

## OPEN-TO-BUY

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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.

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.

Retailers tend to overstock when sales increases are good and to understock 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 overall store profit. 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.

Also important to this concept is that the statistics will indicate the need for adjustment of buying plans long before "gut feel" will. A good Open-to-Buy system helps you recognize the need to react to variances in sales plans. You may need to adjust sales plans, reschedule deliveries, cancel purchase orders or change markdown plans. A good Open-to-Buy system is much more than a theoretical checkbook!

### **Benefits Of Using Open-To-Buy**

1. Ability 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 level of 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 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, and have a similar customer base, 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 may be only 1 Open-To-Buy plan for that classification.

### **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. In addition, a good buyer will attempt to minimize cost and maximize Initial Markup with a retail OTB. This saves real dollars over a cost OTB.

### **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.

### **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 economic conditions, changes in competition, fashion changes, plans to expand customer credit, changes in selling personnel, etc. all impact the sales plan.

### **Markdown Planning**

Markdowns need to be planned and included in the OTB calculation. Why? 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 would not bring in enough new merchandise for any 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 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. It 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.

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 plans. However, many computer software systems either do not offer an Open-To-Buy program or offer one that is too cumbersome and time-consuming for the average retailer to use. Some require that the retailer determine the optimum inventory level for each month and then enter this into the program. Some require that the retailer develop monthly stock-to-sales ratios and enter these for each classification. This means that the retailer must determine 12 monthly stock-to-sales ratios for every classification. If there are 30 classes, this means that 360 individual numbers must be determined and entered into the program. There are not many independent retailers that have time to do this so Open-To-Buy planning is not done.

### **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 cannot 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.

### **Summary**

Retailers 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.

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