

HOW TO BE PROFITABLE DURING BOTH GOOD AND BAD TIMES - OVERVIEW

by Linda Carter

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Right now the economy is a mess and everyone is wondering what is going to happen in the coming months. You are right to be concerned.

Whether the economy is GOOD or BAD, the retailers who will do well are the same ones. They are those retailers who keep their inventory under control either by use of a formal Open-To-Buy or some other means, keep their expenses under control by use of a formal budget and have a motivated selling staff. These retailers are also not carrying an excessive debt load, with it's accompanying interest expense. If you are one of these retailers, congratulations. I do not doubt that you will come out of this current recession doing well.

However, if you have too much inventory, expenses that are too high, too much debt, and a selling staff that just stands around waiting for a customer to come in the door, you are in trouble. Unless you change the way you do business, and do it quickly, you might not be around for the business turnaround that is sure to come.

Do you know where you want your store to be 12 months from now? I'm sure you would like to increase your bottom line - - But, do you know exactly how much you want to increase it to? Do you know how are you going to do it? By increasing sales? By decreasing expenses? By increasing gross profit through better merchandising?

A formal, written business plan will help you to focus on these questions so you can determine the best way for your store to reach its goal. Unless you write down your plan on paper, refer to it often to see how you are doing, and make changes as needed you will never reach your goal.

If you have never done any formal planning you may be asking yourself how anyone can possibly plan for the future. There is no crystal ball to help anyone accurately foresee the future and there are many uncertainties that are impossible to foretell. Strikes, fires, new decisions by competitors, shifts in the economy - - these all have the potential to upset your company's plans. However, by using all the information that you do have available - - your store's historical figures, the news, trade organizations, other retailers -- you can develop a good set of plans.

Well-developed plans help set the direction the company will take in the future and provide the opportunity to change direction if needed. By comparing actual to planned figures you will be able to highlight trouble areas and make needed changes so the adverse effect on the bottom line is minimized.

A good plan must be realistic, achievable and encompass every facet of the business. When working with my clients there are several tasks I require them to do every year. They 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 their selling staff

I am going to give you a very brief summary of each step this month. In coming months I will go into more detail with each step listed above.

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 its low Initial Markup and high markdowns. You may also see the need for an additional classification or more.

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.

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).

Open-To-Buy

The Open-To-Buy is very simply the buyer’s buying budget 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.

The Open-To-Buy is a tool. It is not something etched in stone. That is why, when working with my clients, I recommend revisions during the year as needed.

Pro-forma Income Statement (budget)

The annual Gross Margin Plan and the total of the Open-To-Buy give you most of the information you need to complete the Cost of Goods Sold section of your budget. All the additional information needed is: Sales Discounts, Purchase Discounts and Freight-In.

Once the Cost of Goods Sold section has been completed to your satisfaction, it is time to plan expenses. Expenses are not hard to plan. I usually recommend that clients start with their actual numbers from last year. Then, you can look at current conditions and adjust the numbers as needed. For example, you may have heard on the news that your electric company will be increasing rates by 15%. That means that when you plan this year you will want to increase last year’s numbers by 15%.

Once all the numbers are in place it is time to put them together and make sure you are planning a profit. If it shows a loss it is time to go back through your expenses to see which ones can be decreased or even eliminated.

Cash Flow Projection

After the Pro-forma Income Statement is completed to your satisfaction, the next step is to prepare a Cash Flow Projection. You must always keep in mind that Profit does NOT equal Cash. And you must have cash to stay in business.

The method I use is to start with Net Profit and make adjustments as needed to convert it to cash. For example, depreciation is an expense but does not involve the use of cash so that is added back to Net Profit. In the same way, any payments to loan principal do not show up on the Income Statement (only interest does). So, any payments of loan principal need to be deducted from Net Profit.

Sales Staff Productivity

No matter how well you buy and merchandise your store, you must depend on your sales staff to actually make all the sales. This means they must be knowledgeable and motivated. As the store owner you can not just assume they are doing the 'right' things. Just as you manage your inventory by looking at productivity measurements such as Initial Markup, Markdowns, Stock Turn Rate and Gross Margin you must also look at the productivity measurements for your selling staff. These are: total sales, number of items sold per sales transaction, number of sales transactions per hour worked and dollar amount of average sale.

Summary

This is the overview of what is needed to be successful. You must control your store or you will just drift along and not accomplish what you want

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