2017 RETAIL PERFORMANCE METRICS – FINANCIAL OBSERVATIONS FROM THE FIELD

Improvement starts with two things: awareness and desire. The awareness of how you are performing against standards allows you to understand your strengths and weaknesses, and it's through the measurement against these standards that you can find gaps. Once you know where the gaps are, it's having the desire to create a strategy and act upon an improvement plan that separates the average business managers from the top-tier performers.

Over the course of 2017, industry expert and consultant David McMahon reviewed a wide range of operations through his consulting and performance groups' activities. In doing so he established a set of metrics, which can be used for benchmarking both average and top performing operations. To assist home furnishing retailers in improving their individual operations, and for the good of the industry in general, David has decided to publish the financial portion of the performance observations he made during this period time.

Below are the Profit and Loss (P&L) percentages observed by David during this time, followed by his interpretation of each metric. The numbers are broken down into what is the commonly accepted P&L format amongst industry retailers. They are expressed in three groupings:

1. Average performers
2. Average of double-digit profit club (net income before tax) performers
3. Average of top-tier performer for each metric (top ten-percenter suggestion)

PROFIT Systems a HighJump product

Column #1 shows the average performance for each metric, column #2 shows the average performance for retailers in the double-digit profit club, and column #3 shows the average performance of select top-tier operations (or top "10-percenters"). The observations are expressed in terms of percentages of total retail sales volume to allow operations of different sizes to compare themselves using a "common size" format. For the purposes of compatibility, electronics and appliance merchandise have been excluded from these metrics.

Financial Metric Observations:	Column 1	Column 2	Column 3
Financial Metrics - P&L	**Average of all Observations**	**Average of Double-Digit Profit Club**	**Average of Top-Tier (Top 10%er) in Select Metric**
Sales - Merchandise	96.51%	97.56%	–
Sales - Warranties	3.73%	3.43%	6%
Total Sales	100%	100%	–
Cost of Sales - Merchandise	52.91%	49.84%	47%
Cost of Sales - Warranties	26.18%	21.84%	17%
Total Cost of Sales	51.82%	49.19%	45%
Gross Margin - Merchandise	47.09%	50.16%	53%
Gross Margin - Warranties	73.82%	78.16%	83%
Total Gross Margin	48.18%	50.81%	55%
Financing Expense	-3.04%	-2.51%	-1%
Cash Discounts & Rebates	0.76%	0.47%	3%
Gross Realized Margin	45.91%	48.77%	51%
Operating Expenses:			
Administrative Expense	11.95%	12.31%	7%
Occupancy Expense	8.15%	7.64%	4%
Advertising Expense	5.90%	5.59%	3%
Selling Expenses	9.21%	7.84%	5%
Customer Service Expenses	0.72%	0.16%	0%
Delivery Income	-1.94%	-1.89%	-4%
Warehouse & Delivery Expense	6.15%	4.55%	4%
Total Operating Expenses	40.14%	36.20%	36%
Net Operating Income	5.88%	12.63%	14%
Other Income	0.10%	0.21%	–
Interest Expense	-0.31%	-0.30%	–
Net Income Before Income Taxes	5.67%	12.54%	14%

FINANCIAL METRIC INTERPRETATION:

1. Sales

- Separating the percent of warranty and protection sales with respect to merchandise sales is now the accepted way of producing an industry P&L. This is due to the massive importance of increasing the proportion of warranty sales, which are typically the highest gross margin product a retailer sells.
- The range between average and double-digit operations in percent of warranty sales to total sales: 3.73% and 3.43%. Top-tier operations almost double these averages.

2. Cost of Sales

- With respect to cost of merchandise, double-digit profit operations had a 3% lower cost of goods percentage than an average operation.
- The top-tier performers had an almost 3% cost advantage over the double-digit profit operations at 47%.

3. Gross Margin (GM)

- Gross margin or “GM” percent of sales is the inverse of cost of goods, meaning the operations with the lower cost have the highest margin.
- Average performers show a 48.18% GM, double-digit club members show a 51% GM, and those in the top-tier achieve 55% GM.

4. Gross Realized Margin

- Gross Realized Margin first lists the reduction of costs by vendor rebates and discounts incurred, then increases cost of sales by finance and credit card fees.
- It gives an alternate gross margin number as non-employee direct costs with purchasing the merchandise and making the sale considered.
- Before any operating costs are considered, an average operation has 45.91% of sales dollars left to produce a profit, whereas the double-digit profit club has 48.77%.

