

THE RETAIL MANAGEMENT ADVISORS

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in this issue . . .

- HOW TO USE AN OPEN-TO-BUY TO BE MORE PROFITABLE
- QUOTE OF THE MONTH
- INTERNAL CONTROLS
- WHAT WE DO . . .

HOW TO USE AN OPEN-TO-BUY TO BE MORE PROFITABLE

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The Open-To-Buy is very simply the buyer's buying plan and should be used to ensure you have the "right" amount of inventory to support your sales plans. The goal of the Open-To-Buy is not to keep you from buying! The goal is to ensure the correct inventory level so you do not have too much or too little inventory, have Open-To-Buy dollars available to take advantage of special off-price purchases to increase your Initial Markup, increase your Sales due to always having new fresh merchandise in the store, increase Gross Margin and of course increase your Profit.

While preparing and following an Open-To-Buy is no guarantee of success and lack of a plan is no guarantee of failure, we feel Open-To-Buy planning is essential to ensure the optimum level of inventory to support monthly sales plans and to maximize the return on capital invested in merchandise inventory.

Below is a sample Open-To-Buy for a single classification.

| CLASS xxx - SAMPLE   |          |      |      |       |       |       |       |       |       |       | Today's Date: xx/xx/xxxx |       |       |
|----------------------|----------|------|------|-------|-------|-------|-------|-------|-------|-------|--------------------------|-------|-------|
|                      | PLANNED: |      |      | IMU%  | MD%   | GP%   | STR   |       |       |       |                          |       |       |
|                      |          |      |      | 52.00 | 14.00 | 45.28 | 3.00  |       |       |       |                          |       |       |
| <b>SALES</b>         | Feb      | Mar  | Apr  | May   | Jun   | Jul   | Aug   | Sep   | Oct   | Nov   | Dec                      | Jan   | Total |
| 3 YRS AGO            | 1126     | 1053 | 722  | 608   | 425   | 1642  | 1078  | 1439  | 1622  | 1614  | 4238                     | 1411  | 16978 |
| 2 YRS AGO            | 1267     | 1184 | 813  | 684   | 478   | 1847  | 1212  | 1619  | 1824  | 1816  | 4767                     | 1588  | 19100 |
| LAST YR              | 1408     | 1316 | 903  | 760   | 531   | 2052  | 1347  | 1799  | 2027  | 2018  | 5297                     | 1764  | 21222 |
| THIS YR PLAN         | 1500     | 2000 | 1200 | 1000  | 750   | 2150  | 1350  | 1850  | 2100  | 2100  | 8500                     | 1900  | 26400 |
| ACTUAL               | 1625     | 2133 | 1287 |       |       |       |       |       |       |       |                          |       | 5045  |
| % VARIATION MO       | 8.33     | 6.65 | 7.25 |       |       |       |       |       |       |       |                          |       |       |
| % VARIATION YTD      | 8.33     | 7.37 | 7.34 |       |       |       |       |       |       |       |                          |       |       |
| <b>MARKDOWNS</b>     |          |      |      |       |       |       |       |       |       |       |                          |       |       |
| LAST YR              | 259      | 157  | 385  | 10    | 157   | 385   | 185   | 838   | 325   | 124   | 98                       | 125   | 3048  |
| THIS YR PLAN         | 210      | 280  | 168  | 140   | 105   | 301   | 189   | 259   | 294   | 294   | 1190                     | 266   | 3696  |
| ACTUAL               | 85       | 202  | 118  |       |       |       |       |       |       |       |                          |       | 405   |
| <b>BOM INVENTORY</b> |          |      |      |       |       |       |       |       |       |       |                          |       |       |
| LAST YEAR            | 8124     | 7251 | 9251 | 10500 | 9253  | 8754  | 11124 | 12153 | 14854 | 19215 | 21054                    | 14195 | 12144 |
| THIS YR PLAN         | 7464     | 6314 | 4994 | 5193  | 6111  | 8053  | 7521  | 9038  | 9944  | 12661 | 17642                    | 9464  | 8700  |
| THIS YR ACTUAL       | 9467     | 7432 | 6285 |       |       |       |       |       |       |       |                          |       |       |
| <b>ON ORDER</b>      |          |      |      | 775   | 1950  | 1289  | 500   |       |       |       |                          |       |       |
| <b>OPEN-TO-BUY</b>   |          |      |      | 1283  | 847   | 630   | 2556  | 3015  | 5111  | 7375  | 1512                     | 166   | 22495 |

