Catalog Success

Inventory Management: Stay On Top of the Metrics

George Mollo

Constantly look to improve merchandise profitability

Add a note...

Merchandise analysis is an ongoing process. Although most companies should schedule formal reviews at the end of each season, the key to profitability is staying on top of the metrics that drive any multichannel business. Postmortems, as many of these reviews have been labeled, have a negative connotation in many marketers' minds, and as a result, often are sidestepped.

I've found that changing them to "preseason kick off" reviews promotes an offensive approach to profitability that can be maintained throughout the season. Of course, each business can apply its own weight to the measures to make final decisions.

As multichannel merchants say, "It's all about the merchandise," or "Product is king."

Therefore, you constantly must monitor and improve your ability to:
• select better product,
• improve performance productivity,
• control inventory and
• drive increased profit to the bottom line.

Depending on your system's sophistication, you can develop and produce reports that allow you to look at item-level performance in myriad ways. If you have these tools available, hopefully you're using them productively. I'll look at the key information you should be tracking and, ultimately, reporting.

Now or Later

Starting from a higher category level — or the top-down approach — you need only look at a few measures to determine if the category is or can be (from a planning perspective) profitable. From a preseason planning approach, I should state that one of my business mantras is "almost right now," which is better than "exactly right later." (I'll touch on the "exactly right later" part in a bit.)

By looking at a few ratios, you can obtain a sense of direction. The ratios that follow should be looked at as a "package." That is, only looking at one measure in isolation would result in incorrect conclusions.

First, look at the relationship by category or subcategory of the number of items

(not SKUs) offered to the proportional revenue generated by that category, both historically and in terms of future plans.

For example, a category representing 10 percent of the items offered that generates 10 percent of the demand would have a performance factor of 1.0. Greater than 1.0 is good. Any performance factor less than 1.0 should be looked at for potential improvement.

Using the same concept, compare the percentage of space allocated to the demand generated. For example, this same category (10 percent of the items offered, 10 percent of the demand generated), which has 10 percent of the allocated space, would have a space performance index of 1.0. That's 10 percent of the demand divided by 10 percent of the space.

Looking at Figure 1 (*above*), the performance factors all are relatively good. At first glance, you might say that accessories are not performing as strongly.

However, keep in mind two things: one, accessories tend to be smaller items and generally are lower priced and; two, my caveat is not to jump to conclusions on one factor alone.

Add Space Performance

Look at adding the space performance factor in Figure 2 (*see top pg. 48*). Here, you see accessories, due to higher density, have a reasonable amount of space.

So far, I've only looked at demand ratios, which can be misleading on their own. Adding a few additional pieces of information gives a better "directional" picture of profitability.

Now Add Margin and Sell Ratio

In Figure 3 (*below*), there's an added margin (product initial margin) and sell ratio. Sell ratio — also called "ad to sales" ratio — is the cost of the allocated space or catalog costs shown as a percentage of the demand generated. The industry sell ratio generally is in the upper 20 percent to low 30 percent range. Should sell ratio begin to approach the upper 30 percent range, it becomes almost impossible for a cataloger to stay profitable. The last column in Figure 3 simply is the margin available to cover all remaining operational costs after selling costs.

Now look at the Home category in a slightly different light.

Although the demand and space ratios were acceptable due to the lower product margin (48.9 percent), the remaining margin is only 19.8
percent.

Use industry averages of nonmerchandise variable operating expense, or NMVOE, which consists of:
• order taking,
• picking,

• packing,
• shipping costs, etc.

They range from 8 percent to 12 percent, with fixed operating costs in the same range. So, you potentially have a category that may not be profitable.

Hopefully, by establishing a higher level "almost right now" approach to merchandise analysis, this process can become part of everyday business practice without substantial effort.

On the other hand, this doesn't mean that a much closer, detailed look at item profitability and merchandise analysis is unnecessary.

In fact, a detailed, more encompassing review ought to be available at the item level to provide the "fine line" when determining true item profitability.

I'll explore a detailed item profitability model in the next installment of my column in a few months.

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