

WHAT IS STOCK TURN RATE AND JUST WHY IS IT SO IMPORTANT?

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The inventory of the typical store represents the largest single element of its total assets. The sale of goods from this inventory is the merchant's chief source of operating profit. Thus, the way in which this merchandise investment is put to work is of utmost importance in achieving a profitable operation.

To illustrate, a retailer may carry an average retail inventory of \$200,000, with sales of \$400,000, resulting in a 2.0 Stock Turn Rate. If this retailer had the same \$400,000 sales but a 3.0 Stock Turn Rate, the average retail inventory would be \$133,300. This is a difference of \$66,700 at retail or approximately \$32,000 at cost.

A number of studies have shown the cost of owning excess inventory at approximately 2½% per month, or 30% per year. This is due to increased expenses such as interest, insurance, buying expense, receiving department expense, property taxes, markdowns and shrinkage. Therefore, a retailer can reduce these expenses by reducing his average inventory level. In the example above, the annual savings would be approximately \$10,000 (\$32,000 times 30%).

All other things being equal, a higher stock turn rate tends to lead to higher sales and a higher profit, which should be an essential goal of every merchant. I will discuss this more later, but first we must have a good understanding of what Stock Turn Rate is and how it is to be computed.

WHAT IS STOCK TURN RATE?

Stock Turn Rate is a ratio that compares average inventory to sales. It can be computed using units, cost dollars or retail dollars. For comparative purposes, it is desirable that the Stock Turn Rate calculation be standard. We advocate retail, which is the generally accepted method in the retail industry. It is computed as follows:

$$\text{Stock Turn Rate} = \frac{\text{Annual Sales}}{\text{Average Inventory at Retail}}$$

Example:	A	B
Annual Sales	\$900,000	\$900,000
Average Retail Inventory	450,000	300,000
Stock Turn Rate	2.0	3.0

COMPUTING AVERAGE INVENTORY

The chief problem in computing Stock Turn Rate is to determine the average stock carried during the period. This can be a problem since there are so many variations in use.

The chief methods are:

1. Average of the inventory at the beginning and end of year.
2. Average of inventory at the beginning, middle and end of year.
3. Average of monthly inventory levels.

The standard is to use the average of the monthly inventory levels which is computed as follows:

Inventory at the beginning of each month plus the end of year inventory, divided by thirteen.

WHAT STOCK TURN RATE IS NOT

While Stock Turn Rate is the ratio of sales to average stock, it is not the actual number of times a physical stock of goods is bought and sold during a period. A simplified example follows:

A retailer purchases a 4-month supply of socks, a staple item, and does not restock until the old stock is completely sold out. During the year, three purchases, each \$4,000 are made and three lots are sold, for a total of \$12,000 but the Stock Turn Rate is not three. The average stock is about a 2-month supply, since four month's supply is on hand only at the start of each 4-month period and virtually none is on hand at the end of each 4-month period. Thus the average stock is about half the amount received each 4-month period, or \$2,000. This results in a Stock Turn Rate of approximately six, and a lot of lost sales due to having such a low supply on hand during much of the year.

WHAT IS THE IMPORTANCE OF STOCK TURN RATE?

The Stock Turn Rate ratio measures the effectiveness of inventory planning control. A Stock Turn Rate that is too low indicates poor planning and lack of control. A classification having a very low Stock Turn Rate usually will not be achieving its sales potential due to having too much old merchandise in stock and too little new, fresh merchandise. It is also likely to have higher than normal markdowns, thereby reducing Gross Profit. Stock Turn Rate can also be used to calculate the proper beginning-of-month inventory level for each classification for Open-To-Buy purposes.

ADVANTAGES OF A FAST STOCK TURN RATE

In retailing it is important to realize a large volume of sales on as small an inventory investment as possible while maintaining sufficient inventory to meet customer demands. Also, it is important, as fashions and seasons change, to turn the inventory quickly so as to avoid excessive markdowns or carryover of out-of-season inventory. Another advantage is that a fast Stock Turn Rate will actually increase sales due to the increased flow of fresh new merchandise into the store to create excitement for the sales staff and a reason for the customers to come back frequently.

LIMITATIONS OF A FAST STOCK TURN RATE

While a fast Stock Turn Rate has many advantages, the Stock Turn Rate can be too fast for a particular classification. When that happens the store risks losing sales due to inadequate assortments.

HOW CAN I IMPROVE STOCK TURN RATE?

From a study of the basic Stock Turn Rate formula, it is clear that there are three ways to increase Stock Turn Rate:

1. Increase sales without increasing the average stock assortment.
2. Decrease stocks without interfering with sales.
3. Increase sales and at the same time reduce stocks.

The approach used depends on the circumstances. Probably the surest way to increase Stock Turn Rate over a period of time, is to increase sales volume without a proportionate increase in inventory levels. However, since

a retailer has greater control over his inventory than over his sales, this should be where attention should be given first. The first step to increasing Stock Turn Rate and sales, incidentally, is the preparation of an Open-To-Buy. This should be based upon planned sales, planned markdowns and planned Stock Turn Rate. Once the Open-To-Buy has been prepared, the retailer can turn his attention to taking the necessary steps to reduce the actual inventory on hand to bring it in line with the planned inventory on the Open-To-Buy. A few suggestions on how to do this follow:

1. Buy more frequently, in smaller quantities.
2. Reduce number of assortments (vendors, styles, colors, sizes, prices).
3. Eliminate slow-selling merchandise.
4. Buy closer to the selling season.

SUMMARY

Stock Turn Rate is an important ratio used to measure the effectiveness of merchandise planning and control. Its two most important uses are in Open-To-Buy planning and then in measuring performance against this plan. Most retailers I see that are having problems achieving adequate profits have a poor Stock Turn Rate due to lack of planning, which results in overbuying, excessive markdowns and a low Gross Margin.

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