Retailing

Inventory Pricing Systems

LO 3

• **FIFO** stands for first in, first out and values inventory based on the assumption that the oldest merchandise is sold before the more recently purchased merchandise.

• **LIFO** stands for last in, first out and values inventory based on the assumption that the most recently purchased merchandise is sold first and the oldest merchandise is sold last.
The Merchandise Budget

LO 1

• Merchandising is the planning and control of the buying and selling of goods and services to help the retailer realize its objectives.

• Merchandise budget is a plan of projected sales for an upcoming season, when and how much merchandise is to be purchased, and what markups and reductions will likely occur.

• Gross margin is the difference between net sales and cost of goods sold.
Five Major Merchandising Decisions

LO 1

• What will be the anticipated sales for the department, division, or store?

• How much stock on hand will be needed to achieve this sales plan, given the level of inventory turnover expected?

• What reductions, if any, from the original retail price must be made in order to dispose of all the merchandise brought into the store?

• What additional purchases must be made during the season?

• What gross margin (the difference between sales and cost of goods sold) should the department, division, or store contribute to the overall profitability of the company?
Income Statement

LO 2

• Income Statement is a financial statement that provides a summary of the sales expenses for a given time period, usually a month, quarter, season, or year.

• Gross Sales are the retailer’s total sales including sales for cash or credit.

• Returns and Allowances are the refunds of the purchase price or downward adjustments in selling prices due to customers returning purchases, or adjustments made in the selling price due to customer dissatisfaction with the product or service performance.
Income Statement

LO 2

• **Net Sales** is the gross sales less returns and allowances.

• **Cost of Goods Sold** is the cost of merchandise that has been sold during the period.

• **Operating Expenses** are those expenses that a retailer incurs in running the business other than the cost of the merchandise.
Income Statement

LO 2

- **Operating Profit** is gross margin less operating expenses.

- **Other Income or Expenses** includes income or expense items that the firm incurs which are not in the course of its normal retail operation.

- **Net Profit** is operating profit plus or minus other income or expenses.
Balance Sheet

- **Balance Sheet** identifies and quantifies all of the firm’s assets and liabilities at a particular point in time.

- **Asset** is anything of value that is owned by the retail firm.

- **Current Assets** are assets that can be easily converted into cash within a relatively short period of time (usually a year or less).

- **Accounts and/or Notes Receivable** are amounts that customers owe the retailer for goods and services.
Balance Sheet

LO 2

- **Goodwill** is an intangible asset, usually based on customer loyalty, that a retailer pays for when buying an existing business.

- **Total assets** equal current assets plus noncurrent assets plus goodwill.

- **Liability** is any legitimate financial claim against the retailer’s assets.

- **Current Liabilities** are short-term debts that are payable within a year.
Dollar Merchandise Control

LO 2

• **Open-to-buy (OTB)** refers to the dollar amount that a buyer can currently spend on merchandise without exceeding the planned dollar stock. Computations for OTB are as follows:

  • Planned sales for month + Planned reductions for month + End-of-Month (EOM) planned retail stock – Beginning-of-Month (BOM) stock = Planned purchases at retail

  • Planned purchases at retail – Commitments at retail for current delivery = Open-to-Buy (OTB)
Dollar Merchandise Control:

**Common Buying Errors**  

- Buying merchandise that is either priced too high or too low for the store’s target market.
- Buying the wrong type of merchandise (i.e., too many tops and no skirts) or buying merchandise that is too trendy.
- Having too much or too little basic stock on hand.
- Buying from too many vendors.
- Failing to identify the season’s hot items early enough in the season.
- Failing to let the vendor assist the buyer by adding new items and/or new colors to the mix. (All too often, the original order is merely repeated, resulting in a limited selection.)
Optimal Merchandise Mix

LO 3

- **Variety** refers to the number of different merchandise lines that the retail stocks in the store.

- **Breath (or assortment)** is the number of merchandise brands that are found in a merchandise line.

- **Battle of the Brands** occurs when retailers have their own products competing with the manufacturer’s products for shelf space and control over display location.

- **Depth** is the average number of stock-keeping units within each brand of the merchandise line.
Interactive Pricing Decisions

LO 1

- Merchandise
- Location
- Promotion
- Credit
- Customer Services
- Store Image
- Legal Constraints
Pricing Policies: Pricing Above the Market

LO 1

- **Above-Market Pricing Policy** is a policy where retailers establish high prices because nonprice factors are more important to their target market than price. Some factor that allow above-market pricing include:
  - Merchandise offerings
  - Services provided
  - Convenient locations
  - Extended hours of operation
Below-Market Pricing Policy

is a policy that regularly discounts merchandise from the established market price in order to build store traffic and generate high sales and gross margin dollars per square foot of retailing space.
Specific Pricing Strategies

• Odd Pricing
  is the practice of setting retail prices that end in the digits 5, 8, 9 - such as $29.95, $49.98, or $9.99.
Specific Pricing Strategies

LO 2

- **Bait-and-Switch Pricing** is a practice where a low-priced model of a shopping good, such as an automobile or refrigerator, is used to lure shoppers into a store and then the salesperson attempts to persuade them to purchase a higher-priced model.

- **Private Label Brand Pricing** occurs when a retailer can purchase an item at a cheaper price, have a higher markup percentage, and still be priced lower than a comparable national brand.
Calculating Markups

LO 3

• **Markup** is the selling price of the merchandise less its cost, which is equivalent to gross margin.

• To calculate the selling price (or retail price), the retailer should begin with the following basic markup equation:

\[ SP = C + M \]

where **C** is the dollar cost of merchandise per unit, **M** is the dollar markup per unit and **SP** is the selling price per unit.
Using Markup Formulas when Purchasing Merchandise

LO 3

- If you know that a particular item could be sold for $8 per unit and that you need a 40% markup on selling price to meet your profit objective, how much would you be willing to pay for the item?

\[
\% \text{ of Markup on selling price} = \frac{(SP - C)}{SP}
\]

\[
40\% = \frac{($8 - C)}{$8}
\]

C = $4.80
Using Markup Formulas when Purchasing Merchandise

LO 3

- If a retailer purchases an item for $12 and wants a 40% markup on selling price, how would a retailer determine the selling price?

(SP = C + M), we know that SP = C + .40P since markup is 40% of selling price. If markup is 40% of selling price, cost must be 60% since cost and markup rate complement each other and must total 100%. Thus, if 60% SP = $12 (divide both sides by 60%) then

SP = $20
Planning Initial Markups

- To determine the Initial Markup, use the following formula:

Initial markup percentage = \( \frac{\text{operating expenses} + \text{Net Profit} + \text{Markdowns} + \text{Stock shortages} + \text{Employee and customer discounts} + \text{Alteration costs} - \text{Cash discounts}}{\text{Net sales} + \text{Markdowns} + \text{Stock shortages} + \text{Employee and customer discounts}} \)
Markdown Management

- **Markdown** is any reduction in the price of an item from its initially established price.

- **Markdown percentage:**
  
  Markdown percentage = Amount of reduction/Original selling price
Markdown Policy

LO 4

- **Advantages of Early Markdown Policy:**
  - Secure a more rapid or higher rate of inventory turnover
  - Speed the movement of merchandise by making it more attractive; therefore, markdown percent will be lower
  - Improve cash flow position by providing money for new merchandise and outstanding buys
  - Provide space for merchandise

- **Disadvantages of Early Markdown Policy:**
  - Possible damage to store image
  - Possible loss in customer confidence in store (the customer could begin to think, if I wait a week, the merchandise will cost less)