

PLANNING FOR HIGHER PROFITS

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To be a successful retailer, it has always been important to pay attention to all aspects of your business. In today's retail climate it is essential for your survival. For example, what good does it do to increase sales volume by the use of constant promotions if the markdowns kill Gross Profit? What good is a 44% Gross Profit if Operating Expenses are 46% of sales? Can a well thought out and followed Open-To-Buy help business if the sales effort is lacking?

The retailer needs a way to organize the efforts being made to achieve more profit and a way to know during the year if there are problems that may prevent the store from reaching this profit goal. This is where the formal business plan comes in.

In working with independent retailers throughout the country we have found that too many of them do not have formal written business plans. They do not know how to go about developing them, or do not 'have time' to develop plans, or feel that the development of formal plans will not help their business. We think they are making a mistake. The experts tell us, and it has been shown in studies, that people who put their goals in writing are more likely to achieve them. Writing your goals will not guarantee that you will reach them; however, it will significantly increase the chance for success. Every business should also have a set of written business goals to help in planning business strategies during the year and for measuring actual performance during the year so corrective measures can be taken before it is too late. This is the formal business plan.

The business plan must be based on sound, attainable goals for the coming year. Expressed in financial terms, it charts the course for the retailer's goals and future actions.

Who should take part in this planning process? Every manager who will be accountable for achieving a significant portion of the plan should provide input. For example, buyers should provide input for the Gross Margin Plan and Open-To-Buy. The store managers should provide input concerning all normal store operations. The more input that people with responsibility contribute, the more realistic the plan will be. Also, those taking part in the planning process will feel a greater responsibility for achieving the goals.

We feel the business plan for a retail operation should include the following, which we will discuss in detail below:

1. Gross Margin Plan
2. Open-To-Buy
3. Budgeted Income Statement
4. Cash Flow Budget
5. Salesperson Sales Goals
6. Sales Promotion Plan

GROSS MARGIN PLAN

The store's Gross Margin could be planned for this year by looking at historical figures from past year-end financial statements, but this method is prone to error since it does not take into consideration the current

business environment. For example, the retailer may be planning to add new merchandise lines that have a higher Initial Markup.

The method we recommend to our clients is that Gross Margin planning be done at the classification level. To simplify the calculation we have excluded freight and purchase discounts at the class level. Of course, these must be included when calculating Cost of Goods Sold at the company level. The information required to calculate Gross Margin for each classification is:

planned annual sales
 achievable Initial Markup %
 planned markdown %
 anticipated shrinkage

The formula is as follows:

$$\text{Planned Gross Margin \%} = \text{IMU\%} - ((100.00 - \text{IMU\%})(\text{MD\%} + \text{Shrink\%}))$$

To calculate the planned Gross Margin dollars, simply multiply the planned annual sales for each classification by the planned Gross Margin % for that classification. Once the Gross Margin is planned at the classification level, the results must be totaled to arrive at the total company planned Gross Margin dollars. This allows management to make sure the Gross Margin dollars will be adequate to cover operating expenses and generate the desired level of profit.

The Gross Margin Plan also allows the retailer to review the anticipated performance of each classification before the year begins. If the Gross Margin Plan shows that one or several classifications will not be profitable there will be time to make any changes before the new year begins. It may be possible to search for new resources that will allow a higher initial markup or that require fewer markdowns. Or, management may make the decision to eliminate a classification altogether. The important point to remember is that management will have the information on which to base these merchandising decisions.

Of course, an effectively used Open-To-Buy is critical to the achievement of the planned Gross Margin.

OPEN-TO-BUY

The Open-To-Buy is simply a merchandising budget. It is used by the buyer to plan the seasonal purchase of merchandise, and monthly delivery schedules, for each classification to ensure that the right amount of merchandise will be available to meet sales plans. The Open-To-Buy for **next year** should be completed in a timely manner so the information it generates will be available for completion of the company's formal business plan.

There are good retail software packages available that contain Open-To-Buy programs to handle the tedious computations involved in calculating and updating an Open-To-Buy. In order to calculate the Open-To-Buy the following information is needed for each classification: planned sales by month (annual sales from the Gross Margin Plan divided into monthly sales plans), planned markdowns (from the Gross Margin Plan) and planned beginning of month inventory. The Open-To-Buy formula we recommend, and use in our office, requires the planned annual stock turn rate for each classification (to compute the optimum planned beginning of month inventory for each month).

The formula to compute the monthly Open-To-Buy for each classification is as follows:

$$\text{Planned Sales} + \text{Planned Markdowns} + \text{Planned End of Month Inventory} - \text{Planned Beginning-of-Month Inventory} - \text{On Order} = \text{Open-To-Buy}$$

BUDGETED INCOME STATEMENT

The Budgeted Income Statement will be prepared in the same format as your company's current Income Statement. It is to be completed for the entire year, by month. The information needed to complete the Income and Cost of Goods Sold sections are available on the Gross Margin Plan and Open-To-Buy. All that is left now is to budget the company's expenses and other income items.

