

**HOW TO BE PROFITABLE DURING
BOTH GOOD AND BAD TIMES -
GROSS MARGIN PLAN**

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Previously, I described the 5 steps you, the retailer, must do every year to ensure your store’s profitability. The five steps are:

1. Prepare an annual Gross Margin Plan
2. Use an Open-To-Buy
3. Prepare an annual pro-forma Income Statement (budget, done by month)
4. Prepare an annual Cash Flow Projection (done by month)
5. Track the productivity of your selling staff

This month, I will discuss in more detail the annual Gross Margin Plan. The Gross Margin Plan is an annual plan that gives you the ability to “look into the future” to see if any changes need to be made to your classifications now, before the year begins. For example, once you have your plans on paper and have reviewed them, you may find that you have planned sales too low in a particular area. Or, you may see that a specific class is a good candidate for elimination due to it’s low Initial Markup and high markdowns. You may also see the need for an additional classification or classifications.

The Gross Margin Plan contains a lot of information. An abbreviated sample of a Gross Margin Plan is shown below:

| GROSS MARGIN PLAN | | | | | | | | | |
|--------------------------|--------------|----------------|------|------|--------|------|---------|-----|-----|
| Class | Annual Sales | Sales Contr. % | IMU% | MD% | Shrk % | GM% | GM\$ | STR | CGP |
| Class 100 | 95,000 | 10.0 | 54.0 | 12.0 | 0.5 | 48.3 | 45,838 | 1.8 | 87 |
| Class 110 | 40,000 | 4.2 | 48.8 | 12.0 | 0.5 | 42.4 | 16,960 | 2.6 | 110 |
| Class 120 | 35,000 | 3.7 | 56.0 | 18.0 | 0.5 | 47.9 | 16,751 | 2.5 | 120 |
| Class 130 | 15,000 | 1.6 | 54.0 | 8.0 | 0.5 | 50.1 | 7,514 | 2.2 | 110 |
| Total Dept | 185,000 | 19.5 | 53.3 | 12.8 | 0.5 | 47.0 | 87,009 | 2.1 | 98 |
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| " | | | | | | | | | |
| TOTAL STORE | 950,000 | 100 | 54.5 | 14 | 0.5 | 47.9 | 455,050 | 2.5 | |

The Gross Margin Plan contains a lot of information. Included, by classification, are annual sales, sales contribution % when compared to the total company sales, Initial Markup % that you believe you can achieve, Markdown % plan, Stock Turn Rate goal, average inventory, Gross Margin %, Gross Margin dollars and something you may not have heard of before, the Cumulative Gross Margin. This is all very useful information to the store owner and buyer to use to review the performance of each classification - - before the Open-To-Buy is set up and before the pro-forma Income Statement is developed.

SALES

This column contains the annual sales plans for each classification.

SALES CONTRIBUTION PERCENTAGE

This column shows the Sales Contribution Percentage for each classification. This shows you what percentage of the total store's volume you have planned for each class to do during the next 12 months. If you have a single classification that accounts for more than 10% of the store's sales you may want to consider splitting it out into 2 or even more classifications to give yourself more information and control. It is important, for a profitable store, that your top classifications with respect to Sales Contribution % are also your top classifications with respect to Cumulative Gross Margin.

INITIAL MARKUP %

The next column lists the Initial Markup Percent you anticipate achieving for each classification. The Initial Markup must be high enough to allow you to take needed markdowns and still have an adequate level of Gross Margin. As retailer's expenses have continued to go up year after year, keystone (50%) is no longer acceptable for men's, women's and children's apparel stores. Western stores have traditionally had a lower Initial Markup % due to the boots and jeans they carry. No matter what type of merchandise you carry in your store, you must make sure your Initial Markup is sufficient.

MARKDOWN % AND \$

The planned markdown percentages and dollars are listed in the next two columns. Since markdowns adversely affect gross Margin, it is important that they be monitored and controlled. However, always keep in mind that if you have merchandise that must be cleared out, you must take the markdowns even if you exceed your plan.

SHRINK %

This is the level of shrinkage expected to be achieved by the store. It is included in the Gross Margin Plan since it adversely affects Gross Margin for each classification just like markdowns do. For most specialty apparel stores the shrinkage should never be more than 1% of sales. If yours is higher, it means you need to do a thorough look at your procedures to see where your leaks are. And, remember that typically, employees account for 48% of your shrinkage.

STOCK TURN RATE

This is the planned stock turn rate for each classification. The stock turn rate controls how much inventory you should have. Stock turn rate and the level of inventory have an inverse relationship. As stock turn rate goes up, inventory levels go down. The majority of retailers I have worked with have too much inventory and need to seriously work at reducing their inventory levels. The best way I know to do that is to use an Open-To-Buy as your buying guide - - and then follow it!

AVERAGE INVENTORY

This is the average amount of inventory at retail for each classification. This figure is based upon the total annual sales plan and the planned stock turn rate. Obviously, this will fluctuate from month to month throughout the year.

GROSS MARGIN %

The next column on the report lists the planned Gross Margin Percent. This column should be reviewed, looking for any classifications having a Gross Margin Percent that is too low. Gross Margin must be high enough to cover the company's expenses plus allow for a reasonable amount of profit. If the Gross Margin

Percent for any classification is below the company's operating expense percent, consideration should be given to finding ways to increase it or possibly to eliminating it.

GROSS MARGIN \$

These are the Gross Margin dollars to be generated by each classification, if the plan is met. These are the dollars out of which you must pay all the company's expenses and have some left for profit.

CUMULATIVE GROSS MARGIN

Cumulative Gross Margin is listed in the next column. The Cumulative Gross Margin is an index used to compare the profitability of one class to another. It can be thought of as a retail equivalent of ROI. However, it is easier to calculate than ROI since any good retail software package will give you the Stock Turn Rate. Since it is computed by multiplying the Gross Margin % by the Stock Turn Rate, it allows an analysis of classifications based on the combined strength of two previously separate measures. Because of this, a poor performance of either the Gross Margin % or Stock Turn Rate could be offset by the relative strength of the companion ratio to yield an acceptable result. Minimum acceptable results for a few categories of stores are:

| | |
|---------|-----|
| Men | 110 |
| Women | 150 |
| Shoes | 85 |
| Gifts | 145 |
| Western | 85 |
| Family | 120 |

Once the Gross Margin Plan is set to your satisfaction, the data included is then used in the preparation of the Open-To-Buy and for the company's budget (pro-forma Income Statement). The Open-To-Buy will use sales, Markdown % and Stock Turn Rate. The budget will use the sales and Gross Margin %.

Next, we will talk about the Open-To-Buy.

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