A good Open-To-Buy format will give you management information in addition to buying information. Our example shows 3 years of sales history to help you spot any developing sales trends and variance percentages to plan for both the current month and year-to-date. The sales variance percentages help you see how sales are doing when compared to plan so you can change the plans upward or downward as needed during the year. The goal for Open-To-Buy is to keep the actual sales variance to plan no more than plus or minus 10%.

Every retailer needs to use an Open-To-Buy. The small retailer cannot afford any mistakes because his sales volume and cash flow are critical. The large retailer needs it due to his very size, which makes planning and control all the more critical. Some retailers mistakenly think they can not afford to use an Open-To-Buy Service. I believe

they are wrong. Compared to the benefits of using an Open-To-Buy provided by an outside service, the cost is very affordable. There are very few software packages for smaller retailers that include a good Open-To-Buy. There are also some Open-To-Buy service providers who charge very high fees that the small retailer can not afford to pay. The Retail Management Advisors prices the Open-To-Buy Service so even retailers with low sales volumes can afford to use it. The return on investment is excellent. By using an Open-To-Buy you are able to reduce inventory levels, thus freeing up cash to use to pay off notes and reduce interest expense. Also, reducing inventory allows you to have the funds needed to purchase new goods at discounted prices during the season to increase Initial Markup, which helps profitability. For an example, if a store with a sales volume of \$300,000 and a current turn rate of .65 uses an Open-To-Buy and increases the Stock Turn Rate by 10% to .72 the average inventory will drop from \$461,538 to \$416,667 at retail. Assuming the store has an overall markup of 55%, the cost reduction would be \$20,192. This is much more than our starting monthly fee of just \$311 a month (\$3,732 a year).

Retailers tend to overstock when sales increases are good and to decrease inventory too much when prospects are bad. Thus, a relatively small increase in sales often leads to excessive buying - then when sales slow down high markdowns are taken to clear out this excess supply of merchandise. This, in turn, leads to lower gross profit and lower overall store profit or losses. The goal of good merchandising is to maintain the level of inventory that provides adequate assortments when sales are low and not excessively high assortments when sales pick up. This is where the Open-To-Buy comes into play. It tells you how much inventory should be on hand at the beginning of any given month and how much new merchandise should be received during the month.

#### BENEFITS OF USING OPEN-O-BUY

1. Able to estimate in advance the amount of cash that will be required to be invested in inventory from month to month for the coming season.
2. Helps to ensure an adequate amount of inventory on hand to support the planned sales.
3. Places restraints on merchandise commitments so the store does not receive too much new merchandise too early in the season -- or not enough.
4. Keeps a fresh flow of new merchandise coming into the store throughout the season. This keeps the customer interested in coming back again and again, keeps the sales staff excited and also helps your sales and cash flow.
5. Establishes goals so actual performance can be compared to the plan, thereby pointing out those areas where corrective action needs to be taken.

#### PLANNING LEVELS

An Open-To-Buy can be prepared at many levels. It may be planned at the company level by a multi-store operation or at the store, department, classification or buyer level, or a combination of some of these. However, to be most effective, a buying plan must be prepared at the classification level.

If there are multiple stores that are geographically close so transfers can be made on an as needed basis, the Open-To-Buy is effective at the corporate/classification level. In other words, even though a classification may be carried in 3 stores there is only 1 Open-To-Buy plan for that classification.

However, if the company has stores that are in different cities, there should be a separate Open-To-Buy plan for each store. Even though the merchandise is the same, the mix will be different in different locations so individual Open-To-Buy plans are best. If you try to have a corporate level Open-To-Buy in this case, you will spend too much valuable time trying to determine how to allocate new receipts to each of the stores.

