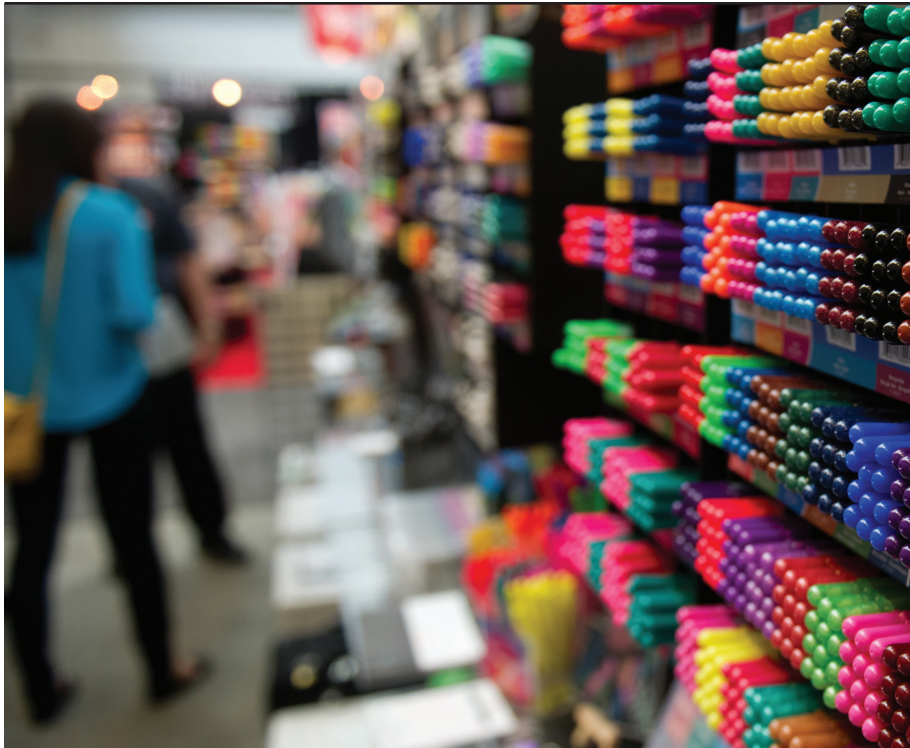


RETAIL OPERATIONS FOR
ART MATERIALS RETAILERS

Merchandising



VOLUME 3: Merchandising



RETAIL OPERATIONS MANUAL

NAMTA
20200 Zion Avenue
Cornelius, NC 28031
T: 704.892.6244
F: 704.892.6247
info@namta.org
namta.org

What is retail merchandising?

Basically, it's the process used to conduct retail sales. As part of the process, the merchandiser pays close attention to the types of products offered for sale, how to best present those products to consumers and determining what is a reasonable retail price for each unit sold.

While art materials retailers have traditionally engaged in the task of retail merchandising in a physical location, the internet has now made it possible to apply these same basic principles online in a virtual store.

Establishing a working relationship with the manufacturers who will provide the goods or services that are ultimately sold is critical. You need to determine what art materials will be carried in your store, and on your website if you are engaging in e-commerce, then negotiate the unit price that will be charged by the manufacturer and arrange for the delivery of those goods. Depending on the number of units you purchase you may be able obtain a discounted unit price, making it easier for the art materials retailer to be competitive in the local marketplace.

Next you must determine the price at which you will sell the product. In all cases, this retail price will be higher than the cost of purchasing the goods from the supplier. It is this difference between the wholesale price and the retail price that allow you to make a profit and remain in business. Some art materials retailers follow a formula of setting the retail price at a fixed percentage above the acquisition price, while others base the retail pricing on factors such as the desirability of the items and the amount of competition from other retailers in the immediate area and on the internet.

After you've set the price, retail merchandising moves to the tasks of setup and display. Setting up the physical store, as well as organizing the website presentation of products, are both concerned with displaying goods to their advantage in a physical or virtual space. The visual display is often the key means of attracting customers who are highly likely to make a purchase. Quick sales lead to higher profits and the chance to secure more products that will result in more sales.

