONTH

" Only put off until tomorrow what you are willing to die having left undone."

Pablo Picasso

FEBRUARY SALES SURVEY

THANK YOU to everyone who participated in our survey. Your participation makes the results meaningful.

To remind everyone, this survey concerns February sales.

COMPARISON OF FEBRUARY 2008 to 2007 SALES			
	MEN	WOMEN	SHOES
More than 15.0% below last year	16%	27%	25%
-10.1% - -15.0%	13%	6%	25%
-5.1% - -10.0%	10%	6%	0%
-.01% - -5.0%	10%	7%	25%
EVEN	6%	0%	0%
+.01% - +5.0%	13%	20%	13%
+5.1% - +10.0%	13%	0%	12%
+10.1% - +15.0%	3%	7%	0%
More than 15.0% above last year	16%	27%	0%
	100%	100%	100%

An insufficient number of sports goods, children/infant, western, gift and dance retailers responded to provide an accurate representation.

TELE-SWAP GROUPS

Join a Tele-SWAP Group to talk to other retailers like yourself! The questions and topics we have discussed in recent sessions are numerous. A few recent examples are:

- ▶ "How are you stimulating business now?"
- ▶ "What benefits do you offer full-time employees?"

- ▶ "Discussed HSA insurance plan one member started a year ago and savings generated."
- ▶ "What do you see as the direction for merchandising your store in the next few years?"
- ▶ "How do you find a good in-house tailor and at what pay scale?"
- ▶ "What has been your most successful line thus far this year? Most disappointing?"

Comments from just a few of retailers taking part in these teleconferences are:

"Retailing is tough for the little guy . . . bouncing ideas off the wall wondering what might work and who . . .or how to adjust a promotion to get it to bring people in. Our SWAP Group allows each of the participants to be open and willing to share ideas with each other. It has energized me." Scott Zahner, Zahner's, Vernon, CT

"I really like the teleconference opportunities to share and ask questions of other retailers. I always come away with at least one idea I want to implement immediately." Nan Napier, Tres Mariposas, El Paso, TX

"I was starting to think I was "alone in the world". I am busy and did not want to participate in something that was not going to help my business. I am thrilled with my participation in the SWAP. I discovered that I am definitely not alone and the other similar businesses have the same challenges and now we are helping find solutions to those challenges together. I strongly recommend trying the SWAP - it is definitely worth my time!" Katie Andrios, GWK Enterprises, Geneseo, IL

If you would like to discuss the types of issues listed above, and others, with retailers who are similar to you, but far enough away they are not competitors, give us a call at 1-877-206-1299 or on our web site at http://www.the-retail-advisor.com/peer_groups_tele-swap.html. Then you can complete an online application. Once I get your application I will contact you about joining a group to take part in a monthly one- hour teleconference call. The biggest commitment will be the one-hour a month for the call. The cost is minor at just \$180 for a 6 month commitment (just \$30 a month).

There are so many retailers around the country who are isolated because they are a small independent retailer. This service gives you an opportunity to talk with others in a similar situation without having to worry about giving away any information to your competition. Get the help and advice you need to be more successful without having to leave your store.

Click on the link above and join a group today!

KEEP YOUR EMPLOYEES HONEST & INCREASE YOUR BOTTOM LINE!

Studies have shown that almost half of all your store's shrinkage is due to employee dishonesty!

If you can reduce shrinkage by 1% that is an additional 1% of profit for you. As the owner it is your job to provide the procedures, checks and balances to keep your employees honest. Also, consider that as our country plunges into this recession, normally honest people may become desperate. Financial need is one of the main reasons given for attempting theft from an employer. Make sure you are doing all you can to help avoid temptation before it strikes.

As a former controller for a 5-store chain of family apparel stores and with my experience working with retailers around the country as a retail management consultant I have developed a manual to help you with this. It is our "Internal Control Manual" that covers all aspects of a retail store's operations. It is set up in an easy question and answer format where a Yes answer means things are OK and a NO answer means you may have a problem that needs further checking.

To get a copy for your store, for just \$95 shipped Priority Mail, visit our website at http://www.the-retail-advisor.com/internal_controls.html.

Do not wait until you discover that a trusted employee has stolen \$70,000 from you (like a retailer I know had happen to him last year). Take steps now to make sure your merchandise and cash are as safe as you can make them.

WHAT WE DO . . .

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- o [Monthly Open-To-Buy Service](#)
 - o Open-To-Buy Implementation on Your System (if available)
 - o Merchandise Performance Evaluation
 - o [Shrinkage Control](#)
 - o Development of Incentive Plans
 - o [Development of Job Descriptions](#)
 - o Seminars On Retail Subjects
 - o Financial Analysis
 - o Financial Budgeting and Cash Flow Projections
 - o Computer/POS System Evaluation, Selection, Usage
 - o Policy and Procedure Development
 - o [Lead Tele-SWAP Groups](#) (Share With A Peer)