#### RETAIL, COST OR UNIT OPEN-TO-BUY?

There are techniques for preparing an Open-To-Buy based on each of three elements: units, cost or retail; or on a combination of two of these three elements, such as units and cost or units and retail or cost and retail.

We believe an Open-To-Buy should be prepared at retail. In a sales organization sales are made at retail and inventory is needed to meet sales plans; therefore, it makes sense that inventory should be managed at retail and buying plans to meet sales goals should be made at retail. Once you have a retail Open-To-Buy those retail numbers can be easily converted to either cost or units if that would help when you are at market.

#### OPEN-TO-BUY TIMEFRAME

The Open-To-Buy can be prepared for almost any timeframe: week, month, season or year. We recommend it be prepared on a monthly basis, for at least 12 months out into the future. Once you have the Open-To-Buy prepared by month you can easily combine the months into seasonal Open-To-Buys. For example, if the season for a classification is 4 months long, just add together the monthly Open-To-Buy amounts for the month preceding the

season plus the first three months of the season. This will give you the Open-To-Buy amount for the season. We "back up" a month since normally, what you receive this month is to support next month's sales.

#### THE OPEN-TO-BUY FORMULA

The Open-To-Buy amount for each month is really the open-to-receive. It is the amount of new merchandise that should be received each month in each classification. The formula for computing Open-To-buy is:

$$\text{OTB} = \text{Planned Sales} + \text{Planned Markdowns} + \text{Planned EOM Inventory} - \text{Planned BOM Inventory} - \text{On Order}$$

The formula to calculate Open-To-Buy is simple. The planning of the various elements that are included in the formula are not so simple. Following we will take a look at the components of Open-To-Buy.

#### SALES PLANNING

Determining the sales plan is the most critical decision the merchant must make, not only for OTB planning but for every other aspect of the business. Expense budgets, the number of employees, etc. are always planned in relation to sales. If sales are planned too low they become a self-fulfilling prophecy. The store will be merchandised for the lower sales level, and will not have sufficient goods on hand to meet a higher demand. Conversely, if sales are planned too high, too much merchandise will be bought and the retailer may find himself unable to pay the bills when the planned sales level is not achieved.

Historical sales records are usually the starting place for setting sales plans. However, the sales plan must also take into consideration a host of variables which the retailer is in the best position to be aware of and to judge. Things such as local and national economic conditions, changes in competition, fashion changes, plans to expand customer credit, changes in selling personnel, etc. all impact the sales plan. No one can know all these factors as well as the store owner / buyer who is there working in the store everyday. That is why we do not presume to plan any retailer's sales for them, though we do help them by doing the calculations if they give us the percentage increase or decrease for each classification.

#### MARKDOWN PLANNING

Markdowns need to be planned and included in the OTB calculation. WHY? The reason is that markdowns reduce the retail amount of inventory on hand, just as sales do. Therefore, if they are not included in Open-To-Buy planning the store might not bring in enough new merchandise for a particular month.

Although markdowns do not occur evenly throughout the year, we recommend that they be planned as a static percent of planned sales for each month. This then acts as a markdown reserve and ensures adequate levels of inventory each month. As an example, for Open-To-Buy purposes, if 60% of the season's markdowns are planned for the last month of the season there will be a large Open-To-Buy amount for that month. However, when it is the end of the season, the retailer does not want to bring in more merchandise just so they can mark it down. In other words, the merchandise that you will be marking down at the end of the season is the merchandise that was received 3, 4 or 5 months ago. Unless you have reserved a significant amount of your Open-To-Buy dollars for the purchase of off-price goods in season, the merchandise on sale is not normally the merchandise that you just received.

#### PLANNING INVENTORY LEVELS

Inventory amounts make up two parts of the Open-To-Buy formula. One is beginning inventory. The other is ending inventory, which is really the beginning inventory for the next period. Too much inventory on hand spells a poor return on investment and high markdowns. Too little means missed sales.