Finally, it's important to remember that to be successful with retail merchandising you must provide consumers with the product's key benefits. Quality products at affordable prices will help art material retailers stand out from the competition.

*In cooperation with Tom Shay of Profits Plus Solutions, Inc. this text on retail **Merchandising** is the third in a Retailer Training series developed by the International Art Materials Association (NAMTA). Prior books include **Managing People** and **Advertising & Marketing**. Visit the Resource Section of NAMTA's website – namta.org – for more details.*

©2015 International Art Materials Association.
All Rights Reserved

This manual is intended to provide general information of use to the Art Materials Retailer. While every effort has been made to provide up-to-date information, this manual is not intended to be used without consultation with accountants, legal counsel and other qualified professionals who may make specific recommendations for individual stores.

The International Art Materials Association does not certify, approve or license art materials retailers or recommend that any general or specific business strategy, policy or procedure described in this manual or elsewhere be employed by them in operating their business.

This book or portions thereof may not be reproduced in any form or by any means, electronic or mechanical, including photocopying, recording or by any information storage and retrieval system, without prior written permission from the International Art Materials Association.

All inquiries should be addressed to:
International Art Materials Association
20200 Zion Ave.
Cornelius, NC 28031

Table of Contents

Chapters

Chapter 1: Target Marketing	5
Chapter 2: Targeting the Right Customer	6
Chapter 3: Selecting Vendors	8
Chapter 4: Terms and Terminology of Pricing	11
Chapter 5: Sales Representatives	14
Chapter 6: Order Writing	15
Chapter 7: Shipping Issues and Costs	16
Chapter 8: Planograms	18
Chapter 9: Departments and Finelines (Categories)	20
Chapter 10: Inventory Control	22
Chapter 11: Clearance Merchandise and Markdowns	24
Chapter 12: Managing the Product Mix	26
Chapter 13: Selecting Pricing Strategies	30
Chapter 14: Attending A Trade Show	34
CONCLUSION	35
APPENDIX: EXHIBITS A - G	40

INTRODUCTION

To what do you think most of your business funds go?

Look at your profit-and-loss statement to find the answer. Traditionally, payroll is a business's largest expense. But it's likely you write the most checks for inventory. Remember that inventory is not just an expense. It is an investment – exchanging one asset (cash) for another (inventory).

On your profit-and-loss statement's second line, you will see "cost of goods sold." While that number is not representative of the amount of inventory purchased during the month, it will give you a good idea of how much inventory you are purchasing.

Mathematically, the "cost of goods sold" is calculated by taking the inventory on hand on the first day of the month, adding the amount of inventory purchased during the month, and then subtracting the amount of inventory on hand on the last day of the month.

Because inventory is where a business often invests most of its money, it's appropriate that this Retail Training series from the International Art Materials Association (NAMTA / namta.org) dedicates one entire book to explaining how to properly buy and manage your inventory. We will include everything from how to select vendors, price products and when to have a clearance sale.

As we discuss merchandising, remember that you cannot have a single strategy to operate the merchandising aspect of your business. Proper merchandising is a blend of many factors, all of which we will discuss at length in this book.

Our discussion will include multiple product lines, multiple manufacturers, multiple vendors, multiple pricing strategies, and multiple margins. Just as the best meals you enjoy combine various ingredients, the merchandising strategy you employ consists of various components. Together, through this book, we will discuss how to create the correct recipe for your business.

One of the most important aspects of merchandising a business is understanding for whom you are merchandising the retail or online store. You don't select products because you like them or like to use them – you should select products on the basis of what your customers will buy.

CHAPTER 1

Target Marketing

When an art materials business is young, picking a vendor or vendors is fairly easy. Perhaps you choose vendors that you knew from your previous work in the art supply industry. Your list might include those vendors that had a sales rep in your area, or perhaps it was simply those vendors that would sell to you.

Most importantly, you should select vendors based on the product or products and services he or she provides. Be sure you discuss with your vendor whether your target customer is likely to purchase the product or service you are choosing to offer.

There is no art supply retailer, regardless of the physical size of his store, catalog or website, who can successfully be everything to every potential consumer. Even a retailer who has no competition in his market must properly identify the ideal customer.

