Managing Key Indicators

Guidelines for department managers

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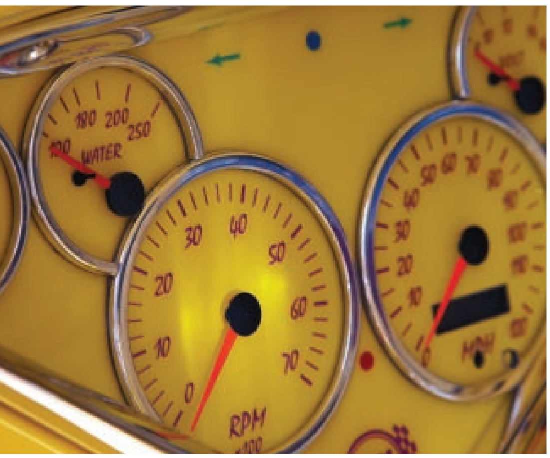

When you drive your automobile, a number of gauges enable you to read critical factors in your auto's performance. The dashboard presents "key indicators" of your auto's health: fuel level, engine temperature, RPMs, oil level and battery charge. If you ignore these indicators, it may cost you much more than it would had you paid attention to your auto's performance and caught a problem when it first showed up on a gauge. Ignoring some of the key indicators may lead to engine failure or other costly repairs.

Much like an automobile, a cooperative retail has a number of operational key indicators that allow you to read the health of your store's operation and alert you to potential problems. Department managers have many responsibilities, but none can be more important than managing the impacting factors of their department's key indicators to maintain or create healthy performance.

Key indicators are numbers that quantify department performance in crucial areas: sales, margin, labor, and inventory management are typical areas that, when managed well, will produce or maintain a strong department. I work with many cooperatives, focusing on their performance in all or some of these critical areas. One thing I've learned is that cooperatives that apply resources to ensuring their managers understand how to manage key indicators are cooperatives that typically do well in their performance and rarely need outside assistance in fixing poor performance.

Understanding the impact of key indicators, and how to manage key indicators, are skills that all department managers should have or develop. When department managers have these skills, their general manager can focus his or her energy on other areas that will enhance the co-op's strength and position in the community.

Key indicators and key relationships

When reviewing key indicator performance, it is important to understand not only what the performance may mean but also the potential relationship between the various indicators. Understanding the full impact of performance in these areas may not be as easy as it appears.

Having high inventory turns typically leads us to believe we are managing our inventory well, but this is true only if achieving high inventory turns does not create higher out of stocks for our customers. Another example: producing a labor to sales ratio that is low or a very high sales per labor hour (either one is typically a department manager's desire) may be a very positive performance, but it may be driven by a low pay scale for employees or by staff being overworked either of which can result in higher turnover, less effective customer service, and sales deterioration. A final example: margin growth is typically a positive achievement, but perhaps not if it has an adverse impact on sales.

> Key indicators quantify department performance in crucial areas such as sales, margin, labor and inventory management.

Understanding what key indicators are telling us is important, but equally important is knowledge about what tactics may need to be applied in order to positively impact related store performance.

Achieved margins

Margin is one of the first areas of responsibility for department managers. Usually the general manager will establish goals for margin performance, and it is then up to the department manager to bring in the desired results.

In managing margins, the first action is to apply margins to product costs and create the product's selling price. One of our primary tools for maintaining margin integrity is price auditing: choosing a number of products on a rotating basis and actually checking the invoice cost, selling price and applied margin. A systematic approach to price audits may reduce the need for investigating margin problems in the future.

How we choose the applied margins may depend on a number of factors such as competition, industry comparisons, department history, and merchandising tactics. The weighted margin takes the variable margins for products and those products' percent of category sales to determine the margin being applied to the category (or department) as a whole.

Understanding the weighted margin is important, because with these applied margins we may begin to see the impact shrink as on our achieved margin. We can then decide whether the known shrink for this category is too high and needs attention or is in the acceptable range. In order to understand the weighted margin, department managers need to become familiar with contribution margin spreadsheets, which means being skilled in using Excel or other spreadsheet programs.

