

# THE FIVE KEYS

To Inventory Management

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As retailers, our inventory is the biggest asset we have that needs constant management to maximize profitability. There are many factors that contribute to a store's profitability, or lack thereof, but mastering the factors that affect our inventory is primary.

There are five key concepts to master, practice constantly, familiarize your staff with, and make part of your corporate culture.

## **Concept Number 1: Know your inventory levels as a percentage of a sales overall and by category.**

Too many retailers in our industry have too much inventory and too much of that is too old. While the NAHFA tells us that the absolute highest acceptable inventory-to-sales ratio is 20% of sales, the most profitable stores have inventory-to-sales ratios of closer to 10%.

It is also important that you look at your inventory by category. Some of your categories may have low GMROI and low turn rates (such as formal dining rooms). You should lower your inventory levels in those categories by reducing their share of your lineup. By doing this, you can force their GMROI to an acceptable level. Overall, 75% of your inventory should be less than 60 days old. This means that only 25% of your merchandise will be marked down. If you have some categories that are not performing well, then other categories must do better. Inventory overstock is by far the most costly problem facing furniture retailers everywhere because of the three types of associated costs it involves:

- **Carrying Costs:** annual out of pocket carrying costs of inventory overstock exceed 30% of landed cost, and we know we are never overstocked with best-sellers, only dogs. This is the smallest of the three costs.
- **Excessive Markdowns:** if you don't have a systematic method of clearing out your dogs, you will have to mark them down more than necessary to get rid of them, robbing you of needed gross margin.
- **Stock-outs:** too much money tied up in dogs means lost sales and margin due to stock-outs of best-sellers. This costs you more in lost profits than carrying costs and excessive markdowns combined.

The reality is that one of the many reasons for insolvency and GOB sales is carrying too much inventory. These retailers have too much inventory, poor buying practices, and no systematic markdown plan for their dogs. They finance inventory with bank loans, default on the loans because they do not move the inventory, cannot get more credit, and go out of business. The answer to inventory overstock is never to quit buying. All that happens then is that you sell your winners and are left with nothing but dogs. You **MUST** re-buy your best-sellers and special order merchandise, and to provide the cash to do that, you **MUST** move your dogs out in a timely manner without excessive markdowns.

## **Concept Number 2: You must know which items in each categories are winners and which are dogs.**

If you have RETAILvantage, your sales analysis by category report will show you that item by item, based upon landed gross margin dollar contribution, ranked from very best to very worst, updated each time you run it. If you are running another system, make sure that this information is constantly updated and constantly available, as it is the most important report in your system. You will never want to run out of a best-seller, and you will never want to re-buy a dog. In The Godfather, Michael Corleone said it best:

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*“Keep your friends close and your enemies closer.”*

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Same with your inventory... keep your winners close, but really keep an eye on your dogs. There are four times as many of those as your winners, and they can really bring your business down if not managed properly.

If you have too much money tied up in dogs, you are likely to be short of cash. This may well lead to an inability to re-buy your best-sellers appropriately. When this happens, the result is stock-outs, lost sales and lost profits. Chronic inventory overstock is always accompanied by chronic understock of best-sellers. You are also probably unable to purchase new, untested items at market, which is where new winners come from. Over time, best-sellers become dogs through a process we call attrition. They must be replaced with new winners. We know that for every five new items we buy, one will be a winner and four will turn out to be dogs. That means we have to acquire a lot of new merchandise to find enough new winners, and THAT means we need to have as our objectives to quickly identify the new winners from the new dogs, reorder the former, and move out the latter quickly. We'll explore systems to accomplish those objectives next.

### **Concept Number 3: Maintain your best-sellers in stock a higher percentage of the time.**

A great way to increase both gross margin dollars and turn rates on best-sellers is to keep them in-stock. After all, what could be more heart-breaking than losing a sale simply because you didn't have stock of the merchandise the customer wanted? Want to know how to avoid that? First, have a naildown program for your winners. Nail them down and NEVER sell them off the floor. Sure, your salespeople may say, "If you don't let me sell her the floor sample, she'll walk". The problem is if you let the floor sample go, you'll lose five or six sales before you get it back in. Don't do it. The price is way too high, as has been proven thousands of times. If you have an effective re-buying system, you won't have that problem.