5. Administrative Costs

- Administrative costs include general overhead expenses that don’t fall under occupancy, advertising, selling, distribution or services. Examples could include office and owner payroll, training, legal, etc.,
- The top-tier in this metric came to a very low 7%, which may be a bit too low for some. Operations under 10% that are able to manage properly are doing exceptionally well.
- Some operations here do not want to be low in this metric as they feel they cannot provide properly for their employees with regard to healthcare, training and technology.

6. Occupancy Costs

- Occupancy costs include all brick-and-mortar showroom facility expenses such as rent, loan expenses, real estate charges, maintenance and utilities.
- This is typically one of the more fixed costs a brick-and-mortar retailer incurs, as it doesn’t change much from one month to the next.
- Average occupancy cost is 8.15% of sales. The double-digit profit club is 7.64% and the select top-tier performers in this metric are as low as 4%.

7. Advertising Expense

- For an average operation, the advertising expense runs 5-6% of sales. Profitable businesses could potentially spend up to 10% depending on location.
- It is good to consider occupancy and advertising expenses together and keep the combined percentage under 15% of sales.

8. Selling Expenses

- Selling expenses cover sales managers and sales people’s wages, bonuses, commissions and other payroll costs.
- Operations in the 5-10% range are common, which is consistent with this data. Average stores are at 9.21%, the double-digit profit club is at 7.84% and the top-tier in this metric is at 5%.
- This cost should be one that is mostly variable, meaning when sales go up or down, selling costs should go up or down as a dollar amount and remain constant as a percentage.

9. Customer Service Expense

- This is actually a net percentage, representing all customer service costs that are related to solving issues with damaged and defective merchandise. Costs are reduced by any income or amounts in credit that are received back as compensation from vendors.
- A highly-functioning operation has very low service costs as a net percentage.

10. Delivery Income

- On average, operations seem to collect around 1.9% of sales in delivery income with top-tier performers doubling that.
- Aim to collect an amount that covers the direct delivery-related expenses. Otherwise, delivery costs will come straight out of gross margin dollars.

11. Warehouse and Delivery Expense

- Warehouse and delivery expenses include all physical merchandise handling as well as logistics employees, their operating facilities, equipment, and any other resources they use.
- On average, operations spend 6.15% of sales here. The double-digit profit club uses 1.6% of sales less cash resources at 4.55% of sales. Top-tier performers are as low as 4% of sales.

12. Total Operating Expenses

- Total operating expenses add up all expenses that are reduced from Gross Realized Margin. It is the total of administrative, occupancy, advertising, selling, service, delivery and warehousing expenses.
- Any operation that's in control and running smoothly with a total operating expense ratio that's less than 40% of sales is a potential goldmine.
- Average performers are at 40.14% while the double-digit profit club is very lean at 36.2%.

13. Net Operating Income

- This is the percent of every sales dollar that remains after all costs of goods and regular operating expenses are deducted.
- Average operations show 5.88% net operating income. Those in the double-digit profit club have 12.63% net operating income, and the select top-tier operations for this metric have 14%.

14. Net Income Before Tax

- Net income is the bottom-line after other non-operating income, non-operating expenses and interest expenses are either added or deducted.
- Overall, the bottom line is not significantly different from net operating income. Average operations show 5.66% net income before tax, double-digit profit club members have 12.54%, and top-tier operations for this metric have a 14% bottom line.

David McMahon, CSCP, CMA, EA is VP of Consulting and Performance Groups at PROFIT*systems*, a HighJump Company. He holds professional certifications as a Certified Supply Chain Professional and is a Certified Management Accountant. David directs four performance groups (the Kaizen, Visionary, Gladiator and TopLine groups) and multiple consulting projects. He can be reached at david.mcmahon@highjump.com.

THE PROFIT*systems* TEAM IS HERE TO HELP!

Find out how we can help you increase profitability and grow your business!

Call us today at 800.888.5565 or email info@profitsystems.com.

ABOUT PROFITSYSTEMS, A HIGHJUMP PRODUCT

PROFIT*systems* is a complete software solution for the modern home goods retailer. Key components of their solutions for retailers include enterprise software, consulting, performance groups, advanced education, eCommerce and business intelligence. PROFIT*systems* features real-time inventory management, customer relations management, point-of-sale, and accounting systems.

For additional information on PROFIT*systems*, a HighJump product, please visit their website at: www.profitsystems.com.