Surviving Tough Economies in Retail

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We find ourselves in the midst of a tough economic period again. Consumer confidence is low, world unrest and terrorism looms over the horizon. But you still have a retail business to run. There are issues that you can control and those that you cannot. The challenge is for you to put effort into what you can control. FOCUS on these things.

I work with a client called Pickles & Ice Cream, a group of maternity stores across the US. Despite dwindling sales, several of these franchises are more profitable than ever before. Some that had not shown a profit are now profitable and, in a couple of instances, net profits have risen 11 percentage points.

What I would like to do in this paper is to first explain why I am a consultant and then review some of the efforts that Pickles & Ice Cream stores have made to progress from red to black.

I spent 12 years as sales manager for several companies that specialized in point-of-sale and inventory management systems. My single biggest frustration was watching retailers buy a system, struggle with implementing it and then, 3 years later, decide to replace it since the business had not changed significantly in that time period. Three years later, they were replacing the replacement.

There were two primary reasons a system failed to change the business:

- Bad selection
- Totally inadequate use of the system

Bad selection usually occurs because the retailer wants to find a system that automates all of the processes they currently do—exactly in the way they currently perform these tasks. In other words, they seek to automate all of the good and horrible business practices already under way. Usually, they can find a generic product that lacks focus and control so that it meets these minimal requirements. Another problem, always on the second and third selections, is a narrow focus on correcting one problem uncovered in the last system. For example, if the receiving function was labor intensive in the last system, retailers will focus on that one issue in the next search at the exclusion of many other necessary functions.

Inadequate use of the system is the fault of both retailer and software vendors. Retailers are to blame because they rarely run reports that might provide them with the information to make a smart business decision. I hold software vendors accountable because most of them believe that inventory management is stock replenishment and reviewing what you sold last month. Therefore, many of their systems are a collection of lists of information. **A list, not a report.**

I have sat in on many system sales presentations and watched someone (who needed spell check to spell PC) show the reports. “Here’s our sales report of what you sold last month. You can sort it by department, by sales clerk, by hour of day, alphabetically according to height, blah, blah, blah. We can also rank it according to gross profits, quantities sold, blah, blah, blah.” And just what would you do with this 500-page report?

If you know anything about accounting, you know that it provides an analysis of a large number of transactions over a period of time. These transactions are stored as general ledger entries. Now look back at the previous paragraph and imagine an accounting system salesperson demonstrating the system. “Here’s our **general ledger report** of what you did last month. You can sort it by blah, blah, blah. We can also rank it according to blah, blah, blah.” The controller, who rarely laughs at anything, would be laughing hysterically. A controller reviews a financial statement, not a list of transactions. The reason is that no one can look at a list of transactions and make a determination (or decision) as to how successful a business is. That is true for accounting and retailing.

Therefore, I became a consultant to help a retailer find a way to use a system to make a difference in their business.

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Now, back to the story of Pickles & Ice Cream and some of the reasons they have made significant strides in profits. Keep in mind these business practices are as applicable for hard goods as well as soft goods. It Works!

1. They use an Open-to-Buy.

In tough economic times, buying more inventory than necessary is a formula for disaster. Prior to each buying market, the stores review their sales performance by department by month against a Plan. Based on trends, the sales plans are adjusted upward or downward so that the right amount of investment is made in each department.

If Dresses are performing below expectations, the natural tendency of a buyer (without an Open-to-Buy) is to purchase more and more until they find the right dresses. This is what I call the mud approach: if the retailer throws enough of a product at customers, they will eventually find a product that sticks. However, all of that mud at that bottom of the wall has to be cleaned up (paid for, marked down and/or donated to charity).

With an Open-to-Buy, if sales are 25% below Plan, then the future sales plan will be adjusted. Therefore, less inventory, not more, will be purchased. The retailer on a budget has to make a smart decision on where to invest this money. If there is no dollar limit, then the buyer will buy from as many vendors as possible. If there is a budget, it is necessary to focus on what has a high likelihood of success.

