

Why some businesses prosper,



even in slow times

by David McMahon

PART 2: Inventory management best practices

In my previous article, I discussed how best-practice financial management helps businesses evaluate their performance and set goals for improvement. Now, I will focus on improving cash flow by becoming more efficient with your largest asset: your inventory.

Understanding, the practice of inventory management is simple: carry as little inventory as possible, sell as much from it as possible, and achieve the highest margin possible.

Well, if it were that easy, then we would have even more competition in the marketplace today.

Obviously, inventory management is a huge challenge.

I'm going to help simplify this by breaking it down into smaller pieces that you can take action on immediately. The following are some key inventory metrics that you need to track in addition to some real life actions that best-practice companies use to achieve fantastic cash flow.

Primary goal is to increase GMROI. This metric is the standard of inventory management because it contains two of the biggest components of cash flow: gross margin dollars produced, and inventory carried. It is no wonder that one of the biggest successes in the industry in the last 10 years is Ashley Furniture Industries, a company that lives by GMROI. Calculate your GMROI on a monthly basis by annualizing the gross margin dollars of the past three months and averaging your inventory. It is very rare to see a business that has positive cash flow with a GMROI of under \$2.

Some of the best businesses that I have worked with achieve \$2.75 or above. This means that for every dollar invested in inventory, they make \$2.75 in gross margin. So, a business like this, that had \$1 million in inventory, would make \$2.75 million in gross margin, and at a GM percent of 45 percent they would have sales of over \$6.1 million. That same size business at a \$2 GMROI with the same margin percent would need to carry about \$1.375 million in inventory. That's a cool \$375,000 in extra cold, hard, cash!

So, how do the best companies do it?

1. By controlling new buying with inventory to sales ratio.

A high profit inventory to sales ratio is 14 to 17 percent. Always make sure you buy best sellers and special order items. Do not buy new merchandise if you are over your target inventory to sales. Why? Because 80 percent of new

merchandise become dogs or also-rans and only 20 percent become best sellers. The fact is, if you buy new inventory before you sell your old (slow) merchandise, you will eventually become over-inventoried, and experience a decline in cash flow. Or, you will be forced to cut operating costs to offset the inefficiency.

Focusing on turns: National Home Furnishings Association's high profit stores reported 3.6 turns last year. That means that those stores as a group take only 101 days to turn their inventory (365/3.6). Average stores have three turns per year which takes 121 days. The high profit stores are FAST. Make it a goal of your business to know how long it takes to move your inventory and then try to improve it.

2. Improving merchandise to display ratio.

Knowing and minimizing the amount of merchandise that you have in your warehouse and the time it takes to display, will increase your turns. The best operations have very few items at any one time that are not displayed. In

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fact, a \$20 million company that I work with had less than 20 items not displayed the last time I visited. It's simple. Each day print out a report on the merchandise that is received and not displayed, and require your merchandising crew to display it fast. To do otherwise is to waste money.

3. Scheduling and delivering more quickly.

This helps increase your turns and decrease the amount of warehouse space required. The best operations that I deal with know exactly what is coming into stock. This enables them to plan their delivery calls and emails to customers immediately. The merchandise arrives; it is taken to the prep area and staged for delivery. Businesses that operate this fast have a higher GMROI, faster revenue stream, and generate cash quickly.

4. Decreasing reorder lead times and working with quick shipping vendors.

Vendors that provide reliable and short reorder lead times make you more money than vendors that have longer production and transit times. You don't need to carry as much inventory due to the increased speed of getting the product. Periodically evaluate your vendors.

5. Knowing and improving sales per square foot of selling space.

Sales per square foot is an excellent gauge of inventory selling productivity. How much inventory do you sell per square foot in your

showroom? Average is just under \$200. But just to show you your potential, some stores sell over \$400 per square foot.

6. Executing a DOG strategy.

A dog strategy is ongoing actions that keep your inventory clean of slow moving merchandise. It is absolutely necessary to execute an effective plan to weed out the dogs and take action promptly. Doing so on a monthly basis will allow you to keep your margins higher and turn your inventory faster. This is key for maximizing GMROI. Operations that do this less often and wait for clearance sales to take action are killing both margins and turns. Identify slow movers by merchandise that doesn't sell in a 60-day period. After each successive 60-day period, take a more aggressive action to entice the sale.

7. Maximizing best-seller-in stock days.

Keep your winners on the floor. This is a simple rule. It is also a simple one to break. You need to keep your best items in stock because they make you the majority of your gross margin dollars. From my experience in looking at thousands of analyses, these best items make you 80 percent of your money. If you sell your last item from the floor and it is hot, guess what? No other customers will see it until you get it back in stock. So you miss out on all the successive sales. This requires discipline. Identify your best items, nail them down, order them for just-in-time, and evaluate often.

8. Ensuring that all best-selling price points are represented properly.

This is a continuation of knowing and keeping your best-selling items in stock. If, for example, you see that \$999 sofas are your best-selling price point sofa make sure you have enough slots in this price point to give your customers selection. For example, if you have 20 sofa slots and \$999 is the best selling price point, logic says that you should carry the most slots here. When deciding which vendor and categories to carry in these slots, look to your historical sales analysis and see what has been performing. Purchase from vendors and categories that are winning for you in GMROI already!

Tracking performance

Now that I have given you some ideas on how you can increase your GMROI and add a lot more profit and cash, you should see where you are now. At the right is a table that you can use to evaluate your inventory metrics. The high performance recommendation comes from my years of experience with reading NHFA's reports, participating in performance groups, and working with the best stores in North America. Complete this now and take proper actions to improve. Then, complete it each month. Meet with your core operations team each week and discuss the progress. You will see great results!

Take emotion out of the equation

The businesses that have maintained above-average levels of profitability and decent liquidity are the ones that do not panic. These business owners are students of their businesses and look at their report card each month with an almost-third-party objectivity. They purely use their data as a

Metric	Your Company	High Performance Recommendation
GMROI		Above \$2.75
Inventory turns		Above 3.6 turns
GM%		Above 45%
Inventory to sales		14% - 17%
Complete for delivery and scheduled %		Over 90%
Merchandise that is not displayed as a % on inventory		Under 2%
Best-seller-in-stock day %		Above 95%
% of inventory aged over 60 days		Under 30%
Sales per square foot		Over \$200
Best-seller evaluation of vendors, categories, and items on a monthly basis		Never miss a month
Hold weekly operations meetings with key team members		Never miss a week

grading tool. Instead of As, Bs, Cs and sometimes Fs they view their various performance numbers in relation to their targets and industry metrics.

By doing this religiously, they are able to recognize areas of strengths and weaknesses immediately. They can then take guided action fast and execute strategies that are based on solid information.

A master key to success is the philosophy of continual improvement in relation to performance metrics. So, professionally recog-

nize and reward areas of achievement and attack the areas of weaknesses. By following these practices, businesses are prospering — even in slow times. **©NHFA**

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