

Second reason for financial distress in a jewelry store:
MORE INVENTORY THAN YOU CAN SELL IN ONE CALENDAR YEAR.

Last week we talked about the five reasons for financial distress in a jewelry store, the first one was **not charging enough for your labor.**

The second reason is

You have more inventory than you can sell in one calendar year.

This is probably the number one killer of jewelry stores. The reason is too much inventory ends up being a huge amount of debt that you can't pay. Your debt usually comes from vendors you owe because of too much inventory. Period

You've met over your life time (or maybe you're one) people who live on a smaller income and manage to pay for life's necessities and some splurges, while having a few bucks left over.

Then there are others who earn gobs of money and never have much left over and have mounds of debt.

Your store can have "gobs of sales" and have little left over as well. It comes from these problems; seen in stores across America (doesn't just have to be a jewelry store.)

So let's look at this. You buy an object for \$100 and sell it for \$200. Getting keystone, you're happy. Typically out of the \$200 over 40-45% goes to pay overhead:

Rent
Advertising
Utilities
Salaries
Stuff you can't get out of paying

That leaves you somewhere between \$110 and \$120 out of the gross profit you have to either **pay or reorder** another item you just sold **leaving you with a whopping \$10 to \$20 in net profit. That's all you get out of selling a \$200 item.**

Whoop de do!

Now a \$20 net is 10% and that's a good number. But here's where everyone goes array. Let's look at this sale again but in the way **you** probably handle the money.

You have a sale of \$200; let's say it's a gold ring. 40% is overhead = \$80.00. This leaves you with \$120.00. (\$100 is the cost of goods and \$20 is going to be your net profit.) You

need to either pay for the object you sold or pay buying another one (It was either something you bought and paid for a long while ago or just got it and have to pay for it).

You have \$120 available to buy another one (really \$100) and therefore hoping for \$20 left over for net (you're planning to use the money to buy a new Porsche). But instead you decide to replace the gold ring that was sold and also buy a diamond pendant for stock for \$100. It's really pretty and you think it will sell.

So now with the \$120 left over you have to make that money stretch because you've put yourself into debt to the tune of \$200. Your accounts payable now shows **\$200 in new bills**.

Your idea will work if you sell the replacement gold ring **plus sell** the diamond pendant.

Remember, you have doubled inventory levels. If sales only increase 20% (that would be nice, wouldn't it?) then you're still behind the 8 ball by the other 80%.

So if sales increased 20% they would be \$240.00. Overhead would be about \$96.00, thus leaving you now \$144 in gross profit. But you owe for 2 items:

- Replacement ring at \$100
- Diamond pendant at \$100
- **Total owed \$200.**
- Total available to pay for these 2 items **\$144!**
- Behind the 8 ball by \$56.00.

The correct amount of inventory to carry in a store is usually equal to your gross profit from the sale of product.

If your store does a million dollars in sales and has a 45% gross profit margin (that's \$450,000) then the inventory level should be \$450,000.00.

There is another inventory level number. Some folks say you should stock the amount equal to your cost of goods. In this example it would be \$550,000.00.

Either way is a little "good" or a little "bad". Why?

If you stock in your case your **Gross Profit amount** (\$450,000) this is what you'll have:

- A slightly smaller selection.
- Less debt

If you stock in your case your **Cost of Goods Sold** amount (\$550,000) this is what you'll have:

- A slightly larger selection.
- More debt

This is not the one and only way to look at inventory levels. The variables that affect your store's health in this example are:

- Your profit margin might be capped. Lines like Rolex and such dictate your margins.
- Lines also dictate the amount of inventory you must carry.
- Overhead as a percentage of sales.

I've spoken to a Cartier store who told me his gross profit margin was dictated by the company (he owned the store as a franchise) and his minimum stocking level was dictated by the company as well. So where you can have more money by either stocking less or charging more, he couldn't do either.

Jewelers who have a higher volume can have the same profit margins percentages as a smaller store and same inventory levels (stocking just enough to equal cost of goods sold) but have more **cash** because their overhead doesn't increase that much going from 1.5 million to 2.5 million. The overhead as a percentage drops and that goes right to the bottom line.

The secret to stocking the right amount of inventory is multi-faceted.