If margin results are not where they are suppose to be, there are a number of areas for a manager to investigate, such as invoice coding, credits, inventory transfers, physical inventory counts and product loss.

One tactic I recommend for perishable departments is to maintain a purchasing log and track sales. Over time, you may be able to tell whether your margin performance is improving (purchases and sales grow further apart) or deteriorating (purchases and sales come closer together) well before your quarterly reports are available. Perishable departments have practically no time to recoup and can lose money very quickly (with packaged goods, if you have too much inventory you can wait for it to sell). So, a tool offering margin information as quickly as possible can only have a positive effect on department margin performance. ■>

MARGIN/GROSS PROFIT	
Applying Margin to a Product: (Creating a retail price)	**Wholesale Cost / Complement of Margin**
Determining Margin Applied to a product:	**(SRP - Wholesale Cost) / SRP**
Determining Achieved Margin: (Gross profit as a percent of sales)	**Sales - COGS / Sales**
Determine Gross Profit: (The $ difference between COGS and sales)	**Sales x Margin**
Determine Cost of Goods Sold (quick formula): (The $ value of products at wholesale)	**Sales x Complement of Margin**

INVENTORY TURNS (How many times you sell you inventory at wholesale, annualized)	
Determine Cost of Goods Sold (COGS)	**(Beginning Inventory + Purchases) - Ending Inventory**
Inventory Turns	**Cost of Goods Sold / Average Inventory**
Average Inventory	**Last Four Inventories / Four**

LABOR	
Labor Percent (What percent of your sales is spent on labor)	**Direct labor dollars / Department Sales**
SPLH (Sales per labor hour) (How much sales are generated for each paid hour)	**Sales / Number of Hours Worked**

MARGIN MINUS LABOR	
MML (What is the spread between these two key indicators)	**Margin % - Labor %**

GROSS PROFIT MINUS LABOR DOLLARS How much money is there to pay the bills after paying the highest variable expense	
Growing this number is the most critical operational issue.	**(Sales Dollars x Margin %) - Labor Dollars**

Margin is a key indicator, but be careful in viewing this area as a stand-alone goal. I have observed some departments that have achieved margin enhancement yet experienced sales stagnation as a possible result. Margin is a tool, with the goal being gross profit enhancement—don't lose sight of this.

Labor

Labor is measured in two ways: labor as a percent of sales and sales per labor hour (SPLH).

Labor as a percent of sales is derived from a department's direct wages (no benefits or taxes) divided by department sales over the same time period (Labor $/Sales $). The figure shows what percent of the department's sales is used for paying the employees of the department. Usually, the lower the labor percent of a department, the more opportunity the department has to be profitable.

Labor percent is a factor of the number of hours and pay rate. I believe it is more difficult for a department manager to control this indicator because, typically, department managers do not control wages. Therefore, I advocate they focus on sales per labor hour (SPLH).

SPLH measures how many sales dollars were produced for every paid labor hour during the same time period (Sales $/Labor hours). This is more a measurement of labor efficiency than of profitability, but of course efficiency and profitability have a significant relationship. Since SPLH is strictly the relation between hours worked and department sales, and since department managers have full control of their department's schedule, it is a key indicator for which a department manager can more fairly be held accountable.

Managing labor can be greatly enhanced if the department manager has the appropriate knowledge and some good tools. A weekly department labor scheduler that totals hours and shows projected SPLH is an excellent tool for keeping the manager tuned into the department's labor use on a regular basis. An annual labor budgeting tool can assist a department manager in forecasting labor needs well before they have materialized. The department manager can plan accordingly, and this information can also be used to feed into the total store's labor budget.

Often when labor is a problem the immediate approach is to reduce hours. While this is not necessarily inappropriate, tools that enhance efficiency can reduce reactive responses and focus the department on proactive approaches. I advocate that all departments use flow charting as a regular part of their improvement process: review all major systems as your business environment changes, and make changes to these systems to maintain their effectiveness. Once you are sure that all your systems are as effective as possible, you may then make a reasonable labor needs forecast that isn't driven by inefficient systems.