In the case of Pickles and Ice Cream stores, there are also departments that perform above expectations. Each month, the stores can identify where additional merchandise needs to be ordered quickly to fulfill inventory levels that are below plan. If Tops are selling above expectations by $3,000 one month, then the store's inventory decreased by $3,000 more than was planned. The store cannot wait until the next market to fill this hole, so they try to find available inventory from another store or from a profitable vendor who might still have some available merchandise for the current selling season. (Since the vendor is now producing goods for another season, they are usually trying to get rid of this older merchandise and will offer it at lower prices.)

There are several results that a typical store can expect from the implementation of an Open-to-Buy:

- A 10-15% reduction in inventory investment.

  Retail trade associations have estimated that the cost of carrying excess inventory is 30-35%. With an inventory investment of $300,000 at cost, a 10% reduction in inventory would result in savings of $9,000 to $10,500 annually.

- A 3-5% point increase in gross margins.

  This is accomplished by significant reductions in markdowns due to overbought situations and by controlling the timing of deliveries for optimum selling price. For $500,000 in sales, this would represent $15,000-$25,000 in additional margins.

2. They use their system to increase the likelihood of successful inventory investment.

Pickles and Ice Cream stores use a retail stock ledger report to identify vendors in each department (not SKU's) that perform profitably and with good sales numbers to decide where to place that investment. If, within a department, Vendor A products provide a gross profit percentage of 52% and Vendor B products are at 43%, then we have our first tidbit of information that **may** provide us with an indication of where to invest. There are other factors to review from their retail stock ledger report. What was the sell-through percentage? How many did we sell? When the buyers get to market, they will review a lot of vendors and products, but they already have some valuable information in their minds that can influence the outcome. The beauty of this is that it is factual information, not a feeling. When the decision is made on where to invest, it is influenced by emotion, but decided with a combination of facts and emotions. Therefore, it has a higher likelihood of success once it reaches the store.

Their approach goes back to our discussion of not running a list of what sold. The retail stock ledger serves as the sales and inventory equivalent of their financial statement. After identifying a problem at the department level, the store will drill down one level to look at the vendors' performances. Since there is little likelihood of being able to reorder specific colors or sizes of fashion merchandise, there is little need to look at the performance of styles, colors and sizes. However, there

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is a time when the information at these other detail levels is valuable. The buyers from Pickles and Ice Cream work with their vendors, even one whose products performed poorly. The performance is discussed with the vendor in the hope that corrections will be made. Some of the problems that Pickles and Ice Cream identified related to bad fits, inferior material, durability, wrong colors, etc. Some of this is available from this report. Some of it is knowledge from being in the store and working with customers.

3. They stopped using a formula to calculate selling price.

In the past, the stores all had the same selling price. When you are trying to earn enough profit to pay your cost of doing business (operating expenses), a store in Dallas, TX pays a lot more rent each month than one in Augusta, GA. These two stores can and should have different selling prices for the same merchandise. When we first discussed this, I used the concept of hotel chains. I said that I could not stop at the Courtyard by Marriot in Atlanta (Buckhead), GA and demand that they charge the same price from the Dalton, GA location. So they started a concept called “charging a price that the market will bear”.

Astute buyers will tell a vendor at buying markets to not tell them the cost price until they have had a chance to determine what price they believe their customers would be willing to pay for that item. If they look at what they consider to be a great top that they believe their customer will pay $50 to own and then the vendor says cost is $40, they say “Pass!”. If that top turns out to be $15, they still try to sell it at $50.

There is more to the story, but these are the significant items that led to a change. I can tell you that there is not much that can give me more satisfaction in my career than knowing that a client who was facing bankruptcy or forced sale of the business is now both profitable and sleeping at night again.

With Pickles and Ice Cream stores, the change was to work on planning, evaluating, analyzing and reacting. Not one “500-page report” was produced to accomplish this. Rather it was a series of small focused reports that gave someone the information to decide an issue with a high likelihood of success.

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