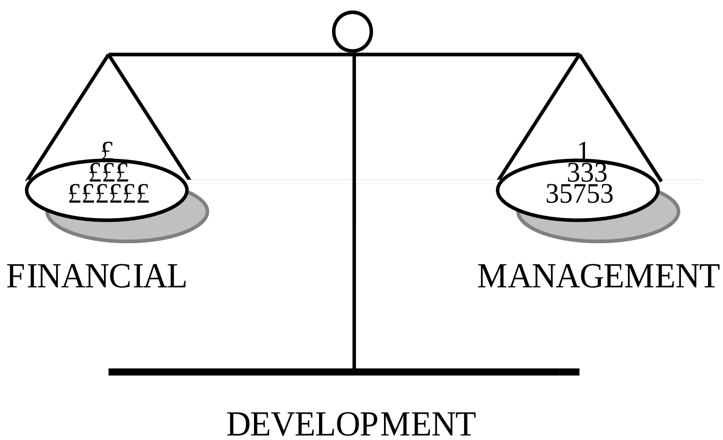
# FINANCIAL MANAGEMENT DEVELOPMENT

# MANAGING RETAIL OUTLETS

# NO 602

# STOCKING FOR PROFIT




**ONE OF A SERIES OF GUIDES FOR**

**FINANCIAL MANAGEMENT DEVELOPMENT**

**FROM**

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

# STOCKING FOR PROFIT

You only buy stock in order to sell it at a profit but **when should you buy? how much? where should you buy it? and how should you pay for it?**

Profit is your sales income less your costs. Another paper looks at how to manage your selling space in order to maximise profit from minimum space. That was an example of maximising contribution from a scarce resource. In this article we look at one of your key variable costs - the cost of stock and how you might consider decisions on stock purchasing and stock holding to improve your profit.

Stock is anything you buy with the intention of selling it. Many retailers buy goods to make the shop look nice or because they want the shelves looking full. If that is the objective fine - but do not fill the shop with expensive ornaments - make everything you buy pay for itself. A picture may be cheaper than a real item and doesn't need replacing.

**WHEN SHOULD YOU BUY?**

**J**ust in **T**ime is more than just a phrase. Your objective should be to have the shortest possible time between delivery of stock and sale and this is achieved by good planning. Work out your own seasonal and daily sales patterns. Do not forget Bank Holidays can move and that your trade may be affected by local events. If you sell strawberries in Wimbledon you need to know when the tennis is on and you pray it doesn't rain or possibly take out insurance (or both!) Good suppliers will help by telling you what you ordered in the past. Talking to customers may help with this. Knowing the local factory is going on short time or overtime will help planning. Look round the shop and the stockroom. What lines sell out fast? They won't be there! What lines take a long time to sell? Don't rush to get more.

Is your supplier meeting your needs? You may want some lines delivered daily, others weekly, others only per season (Christmas Cards, Sun Glasses, Easter Eggs, etc.) There are lots of complicated mathematical models on stock reordering policy. They all amount to comparing the cost of a stock out (i.e. the gross profit on lost sales) to the cost of reordering (delivery and all the administration that goes with it) plus the cost of stock holding. You need to think in terms of the true cost of a lost sale (sometimes nothing) "We had no Polos so they bought Trebor Mints"; (sometimes much more) "We couldn't get the milk so we may as well buy the cornflakes and everything else down the road".

If you collect your stock rather than having it delivered then do not forget the cost of your time. Minimise your time by maximising the effectiveness of your visits. Cost of stockholding is more than just the money tied up. It includes the true cost of space etc. being occupied, which may include the profit you could have made by storing and selling something else. The amount you should buy and how often you buy it are inextricably linked to what you expect to sell. Costing out the alternative approaches will help decide when to buy.

 

**HOW MUCH SHOULD YOU BUY?**

Only buy what you can sell. The problem is forecasting what you will sell. There is a big difference between the policy you adopt for perishable and non-perishable goods. Beware of fashionable and fad items. For non-fashionable and non-perishable items e.g. cigarettes, you can afford to buy in bulk; storage, insurance costs and space permitting. Set realistic levels e.g. buy two weeks worth of sales, every two weeks, two days before running out. For perishable or fad items, consider the relative risk. If you buy 100 toys at £2 hoping to sell them for £4 you will spend £400 to gain a profit of £200. If you only sell 30 you will lose £280 (being £400 less £120) and be left with 70 ornaments. Don't be scared to take a risk but do it with your eyes open. It may be sensible to by cheap Christmas Cards in January but don't expect to get your money back till December.

For goods with fluctuating demand, try to spot trends. Sandwich sales may always fall on a Friday because office workers go to the pub instead. Pay day at the local factory may double chocolate and impulse buy sales. One way of predicting demand is to ask your customers. It is also a good way of involving them. "If I stocked chocolate covered prunes would you buy them?" They will not only be flattered but will probably come back to find out if you did. It is easier and less risky to understock. Many retail failures are caused by the wonderful bargain volume discount, normally bought just too late to catch the boom. If you can see a bandwagon you are probably too late to get on it.

**WHERE SHOULD YOU BUY IT?**

Cash and Carry, Wholesalers or Suppliers? The main differences are the volumes and the terms. Work out what money costs you. If you are paying overdraft interest of 13% your money costs you about 1% a month (depending on when the interest is charged). Cash is therefore 1% more expensive than 30 days credit terms. Some wholesalers and suppliers also help with promotional material, forecasting demand and analysing your past purchases. You need to consider the value of these services to you.

Cash and Carry also occupies your valuable time. Make sure you include a notional hourly rate for yourself in any calculation of whether you should do something yourself or get someone else to do it. Often the best approach is to work out a broad strategy for your main stock items and perishables, but do allow some flexibility for emergency action if demand is unexpected. If possible, buy goods on sale or return. This is particularly important for perishable items. It dramatically reduces your risk and can often be a considerable help to cashflow. Remember you are in business to make money so don't spend cash unless you have it. Cashflow management is vital.

**HOW SHOULD YOU PAY FOR IT?**

The key message is use cash as a last resort and only if you get a discount. Paying on credit gives you a stronger hand if there are problems with the goods. Credit Cards can give an effective six week interest free credit. Watch for special deals but check whether everyone else is doing the same. 20 retailers in one area all selling the latest fad is a sure recipe for making losses. Assess the value of volume discounts in terms of risk. Remember if you do buy too much of the wrong thing it need not be a disaster. Use them as give-aways with other profitable lines (Free tin of beans with your Christmas Turkey) or as promotional (buy two get one free) tools. Having put you money into stock your job is to turn it back into money again as fast as possible.

 

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development and has been an Ordained as a Deacon in the Catholic Church.

He has worked as a Financial Controller and Company Secretary in the Finance industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material. He has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website:
**FinancialManagementDevelopment.com** including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).

 