Inventory turns

Turns are a measure of how effectively the department is using its inventory. We define them as annual turns: how many times per year we sell the wholesale value of our average inventory. The formula is: Cost of Goods Sold/ Average Inventory.

While inventory management is typically not a profitability issue, it has a significant cash impact. Most general managers would rather have cash available for store management needs than have it tied up as excessive inventory in the back or on the retail shelves.

Looking at the formula, you can see the two basic ways to impact inventory turns: in the management of COGS, which to a large extent is driven by sales, and management of average inventory (last four inventories/four). If you increase sales and maintain the same average inventory, the annual turns will increase, as they would if you continued selling the same amount of goods but reduced your average inventory.

Department managers can use purchasing budgets to assist them in managing their inventory. There are a number of other approaches to consider: denoting all top sellers on the shelf tags to keep buyers focused on important

<■ items to keep in stock, regularly reviewing product movement reports and eliminating slow sellers, increasing facings of top sellers, negotiating with suppliers for more frequent deliveries, and establishing reorder points for your products.

As with all indicators, your strategic approach will impact your results. If you focus on investment buying (purchasing products on deal and selling them at regular price), your turns may never be as high as a similar store that does not do investment buying. The department manager needs to understand the impact of the tactics applied to make a valid assessment of the benefits. Greater inventory turns is a goal, but we must be careful that high turns is not an indicator of growing out of stocks.

Sales growth

Sales growth is the sign of a healthy market; more people are telling you that what you are doing is meeting their needs. Sales growth is measured from one period to the same period in the previous year: the difference in sales is divided by the older year's sales (sales 2008 minus sales 2007).

While managers must look at approaches to increasing sales, a department manager does not control all the impacting factors. If a department does not get appropriate marketing support or its labor budget has been reduced, and that negatively impacts customer service, the result could be lack of sales growth through no fault of the department. However, it is still a department manager's charge to do everything within his or her power to grow sales.

Merchandising has a key impact on sales. Do you have the right products, the right price, the right placement, and the right promotion to be as successful as possible in growing your sales? Are you aware of consumer trends, and have you positioned your department to take advantage of these trends? Strongly merchandised departments offer regular samples and food demonstrations, have signage that informs and attracts the consumer, run specials so there is a sense of "I can get a great deal," and always have top sellers in stock. Having staff who suggest products to the customer can increase sales more than staff who are passive. Creating a positive shopping experience is the work of all staff, and the more positive the shopping experience is for the customer the more likely you will get repeat sales.

Sales growth is typically a healthy sign for a department, but if we create this growth by greatly reducing our margin to lower our shelf prices we may find that we have reduced our gross profit in pursuit of greater sales. We also run the risk of creating greater labor inefficiencies with greatly increased sales if we have not taken the appropriate approach to managing our labor for sales growth.

Margin minus labor

The Margin Minus Labor (MML) key indicator is a simple formula of subtracting labor percent from achieved margin (margin percent minus labor percent). It removes the department's largest variable expense and shows what percent of sales remain to cover all expenses outside of labor.

As this key indicator grows, the department is typically becoming more profitable, as it shrinks, less profitable. One value in using MML is that it allows departments to measure themselves against the same department in other stores, even if the approach to retail is slightly different (a store with a full-service prepared foods department versus a self-serve one). MML can also show that a store with higher labor may need to achieve higher margins in order to be profitable. Regardless of how much one department spends on labor, when we review the MML we are using an approach that allows for stronger comparison of performance between stores.

Recalling the potential margin and labor questions mentioned earlier, note that the MML indicator raises the same issues that these two stand-alone indicators have.

Review regularly

With a number of areas to keep informed about, what can a manager do to best utilize time and ensure optimum department performance?

- Become familiar with how each key indicator is derived.
- Learn a number of ways in which you and your staff can impact key indicators.
- Become educated as to how performance in one area may impact performance in another area.
- Compare your performance in these areas with other industry stores (CoCoFiSt graphs are an excellent tool).
- Establish specific benchmarks for your department in all key indicators.
- Regularly review key indicator performance and hold department team discussions on how to proceed when action is needed. ■