

## Understanding Inventory Turns

Like the gauges on your car dash board, successful retailers use ratios to determine the operating efficiency of their retail store. There are many of these retail ratios but probably not many more important than the Inventory Turns.

Inventory Turns is a retail gauge that measures how often inventory is being cycled. This Ratio is usually calculated at the department level.

**Example:** *Mary's Gift Store had an average inventory cost of \$5,000 for her candle department last year. Her POS software reported that she had sold \$20,000 worth of candles, at cost last year. Her Turn Ratio for the year would be 4 times,  $\$20,000 / \$5,000$ .*

Inventory turns then is a general measurement for effective inventory management. If your business plan has as a goal four turns per year for a given department, and you meet that objective, then you have effectively managed your inventory. If the actual results were significantly higher or lower, than just like that flashing light on my gas gage, it is a warning that inventory for that department needs a close look, and action taken.

To better understand Inventory turns it's necessary to understand the factors and how they relate. The first factor is average inventory on hand, at cost, for the department. This number needs to be as accurate as possible. Averages are harder to calculate if there is a large fluctuation during the period, do the best you can. The second factor is the cost of goods sold for the period; ordinarily this will be an easier number to find. If the sales period is not a full year, it needs to be annualized. Do this by dividing the cost of goods sold by the number of days in the period and multiplying it by 365.

**Example Two** - *Mary's Gift Store liquidated the extremely slow moving items from the candle department. The average inventory dropped to \$4,000 for the next year. Sales stayed the same, with cost of goods sold at \$20,000. Now Inventory Turns are 5 times a year. Without effecting revenue Mary freed up \$1,000 to use on another department.*

**Example Three** - *Mary's Gift Store wasn't watching the gauges and ended up with only three turns for the year. The average inventory remains at \$5,000 but the cost of candles sold is only \$15,000. Clearly not an effectent use of invested funds.*

To use inventory turns as a tool you need an effective budget so you know when the warning light may go off. The first place to look is industry averages, many associations publish average benchmark numbers. If not, ask a successful friend, with a similar retail store, that is not in your competitive range. The next place to look is at a stores own numbers, they can give a good idea as to how well the store is doing. If there are two turns a year in a department, it may make sense to set the goal for three turns next year.

It's important to set inventory turn goals for each department. Store wide goals are difficult to get a handle on and react to, item or category goals may keep a manager on the run dealing with too much detail, in most cases departments are the right level for setting inventory turn goals and tracking the result. As an aside, from all accounts, seven is a magic number for managing departments, meaning, seven is about the maximum number of departments one person can keep track of effectively.

Now, here are some practical applications to inventory turns that can be used to practice the concept. If, for the notions department, a goal is set for inventory turns to be four in the upcoming year but midyear calculations show the store on track for six turns, is that good?

***Turns to High.*** *It sounds good. But, the truth is, a high turn ratio is also a warning. One or more of the following may be true if turns are higher than planned:*

- 1. Inventory may be too low, meaning selection is limited so customers may not return.*
- 2. There may be too much time spent placing purchase orders, receiving, labeling and stocking displays.*
- 3. Prices may be too low, resulting in higher sales, but smaller margins.*

***Turns To Low.*** *If goals are set for Inventory turns of four turns per year in the paper department but midyear calculations show you are on track for two turns a year. The following are things that may be considered.*

- 1. There may be slow moving or obsolete inventory in the department. These items are like an anchor to the rest of the items in the department.  
(Run a "no sales" report or a "margin ranking" report to sort these items out.  
Merchandise them better or put them on sale in order to exchange bad inventory dollars invested for good inventory.)*
- 2. Department foot traffic may be low. Customer traffic reports will give the percentage of those customers who buy compared to the total traffic in the store.*
- 3. The departmental pricing may be high, do a comparative price study.*
- 4. Items in the department may not match the buying habits of the customers.*
- 5. The products need better marketing and/or merchandising.*

The "Big Boys" have learned to use inventory turns as one of their basic management tools. They set benchmarks for each department, and they are serious about maintaining those benchmarks. They review the turn ratios, at least monthly, if a warning light comes on, they dig deeper to find out what why.

POS•IM has an excellent Item Turn Ratio Report. It allows for you to define a time period and a comparative time period. Remember the most effective way to run this report is by department. Below is an example of a turn report by department.

Report Preview

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### Item Turn Ratio Report

09/21/2005

Sorted On: Dept  
 Sub Sorted On: Item ID  
 From First to Last  
 Report from dates 1/1/04 to 6/1/04  
 Item turn ratio 2 from dates 6/1/04 to 12/1/04

ID	Description	Qty Sold	Annual COGS	Avg Inv Cost	Turn Ratio 1	Turn Ratio 2
Embroidery	Embroidery	10	1550.65	873.62	1.77	1.55
Embroidery	Embroidery	3	422.25	316.98	1.33	2.16
Fabric	Fabric	20677.1256	163517.02	367024.10	0.45	0.54
Fabric	Fabric	39.091	369.01	322.64	1.14	0.61
Gift	Gift	213.5	2448.86	808.25	3.03	0.60
Kit	Kit	872.5	19583.66	16608.93	1.18	1.21
Machine	Machine	-4	2484.03	544.82	4.56	2.93

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The inventory turn ratio can be a warning light, if, upon inspection, the turns are higher, they understand what may have caused that condition and quickly run the needed reports to make decisions and corrections.

No one would drive a car without a gas gauge and check it regularly, in like manner, a retail business shouldn't operate without basic bench marks; inventory turn ratios are a key bench marks. If this concept is still a little foreign, don't be afraid to ask an accountant to help you calculate the various departments inventory turns. I guarantee a great feeling of satisfaction will accompany the effort of setting inventory turn goals, tracking results and taking action to maintain proper inventory levels.

A very successful friend of mine once told me, "It doesn't matter as much where you are, as what direction you are heading in." And as long as the tank is full, you'll go far.

