Retail Business Definitions and Equations for Everyday Use

Blog · https://retailedge.com/docs/retail-definitions

It's Retail, How Hard Could It Be?

About 10 years ago, we had a client who was a Hedge Fund manager tell me he figured he would open a store and hire some people to run the store while he ran his Hedge Fund. His logic was “its retail, how hard can it be?” Retail may be a place where a lot of young people get their first start in the working world, but retail is no different than any other business. In retail you must be a social media whiz, know how to manage your own website and understand AdWords and analytics as well as be your own HR department, accountant and janitor. On top that, Retail is an industry that has its own language as well as its own math.

Let’s talk about the key terms that come up in a day to day conversation. If you understand the vocabulary, then you have a better chance of making it through the day and making better buying decisions using real terms and retail math to back it up. Because in the end, intuition a good start but intuition backed by data is even better.

Open To Buy (OTB)

An open-to-buy plan determines how much of each department or category of merchandise you can purchase every month. The main purpose of an open-to-buy is to make sure that you don’t have too much or too little of each category of product so you can more accurately meet the demand of your customers. This is where retail math comes in. How do you calculate your Open to Buy? Start with your projected sales, then add in the projected end of month inventory, then subtract the previous month’s projected ending inventory, then add in your inventory adjustments such as RMA’s and your markdowns. (See markdowns below) Confused yet? Now you know how much inventory you need, including your sales and markdowns in order to end up with your projected end of month inventory.

Planned Sales + Planned Markdowns + Planned End of Month Inventory - Planned Beginning of Month Inventory = Open-to-Buy

Markdowns

A markdown is essentially any reduction in retail price after merchandise has been initially stocked. The difference between the new discounted selling price and the previous selling price is the dollar amount of the markdown. And don't forget that discounted sales should always be recorded at the markdown price and categorized as markdown dollars. This is done in retail dollars and not at cost.

Departments and Categories

A **Department or Category** is simply a grouping of merchandise. In other articles we have discussed the importance of a well-organized database. If you analyze your inventory by department instead of by actual item, you can get a much better feel for what types of items are moving or not moving. When it comes to Departments you can always change things up as your store evolves. So just because the departments were set up a certain way in the beginning does not mean that this is the correct way to do it now.

Class or Subcategory

A class is a further categorization of your inventory for reporting. This is a sub department or sub-category. The organization of your data is the key to how you get information out and these are services that are offered by our partners at Management-One as well as with our team here at RetailEdge.

IMU (Initial Markup)

The initial markup is the difference between the cost of your inventory and the original price at which you sell it. In order to calculate your Initial Markup, you need to start with what you need your profits on that inventory to be, then include in your expenses and what you think your projected markdowns will be. Remember, controlling markdowns can really play a factor on how you mark up your inventory and proper planning helps maintain that you are not overusing markdowns to reduce your inventory.

Margin and Markup

These two are constantly mixed up. In RetailEdge we calculate margin, however when you are trying to quantify what you will sell your product for you need to know how much you are “marking it up.” **The definition of a markup** is any increase in the retail price of merchandise after that merchandise has already been stocked. If we have an example item that has a retail price of $100.00, and a cost of $80.00 then our profit is $20.00. The Markup = gross profit/wholesale cost. ($20.00 / $80.00 = 0.25 or a 25% markup)

Margin

Now margin on the other hand is a ratio of profit to revenue as opposed to markup's ratio of profit to cost. The profit margin allows you to compare your profit to the sale price, and not the purchase price. So that same item that had a wholesale cost of $80.00 and a Retail Price of $100.00 would have a profit margin of 20%. The standard retail calculation for margin is (1-wholesalecost/Retail Price)

Maintained Markup

Oh, wait there’s more. Now we also must manage the **Maintained Markup (MMU).** The Maintained Markup is the markup on the merchandise that is sold, or the difference between the cost of inventory and the actual retail price of the inventory when sold. It is based on actual sales, not planned or forecasted sales, and actual happenings such as markdowns in the store. In other words, it is not what you hoped for the planned initial markup to be. It is the actual markup that relates the actual cost of inventory and other costs by the vendor as well as the costs to ship the inventory to the store.

Why is this important? Because this is the actual measure of how much money you’re making on your inventory to help determine the health of your business.

Turnover

This is the number of times that your average stock is sold within a given period—normally one year. To calculate turnover, you take your annual sales and divide that by your average monthly inventory. Is there a magic number when it comes to turn? Not really. It all comes down to the what it is you are selling and the cost of those items.

A fashion clothing store will typically turn 2-3 times a year where a specialty store may only do 1-2 times. Coincidentally RetailEdge has this report already built in as well so its pretty easy to calculate your Turn Rate.

Stock-To-Sales Ratio

Stock-to-sales ratio: The ratio between the beginning-of-month (BOM) inventory and sales for that same month. This ratio is dynamic and changes over the year. This is due to seasonality because some months will need a full store due to the time of year where other times you may be at a lower level due to annual slowness such as post-holiday or end of the year. When your stock-to-sales ratio is dialed in you are on track to achieve the best turnover rate.

Cost of Goods Sold (COGS)

Cost of goods sold (COGS) is the cost of the items sold during a given period. To calculate your COGS, you take the cost of your beginning inventory, add in the cost of any purchases you made during that period, and subtract the cost of your ending inventory. This one is simple.

Gross margin return on investment

GMROI (Gross margin return on investment) This is the turnover of your inventory as it relates to your total sales. To calculate GMROI, take your gross profit (your net sales minus the cost of goods sold) and divide it by your average cost of inventory. Quick note. If you lower the price of your product your GMROI goes down. However, if you raise the price and sell fewer, your GMROI can also goes down. So, finding the Balance can be tricky.

Net Sales, Gross and Net Profit

Net sales: Your net sales amount is the total value of merchandise sold to your customers. Markdowns and sales taxes should be subtracted.
Gross profit: Gross profit is your net sales minus your cost of goods sold.
Net profit: gross profit minus all your operating expenses.

So now that you have a thorough grasp of the vocabulary you are ready to meet your vendors and write your orders with confidence. Or you now have a cheat sheet you can use when you go to

market or work on your next season’s orders. Either way these tools will help you with your planning and making informed decisions going into the next season.