



Forget Average Profitability... 10% isn't hard – Part 2

Double-digit (10% or more) net profits are not only possible; they aren't even that difficult to achieve, but you've got to know how, and you've got to follow the rules.

By Larry Stark

According to the annual NHFA Retail Performance Report for 2003, the average furniture retailer netted 4.4% (pre-tax) to sales in 2002, with the middle range being 1.5% to 6.6%. On the face of it, that appears to be a pretty good showing, inasmuch as it was a significant improvement from the previous year, and the economy still wasn't booming. At the same time, however, it's really very low, compared to other industries; other types of retail and the high profit half of furniture retailers reporting. The high profit half of the firm's surveyed averaged 9.2% pre-tax net profit to sales, with the middle range being 7.8% to 10.2%. Even those results aren't that good, compared to clients of ours, many of whom netted in the 12% to 15% range, with one even topping out at 18%.

In our last article we talked about the mindsets of high profit furniture dealers compared to those of average profit dealers, and how profit maximization is really achieved in two different areas of your store... the front end and the back end. We discussed how to go to about managing your front activities to maximize profitability. Now it's time to examine the management of your back end activities.

Managing The Back End... The "Five SMART Steps"

The back end of your business... the merchandising and operational end... is every bit as important to the profitability of your business as the front end. No matter how well trained and competent your sales force is, if you don't have what your customers want when they come in to buy, you'll never be able to maximize your sales and profits. Likewise, if your sales force is not motivated properly to sell the way you want them to, and/or if you don't have effective programs in place to bring old customers back for more, sales and profit maximization won't happen. The Five SMART Steps give you a step-by-step program to follow to optimize your back end to maximize your profits:

SMART Step 1: Spot the winners and the losers.

As we all know, you can't improve what you don't measure, and it's just as true in merchandising as in any other area of your business. The first step in improving your inventory management has to be having a very good handle on what's hot and what's not. And we're not talking about knowing the few spectacular winners and the few notorious dogs... you must have a handle on where every item in your inventory ranks against every other item in each merchandise category. Just as counting traffic is critically important to improving the front end, maximizing the profitability of the back end depends on precise measurement of the profitability of each and every inventory item. Nothing else can happen until that's accomplished. You need



a report to analyze sales by gross margin dollars actually realized within each category to Sales identify and rank every winner and every loser in your inventory.

SMART Step 2: Maintain the winners in stock.

With a firm grip on which inventory items are winners and which are losers, you're in a position to maintain the winners in stock a much higher percentage of the time. You'll be amazed how greatly sales will increase by doing just that one thing alone. In our own store, we increased our sales 25% the first year after we implemented the Purchase Advice Report that allowed us to keep our winners in stock over 90% of the time while at the same time speeding up our stock turns and increasing our GMROI. You need a buying report like this that: (1) tracks the sales of each item, (2) calculates the rate of sale based on in-stock days, (3) tracks a moving, weighted average reorder lead time of each item over the last several shipments, (4) calculates the stock required to cover your sales over that reorder lead time, (5) compares that need with your unsold stock on hand plus what you have on order that's unsold and (6) recommends an order for any negative difference that's been calculated.

SMART Step 3: Auto-move the losers from stock.

Obviously, you can't truly optimize your inventory management without a really effective means of moving out the dogs from your inventory in the shortest possible time and at the least possible cost. You need a system that generates periodic markdown recommendations as follows: (1) The system tracks the time since the receipt of the last shipment of each slow seller (as identified in SMART Step 1 above), (2) compares that time against a markdown schedule that you have defined and (3) recommends a markdown based on that schedule for each item where the time in (1) above is greater than the time in the schedule. Since this type of system starts working on moving out each poor seller immediately upon its being identified as a dog, no other method will achieve faster results. And since an item is never marked down more than is required to sell it, the results are achieved at the lowest possible cost!

SMART Step 4: Reward high margin sales effort.

The problem with flat-rate commission systems is that, while they are very effective at motivating salespeople to maximum *sales* effort, they are a definite demotivator regarding maintaining profitable gross margins. Salespeople have a natural fear of allowing customers to walk, and most believe that the easiest way to make sales is to cut price. To overcome the fear, you must make the reward for earning a good gross margin on a sale a stronger motivator than the fear is a demotivator. Our clients have had excellent success with a variable commission system that calculates commissions on a sliding scale that increases the commission rate paid by 1% for each 5% improvement in gross margin (or relative fractions thereof) over the historical gross margin earned before implementing the variable commission system. This system overcomes the salesperson's fear so efficiently that we've never had a client report less than a 3% (of sales) improvement in gross margin, and the average gross margin improvement is more on the order of 5%!



SMART Step 5: Target mail old customers to bring 'em back.

It costs far more to bring a new customer through the front door than to bring an old customer back for more. Not only that, but the close rate on repeat customer traffic is always far better than that for new customers. Put those two together, and it's obvious that old customers are far more profitable than new customers. You need both, of course, but a store that doesn't have an efficient, effective systematic program to bring old customers back for more can't hope to maximize profitability. You need a system of producing targeted mailings that is sufficiently automated to be virtually effortless. (The reason that most stores don't already have a system of targeted mailings is that most systems require too much work.) Not only that, but the targeting needs to be sufficiently accurate that a hundred targeted letters will produce more sales than thousands of broadside mailers. This isn't difficult with the right computer software. Since the targeted letters don't involve expensive four-color production costs... only the cost of the stationery and postage... and since you're not sending out thousands of pieces in a broadside barrage... rather a few personal letters to highly targeted old customers, the cost as a percentage of sales is almost nothing!

But How Do You Implement All This?

It's really simple if you're using PROFIT*windows*. All of the Five SMART Steps are standard in PROFIT*windows*. If not, contact your software vendor to see if these steps can be implemented while using their software. For further information, call me... I'll be glad to help in any way I can without charge.

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