How much inventory is enough? Oversimplified, you could divide the annual sales plan by the desired stock turn rate to get the monthly amount. For example, for an annual sales plan of \$54,000 and a stock turn rate of 3.0 the average beginning-of-month inventory should be \$18,000 (\$54,000 divided by 3.0). This would be fine if sales for each month were \$4,500 (\$54,000 divided by 12), but it never happens that way.

Ideally, beginning-of-month inventory should be higher in the months sales will exceed the average and less in the months you plan less than average sales. However, it doesn't take twice as much inventory on hand at the beginning-of-the month to do twice as much volume.

Management must complement this mathematical process or formula with that mysterious sixth sense called "feel". There is no substitute for knowledge gained from past mistakes, talk with other merchants and good, common horse sense and judgment of the owner and buyer.

The users of certain computer software systems enjoy the benefits of more sophisticated techniques that we have developed for their users. This makes it easier for the retailer since the software program handles the complicated task of planning the optimum monthly inventory levels, based on the retailers Sales and Stock Turn Rate plans. For others, we offer an Open-To-Buy service that allows us to "look over your shoulder" to make sure you are following your plans and revising plans as necessary. One of the issues an independent retailer has is that there is no one available to question anything she or he does. By using an outside service the retailer can avail himself or herself with an objective outside opinion. When the retailer is questioned and must justify himself to another, goals will come into more focus and obvious errors will be corrected.

**ON ORDER**

The Open-To-Buy for each month must be reduced by the amount of merchandise on order scheduled for delivery during that month. Open-To-Buy can not be used effectively to control inventory unless a purchase order is generated for every order placed. If all orders are not recorded as soon as they are placed, the Open-To-Buy amount will be overstated and overbuying will occur, leading to future high markdowns and lower profits.

A very important part of using the Open-To-Buy is determining how much of your Open-To-Buy to commit to advance-of-season purchases. This amount cannot be determined statistically by computer. To decide, get the latest input from the market place. You must consider textile availability, delivery schedules and how much merchandise will be ordered in-season (re-orders, special orders, new mid-season items, vendor close-outs and promotions).

**SUMMARY**

You can be more successful with a well-formulated Open-To-Buy plan, skillfully combining statistical techniques with the human element of sensitivity and insight. If you are not using a monthly classification-level Open-To-Buy you are missing a valuable extra-profit opportunity.

If you are not using an Open-To-Buy, or if the one you are using is too expensive or not working well for you, log onto our web site for information on our service at [www.the-retail-advisor.com/open-to-buy.html](http://www.the-retail-advisor.com/open-to-buy.html).

**OUR NEXT SURVEY**

Our next survey will go out tomorrow morning. It concerns your customer/client mail lists. Given the current economy, we are all looking for ways to cut expenses without cutting services. However, cutting expenses to improve service is a good idea in any economy.

The results of this survey will be sent to participants only. Be sure to reply in a timely manner as this survey will close on Tuesday, October 20. Thank you in advance for your participation.

**QUOTE OF THE MONTH**

"Don't say you don't have enough time. You have exactly the same number of hours per day that were given to Helen Keller, Pasteur, Michelangelo, Mother Teresea, Leonardo da Vinci, Thomas Jefferson and Albert Einstein."

Life's Little Instruction Book, compiled by H. Jackson Brown, Jr.

**INTERNAL CONTROLS**

*The Wall Street Journal* reported that up to 75% of all employees have stolen at least once. Dishonest employees steal approximately 6.6 times the amount stolen by shoplifters. Police say the most common reason employees steal is opportunity.

When was the last time you did a thorough procedures study of your store? Was it a meticulous exam of each position or a meandering walk through the store? The Retail Management Advisors, Inc. has developed a comprehensive manual to help you examine your store and find areas of concern. Our Internal Control Manual covers all aspects of a retail store's operations in an easy yes/no answer system with a NO answer indicating possible problems. To get a copy for your store, for just \$95 shipped Priority Mail, visit our website at [http://the-retail-advisor.com/internal\\_controls.html](http://the-retail-advisor.com/internal_controls.html).

## 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)