- Items over 1 year old are a killer and can't make you any money. This hurts **turn**.
- The lower the gross profit percentage of an item, the less time (less than a year) you can afford to stock it. "Turn" is how many times in a year an item sells. Jeweler should look for an overall turn of 1 or better. If you make 40% rather than 50% on an item, it should be sold in about 10 months (turn is 1.2).
- Dig deeper into sales. Look at items sold by price point. This is a fantastic way to see exactly what is moving.

The secret formula is called "Gross Margin Return on Investment". Fancy schmancey name for a way to see what's making us money and what's not. Now don't go off on the deep end, ride along with me here. GMROI is the gross profit dollar made from product sales for 1 year divided by the average inventory.

Overall a healthy jewelry store has a GMROI of over \$1.00. \$1.10 is good, higher is better.

So let's use the example several pages up, the gold ring selling for \$200. It cost \$100 and if it took a year to sell, then we had in the case \$100 (that's inventory) for the year.

1. Item sells for \$200
2. Gives us \$100 in gross profit
3. Inventory level is \$100

Gross profit divided by average inventory = GMROI. OR.....

\$100 divided by \$100 = \$1.00 GMROI. Cool.

But remember how we went and bought two pieces of inventory? Now here's the number:

Gross profit (\$100) divided by average inventory (now \$200) equals GMROI of .50 (fifty cents).

Stores with a GMROI of less than \$1.00 have a hard time paying their bills on time.

Its O.K. to have some departments in a store with a low GMROI (less than \$1.00, diamonds and watches come to mind) as long as you have other areas take up the slack and the store's overall GMROI is above a buck.

Here's a GMROI report using Jewelry Shopkeeper. The report lists the numbers for each category and the store's total. Here we see the stores overall GMROI is

11/12/2006 PAGE NO. 1													
Silver Jewelers													
FOR SALES BETWEEN: 01/01/2004 & 12/31/2004													
REMAINING INVENTORY INCLUDES MEMOS AND EXCLUDES LAYAWAYS													
RETURN ON INVESTMENT ANALYSIS BY MAJOR CLASS CODE													
366 Days in the Report													
MAJOR CLASS CODE	UNITS SOLD	SALES TOTALS	COST OF SALES	PROFIT PER ITEM	GROSS PROFIT	GROSS MARGIN PCT %	AVERAGE INVENTORY COST LEVEL	# OF YEARLY TURNS PER YEAR	YEARLY GROSS MARGIN R.O.I.	% OF TOTAL GROSS PROFIT	COST OF REMAINING INVENTORY	QTY LEFT	
971 CUSTOM MADE JEWELRY	0	0	0	0	0	0.0	290	0.00	0.0	0.0	290	1	
975 \$100.00 GIFT CERTIF	0	0	0	0	0	0.0	0	0.00	0.0	0.0	0	16	
976 \$50.00 GIFT CERTIFI	0	0	0	0	0	0.0%	0	0.00	0.0%	0.0%	0	25	
RES 995 RESTOCKING FEE	32	2,812	0	88	2,812	100.0	0	0.00	0.0	1.0	0	-36	
>> REPORT TOTALS >>	3,120	\$486,299	\$212,964	\$88	\$273,343	56.2%	\$514,588	0.40	53.0%	99.9%	\$542,227	4066	

Look at the 4th column from the right "Yearly Gross Margin ROI". This GMROI column shows the store has a GMROI of 53 cents. It should be over \$1.00. Also look at the 7th column from the right, plain old "Gross Profit Margin Pct". The store is making *overall* a margin of 56%. Not bad! So what's wrong? Look at the two circled item. The average inventory level is higher than the gross profit in dollars.

Gross profit should be **HIGHER** than inventory. Here average inventory level is \$241,245 higher than gross profit (\$273,343 vs. \$514,588).

Also look at far left: Unit's Sold versus the right hand column: Qty Left.

In a years time they sold 3,120 units and still have 4,066 left. The 1st secret is to stock no more than you'll sell in one calendar year. They have almost 1000 units too many.

So this store makes money when they sell their inventory, they just buy too much. For every \$1 they sell at costs, they then call on the phone and order \$1.88 more. Unless sales are going to increase by 88%, they need only reorder what sold. If they expect sales to increase this year by 10%, by \$1.10 worth, not \$1.88.

So this is our first place to look AT INVENTORY: How much inventory we sell and stock in one year. The amount you should stock is equal to your gross profit from selling those items.

Net email is looking deeper into inventory, taking a peek by price points.

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