And that leads us to the second element: really having the merchandise in-stock to deliver. If you have RETAIL*vantage*, your Purchase Advice Report will keep your winners in-stock over 90% of the time, without a lot of work on your part. If you don't have RETAIL*vantage*, ask yourself if your system will do that. If not, you are missing out on a LOT of profit. Remember, it's not how many you buy; it's when you buy them. Regular buying of appropriate quantities permits a high level of customer service, low inventories, high GMROI, and high profits, with no stock-outs. Only RETAIL*vantage* has a Purchase Advice Report that tracks the key factors that are necessary for a valid reorder quantity recommendation:

- in-stock and out-of-stock days
- rate of sale
- reorder lead time by item and location.

After all, you want to maintain appropriate inventory levels, even of best-sellers. The Purchase Advice Report will do that for you and remember you NEVER mark-down a best-seller. After all, a best-seller is a best-seller for 3 reasons:

- the public loves them
- salespeople find them easy to sell
- you don't have to mark them down.

If you have a problem with your salespeople cutting price, we can show you how to stop that practice overnight. Just contact us and ask for the info.

### **Concept Number 4: Move your dogs out on a timely basis.**

Most retailers hang onto their dogs too long, and then have to mark them down close to cost, or even below, to move them out, thereby destroying gross margin. After all, what makes more sense? Put a piece on the floor, leave it there for nine months, and then mark it 40% off during your annual sale to get rid of it? Or, mark it down 20% and sell it in 135 days? The second alternative doubles your turn rate, and cuts the markdown in half, thereby preserving some margin. Can you see how some retailers have such high GMROI's and profits? They maximize gross margin and turns from best-sellers by keeping them in stock and never marking them down. They maximize gross margin and turns from dogs by moving them out on a timely basis without cutting the price more than necessary. And they do it automatically. After all, a store with

2,500 SKU's has 2,000 dogs. No human being can keep track of, "Now when did I mark that piece down last, and by how much, and when is it due for another markdown, and by how much?" for 2,000 SKU's. There is just no way. However, that's something that computers are good at. RETAIL*vantage* will handle your markdowns effortlessly, on a schedule that YOU define, and even print out your markdown price tags for each markdown period. What could be easier?

#### **Concept Number 5: Consider all of the other tools at your disposal.**

Become active in PROFIT*groups*, our CEO Roundtable forum that offers a venue for seeking solutions and exploring industry-specific issues that are facing independent home furnishings retailers today. PROFIT*groups* has facilitated content rich meetings designed to "recharge the batteries" and energize the spirits of hundreds of companies with valuable new ideas, proven best practices, and fresh perspectives.

Open a "virtual showroom" that's open to your customers 24/7/365! Your website offers a huge opportunity to drive customers into your store, but is it a comfortable online shopping experience complete with up-to-date pictures of your best-selling merchandise? Your customers should be able to browse products, view images, and create a "wish list" of products they want to purchase from you. PROFIT*systems'* eCommerce is a complete solution that integrates your inventory information, images, and prices without the necessity of devoting excessive hours of your time to keep it current. Your customers can browse your online catalog, create a shopping cart, and check out with the click of a button. Data from your customer's shopping cart is imported from your website into RETAIL*vantage* and a quote is created for your customer. It's as simple as that! Our eCommerce solution is an affordable way to offer your clients an outstanding online shopping experience.

The independent retailer is under tremendous pressure these days to survive against the big box stores. We have lots of tips and tricks that we'd be happy to share with you. Call us anytime at 800.888.5565.

### **About PROFIT*systems*, a HighJump product**

PROFIT*systems* is a complete software solution for the modern home goods retailer. Key components of their solutions for retailers include enterprise software, consulting, performance groups, advanced education, group-buying freight programs, eCommerce and business intelligence. PROFIT*systems* features real-time inventory management, customer relations management, point-of-sale, and accounting systems. For additional information on PROFIT*systems*, a HighJump product, please visit their website at: [www.profitsystems.com](http://www.profitsystems.com).



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