How does the retailer go about planning expenses for next year? One method is to look at the company's historical records to determine how much each expense was last year, then adjust that amount for inflation and other factors for the coming year. Another method is called zero-based budgeting. Zero-based budgeting requires that you start from zero and justify every expenditure. It examines the costs and benefits of all expenditures. Whichever method is used, and it may be a combination of the two, this is a good time to thoroughly review all the company's expenses to find new and better ways of doing things or discover what expense items can be eliminated entirely. For example, would an outside alteration service work as well and be less expensive than an in-house tailor? Are there housekeeping tasks being done by store employees, such as cleaning windows and waxing floors, that could be done cheaper by outside contracting services? Don't continue doing things just because that is the way things have always been done. Every expense dollar saved is added to the bottom line for increased profits.

Once all items on the Budgeted Income Statement have been determined, the planned Net Income can be calculated and reviewed for adequacy.

CASH FLOW BUDGET

A company can operate for a time without making a profit -- but it can not operate without enough cash to pay its bills. The preparation of a Cash Flow Budget, the final step in the business plan, allows the retailer to know ahead of time when extra operating funds will be needed so there will be time to search for and negotiate short term loans or make other adjustments to operations so bills can be paid on time.

There are two basic ways to approach Cash Flow budgeting:

1. The Cash Receipts And Disbursements Method
2. The Adjusted Net Income Method.

We recommend the Adjusted Net Income Method. Since the Adjusted Net Income Method begins with Net Income it is simply a continuation of the Budgeted Income Statement.

Using this method, we begin with the Net Income and make adjustments to it as needed to take into account non-cash items such as depreciation that appear on the Income Statement and cash items such as note principal payments that do not appear on the Income Statement. Adjustments are also made to net income for any anticipated increases or decreases in payables, receivables and inventory. A simplified version appears on the following page.

Cash Flow Adjustments

1. Net Income	_____
2. Adjustments to Income:	
Depreciation	_____
Increase/(Decrease) in A/P	_____
(Increase)/Decrease in A/R	_____
(Increase)/Decrease in Fixed Assets	_____
(Other Capital Expenditures)	_____
3. Monthly Cash Flow (Increase/Decrease) (#1 +/- #2)	_____
4. Plus Beginning Cash Balance	_____
5. Adjusted Cash Balance (#3 + #4)	_____

FOLLOW-UP

It is important to remember that a budget is our "best guess" of what will occur in the future. As the year progresses and actual performance is compared to the plans, you may find that sales or Gross Margin are below plan or that expenses are above plan. When this occurs, steps must be taken as soon as possible to correct the problem or revise the plans to keep them in sync with what is actually occurring in your store. This is an important part of the planning process. Also, remember that it is much more effective to analyze variations from plan than to examine comparisons to last year's results.

SALESPERSON SALES GOALS

It is not enough just to set the store's sales goals. In order for the store to achieve the overall goal, each salesperson must have their own set of sales goals for which they are responsible. These should be given to them for each month of the year. They can then break them down into weekly and daily goals. Of course, management must follow up by comparing each salesperson's sales against their goal and working with the salespeople to help them improve their performance, if needed.

SALES PROMOTION PLAN

The Sales Promotion Plan should be developed prior to the beginning of the year. It will be your guide to monthly promotions, both Sales and Events. The sales promotion plan will list the general advertising focus for each month plus any planned Sales. For example, January-Clearance Sale, February-Valentines Day. Events such as fashion shows, trunk shows, etc. bring customers into your store. If done well, customers will react to an event as well as to a sale and merchandise can be sold at full price. Once the Sales Promotion Plan has been determined, a plan of action needs to be developed for carrying it out. This is done by determining for each month's promotional event, which type of media would work best while staying within the constraints of the advertising budget. It is important to note that spending more dollars does not necessarily guarantee more effective advertising. A smaller advertising budget can be just as effective as a larger budget if used creatively.

SUMMARY

The preparation of the business plan forces you to take a good hard look at your business - where it is, where you want it to be a year from now. Since each store is unique, each will have its own method for reaching its profit goal. For example, if we set 10% as our profit goal we can achieve it by attaining a 48% Gross Profit and keeping our expense level at 38%. We could also achieve a 10% profit with a 44% Gross Profit if we lower our expenses to 34%. The choice is yours. The important thing to remember is that a good profit level does not just "happen". You must realistically set your goal and then strive to achieve it.

In this article we have briefly reviewed the complete, six step budgeting process, from the preparation of the Gross Margin Plan through the development of a Sales Promotion Plan. It takes time to develop a good, sound business plan, and with the busy holiday season just around the corner, now is not too early to start developing your plan for next year.

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