GROWERTALKS

Features

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Keeping Count

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A solid inventory analysis can be the magic bullet that makes this season a money-making one for you. It lets you do more with what you have. It tells you what is making money and what isn't. It can keep you in business, or take a strong business to the next level. For a garden center, it is one of the most cost-effective analyses you can do to increase profitability. It can tell you if the dollars you invested are working well for you.

There are three distinct approaches to managing your inventory: instinctual, historical and analytical.

Inventory Management Methods

Instinctual is just what it sounds like: It's using your gut to make purchasing decisions and waiting to see if those decisions were good. It's a little seat-of-the-pants, but for many, it's an important part of the decision process, particularly for new items or things you haven't offered before. The main ingredient for success is having confidence that you've got the knack for buying what's hot, then proving your skill by selling fast and hard.

The second approach is historical, which is reviewing your purchases and sales data from the previous year and extrapolating a decision about how much to buy and what to charge for it in the coming season. For many smaller operations a historical inventory analysis works very well, but it can backfire. It can make you nervous and lead you to make decisions that aren't aggressive enough. And without some additional analysis it tends to tell you a whole lot more about your past mistakes than your future successes.

You could be buying too much of a product that sold well last year and be forced to sell it at a discount this year. If looking for new winners isn't part of your product decision-making for the next year, you may find yourself in trouble in future seasons. You'll find that product representatives are famously willing to help you choose which of their goods to buy. Your success lies in balancing your historical data with the salesperson's trendy recommendations.

The analytical method is vast to the point of intimidation. It involves dozens of ways to identify strong or weak margins from the level of your entire business down to a single product line. But before you decide that it's too big a task, consider that a decision not to do any analysis will likely leave money on the table. Inventory analysis benefits your business just by thinking about it. Once you understand the following analytic tools, your perspective will change and you'll want to know what's best for your bottom line.

Dig Deeper

Physical turns of inventory looks at how many products actually moved through a given retail space. The calculation is straightforward: units per area over time. The more specific the product or space that you're analyzing, the more useful your data will be. Generally speaking, green industry veterans are experts at resourceful use of their growing space and take pride in that efficiency. Unleash that competency on your retail space.

In the garden center business, there is a wide range of benchmarks for turns, depending on the product. Hanging baskets or herbs will turn relatively quickly, while larger nursery stock may remain unsold for more than one season. Generating the expected number of turns for these different types of products requires detailed knowledge of product and carrying costs. You've got to have records of what you've done in the past in order to turn that information into future income.

For many, the challenge is changing their records from a compliance level useful for tax preparation into a more meaningful management tool. Usually the first change (and challenge) is to align your sales categories, COGS categories and inventory categories. This sets up a basic but powerful profitability-analysis tool. Allocating labor expense appropriately between growing, selling and management responsibilities often seems impossible until you actually commit to counting how your workers spend their time. Without keeping track of the time spent on each task, how do you know if it's money well spent?

Looking at your Gross Margin Percentage for your entire inventory is a good start, allowing comparison of historical data from year to year. While it's useful to compare monthly sales, like June 2010 to June 2009, that will only tell if you bought and sold well, not what you bought and sold well. Gross Margin Percentage is a yardstick that's too rough a measure to apply equally to all areas of your garden center business. By organizing your chart of accounts so that sales, COGS and inventory match, you will gain more useful data.

Doing detailed costs and turns analysis by department is an especially strong tool to check the efficiency of your managers and how well they move product over time. Different departments typically operate at different margins, so it would be unfair to compare a grocery manager in a buy-and-sell operation to an annuals manager in a grow-it-yourself operation.

Capital Efficiency

Generally speaking, you must gain higher margins on products that turn more slowly. Self-grown products often need to be a high-margin crop for garden centers because they're really only turning one crop per year, though the maturity of that crop may be staggered. Often products that are bought in can be lower margin, but are required to turn more quickly to make the same dollars.

Another way to look at turns is to measure their efficiency in financial terms; not how many products were sold from that shelf space, but how many dollars invested in inventory were turned into profit. This measure is called Inventory Management Index, which was developed by University of Wisconsin professor James J. Wadsworth.

> How to determine Inventory Management Index:

STEP 1 | Sum period-end inventory values, at cost.

STEP 2 | Divide by the number of periods to get an average inventory value.

STEP 3 | Divide your sales by inventory value to determine the number of turns.
What this does is calculate the number of times you turned your (average) investment in inventory into gross sales. A higher number ratio is more efficient.

STEP 4 | Subtract COGS, including shrink, from gross sales to determine gross margin.

STEP 5 | Divide gross margin by sales to determine your gross margin percentage.

STEP 6 | Divide gross margin into COGS to determine gross markup.
There is a key difference between gross margin and gross markup: Gross margin percentage is what you made from the inventory you sold. Gross markup is the percentage of cost you are adding to determine the sales price. Gross markup is particularly valuable when working with historical numbers, because it will take into account your average discount or sell down. Now the fun part:

STEP 7 | Multiply the number of turns (from Step 3) by your gross markup (Step 6) to calculate Inventory Management Index (IMI).

The higher the IMI, the more efficiently you're using your investment in inventory. It's a formula that balances the number of turns with the margin you receive on that product or department. Ranking your products via IMI will tell you which are most capital efficient and which aren't getting it done. Using a slow-SKU report to weed out underperforming products is taking a shortcut that might otherwise leave a perfectly profitable one on the shelf.

Looking at the profitability of individual products—and having your managers or key employees work on it with you—will yield the most immediate solutions and suggestions. For this information to be effective, careful recordkeeping is crucial. The better your historical cost accounting, the more effective your analysis can be. The more you bring managers and key employees in on the process, the faster and longer lasting will be the results. **GP**

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