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Features

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Death by Inventory, Part I

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Inventory is the bane of a retailer's existence. I bet you're wondering what the word bane means now that it's been connected directly to you. *("The source or cause of misfortune, unhappiness, frustration or anxiety, usually used hyperbolically"—The Free Dictionary)*

Despite its difficulties, inventory is a necessary evil. Gaining a clear perspective on inventory is the first step to taming the monster. Inventory is inherently evil in that without tightly defined and rigorous management and manipulation it always becomes a problem.

It must be curated, purchased, valued, edited, displayed, signed, priced, maintained, moved, paid for, financed, marked down, and well … what did I miss? We could probably apply a dozen or so other words.

The Unexamined Life of Inventory

Socrates said, "The unexamined life is not worth living." The same could be said of inventory. The failure to measure inventory performance with both internal and external benchmarking is like flying an airplane in a fog without the knowledge of how to read the instruments. In those conditions, you may eventually crash your entire business, as others before you have. Managing merchandise inventory isn't for the faint of heart. It requires a delicate balance of boldness and conservatism.

Standardized Performance Measurement

Unbelievable as it may be, in a simple Google search you'll find that there are many ways to measure inventory performance and the measurements by reputable companies conflicting with each other. This makes external benchmarking all but impossible if you don't subscribe to a standardized methodology. It's arguable that if you're only measuring against your own performance and are consistent, it doesn't matter which measure you use. However, when put against net profitability some methods are superior to others.

Merchant Math

Financial Consultant Steve Bailey and I have collaborated to produce a booklet of financial terms. Send an email to Sid@HorticulturalAdvantage.com to get a PDF copy returned to you. I'm going to infringe on Steve's space some in this article, but not on what he does for you. My aim is to illustrate that we must get a grip on measuring inventory performance to better understand how to control it so it doesn't control us.

Inventory Creates Margin

The sale of merchandise produces gross margin, the difference between the landed price and selling price. When we learned this in fifth grade it was called Gross Margin. I agree that it is gross—as in YUCK! While the margin should contain net profit, often this is not the case, therefore, I recommend that your company vocabulary isn't permitted to include the term "gross profit." By definition, the margin earned in the sale of products and services must pay all the expenses of running the business, including wages and benefits, operating expenses and profit.

There's No Margin, Until Inventory Turns

Many are incorrectly pontificating, or debating, that you should lower the price of goods to lower price resistance barriers to turn more inventory. Increased volume is rarely, if ever, the result unless matched with better weather. Others relentlessly pursue high margins to drive profitability, which can also be a failed strategy.

In the micro-economics of specialty retail, making up revenue on volume rarely, if ever, actually occurs, and if it does, the net result is almost always a net loss. You'll almost never sell enough of a lowered-price item to make up the margin difference. To the contrary, increasing pricing will often yield greater margin dollars, and if presented well, can increase unit volume and margin volume.

Value Confused?

We can't be cavalier about raising prices or lazy about adding perceived value. There's a point of going too far and that's when the price exceeds the perceived value of the customer. However, most owners and employees in the garden business have a bigger problem at the other end of the spectrum, believing their inventory has the value required to pay for itself, plus earn the margin required for a decent profit yield. If you can't believe your inventory is worth the price you need, please stop buying it in the first place.

Velocity of Turns

The concept of velocity is well covered in the very smart little book titled "What the CEO Wants You to Know" by Ram Charan. It would do the CEO of your enterprise well to read this book and then share it with his or her entire team. Velocity is the number of inventory turns achieved. The sum of the total inventory turns of all products is a key indicator of retail health. In all retail, a velocity of five to seven turns is typically a healthy financial environment. Garden centers typically turn inventory three to four times—a woefully inadequate velocity to spin enough cash to pay all the bills and have a decent amount left for a profit.

Inventory is a (Rapidly) Depreciating Asset

While inventory is technically a balance sheet asset, it's a depreciating asset. The half-life of inventory is just a few weeks beyond the period in which it should have been converted to margin or sold. Add to this the cost of maintaining inventory and even a good retailer is eaten alive with labor expenses associated directly to inventory.

Inventory Has a Shelf Life

We typically think of perishable items having a "shelf life," or in modern terms, until the expiration date arrives. The truth is that non-perishables also have a shelf life. The Merchant's Mantra is: "Never buy what you can't sell before you have to pay for it." Inventory that sits on the shelf or bench too long costs more than it can earn in margin. If we think of an expiration date on inventory and treat it as if it were all heads of lettuce, we'd be less likely to carry so much of it. **GP**

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Next Month

Sid tackles shrink and editing your inventory for a "curated" offering, plus much more. Don't miss the next installment in the April issue!