

CATEGORY MANAGEMENT LEARNING FORUM

TOPIC: RETAILER ECONOMICS AND SUPPLY CHAIN

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If you work for a retailer, it's important to understand how the day-to-day decisions that you make, and how the measures that you track and/or are responsible for drive the overall results in the financial statement. If you are a supplier calling on a retailer, it's important to understand your retailer's financial statement. By linking retailer's overall financial results to some of the day-to-day decisions that a category management team makes, and what their overall objectives and targets are for the upcoming year, you will be able to come up with business solutions that are aligned to the retailer's overall financial responsibilities – at a category level.

When you look at the basic retailer income statement to the right, what areas of the income statement can retailer category management teams influence the most? They obviously have influence on sales, driven by the 4 P's – product assortment, product placement, pricing and promotion. They also influence the cost of goods sold, which includes cost from suppliers plus any additional costs to get the merchandise into inventory and ready for sale.

So based on this income statement, there are two ways that retailers can build gross profit (the third line of the income statement). They can increase sales and/or decrease cost of goods sold. To increase sales, they usually look at two key performance indicators. First, they want to understand how sales are performing compared to prior period, which is usually year ago. Next, they want to know how sales are performing vs their targets or budgets for the fiscal year.

Retailers can reduce cost of goods sold through vendor negotiations, pricing strategy, promotional events, and through effective product supply. Significant planning time is spent, both for the retailer and supplier, to create business plans that will help them to achieve their overall company objectives. Then, through retailer & vendor negotiations, an agreement is made on volume targets, O&A deals and payment terms that will collectively affect the "Sales" and "Other Income" for the retailer on their income statement. The objective of the negotiations is to come up with a joint business plan that helps both companies to achieve their overall goals.

Pricing has a direct influence on profit for the retailer, and is a daily focus for retailers. Retailers measure profit by using two basic methods, gross margin and markup. Both methods give a description of the gross profit of the sale. Breakeven points give retailer an understanding of how much lift they need on a promotion, based on the % discount on the item, to break even in gross margin. These measures are important for retailers and suppliers to know how to explain and calculate, even though they are typically automatic generations in retailer's POS systems. And once again, these directly impact results on the retailer's income statement. To the left are some of the things that influence profit.

Inventory is merchandise purchased by retailers, for the purpose of being sold to customers through their retail outlets. The cost of the merchandise purchased but not yet sold is reported in the retailer's inventory as part of the accounting process, and considered to be a financial asset for the company. It also impacts operating expenses in the income statement. Dollars that are tied up in inventory for the retailer can't be used more productively in investments in other areas of the business. Inventory turnover, inventory days on hand and gross margin return on investment are 3 key measures that retailers need to measure on an ongoing basis.

Whether you work for a retailer or supplier, understanding the basic retailer economics will help you to build better business plans. Good luck with your business plans!

Retailer Income Statement		
	\$	Margin
Sales	328,600.00	100.0%
Cost of Goods Sold	-240,700.00	-73.3%
Gross Profit	83,800.00	25.5%
Operating Expenses	-63,400.00	-19.3%
Non Operating Expenses	-3,381.00	-1.0%
Net Income	17,019.00	5.2%



If you like this tip, you may be interested in CMKG's related, accredited \$99 eLearning courses: "[Retailer Economics and the Product Supply Chain](#)" or "[Strategic Supply Chain Management](#)". These two courses will give you a deeper understanding of retail math, and the product supply chain process from start to finish.