Look at Walmart. If Walmart could be everything to every potential customer, then why is there often a Target located nearby? For every mass merchant in the marketplace, there are specialty retailers who do an excellent job identifying their niche in their market.

The successful art supply retailer identifies the target market that he believes he can successfully invite into the new business.

Remember that every consumer in your new trade area has been making purchases before you appeared. Now you have to figure out if you can transfer their loyalty to your business. This strategy requires taking customers away from other businesses that have physical and/or online stores. Another strategy is to enlarge the market by developing new customers.

The concept is to design the art supply business so that you can sell more items to every customer rather than a

few items to a handful of customers. This not only builds customer loyalty, but it also creates customers who become more dependent on your retail or online store because you sell everything they want. This is target marketing at its best.

Most retailers utilize a combination of these ideas. Using appropriate marketing and advertising media, they will work to move customers from existing stores to their retail or online store. The goal is to provide customers with products that the competition is currently not providing, products at better prices, and services that customers need and appreciate. The art material retailer can also work to actively grow the industry by bringing new customers into the art world.

Ask yourself (and your staff) what your business does that no other art material retailer does ... what do you do better. Leverage those items both online and offline.

CHAPTER 2

Targeting the Right Customer

Targeting customers is perhaps the most important – and most challenging – task facing new or established art material retailers. Attracting more customers should always be high on a retailer's list. Knowing your customers before you begin ordering merchandise can save the retailer a lot of time and money. Obviously the art store retailer wants to know his customer and what he or she will buy. No retailer can stock everything needed for every possible customer in a physical or online community, regardless of how large or small the population base.

There will always be customers that are pleased with where they are buying merchandise, customers that are doing business with friends, customers that prefer to do business with a retailer that is not in the immediate trade area, and customers that prefer to buy online.

Retail Store Customers

Sources of Information About Customers

Certain products appeal to certain customers, so remember when you're developing your retail customer base that your knowledge about potential customers can come from a number of sources. You can give yourself a significant edge by taking advantage of this information.

Media

Use the media outlets in your trade area to research your target market. Information they can provide includes: number of homes, average income, number of people in each home, percentage of rental homes to owned homes, number of apartment residents, age and gender of the residents, number, gender and ages of children, and distance driven to work.

Chamber of Commerce

Some of this data can also be found through a local chamber of commerce as well as through the census bureau. All of this information will help art material retailers develop a picture of the type and number of customers that live and work in the trade area of their store.

Mass-Merchant Retail Customers

The art supplies retailer should take the time to look carefully at all of the retail competition in the trade area. Attention should be given to the brands of products carried, individual products stocked and services being offered.

Mass merchants are known for stocking a wide variety of art supplies and general merchandise in their stores. Individual art supply retailers should expect to see that these businesses offer the most popular selling items. And because of their limited customer service and expense-saving economics of scale, you'll find that these mass merchants are selling these popular items with low margins. This makes it challenging for the small art material retailer to offer these same items to their customers. It's important to pay attention to which items your customers can buy at the mass market stores and to remember that you have an advantage in that you can carry more variety and offer more options.

Although it's tempting to not stock any of the products that the local mass merchant is offering, remember that the mass merchant has done their homework and knows the items that attract the largest number of customers to their store.

By offering these items, but at higher margins, the art materials retailer may find that customers have identified your store as being high priced. This is the result of the mass-merchant's advertising. Your customer might already know the price the mass merchant is charging for the item the minute he or she walks into your store.

The progressive retailer can find a way to include these items in the product offering if doing so helps to attract the target customers. This aspect will be outlined later in this book in the section on pricing. Remember that the mass merchant sells only a small percentage of the items produced by industry manufacturers. In light of the large offering of new and unique art materials seen at trade shows, like NAMTA's Art Materials World, retailers should always continue developing their own business.

Shopping the Retail Competition

Another information-gathering trick is visiting the retail competition in your market. Take a look at the customers shopping there, and then ask yourself:

- What are these customers not getting at the existing store that they may want or need?
- If it's worthwhile to persuade these customers to shop at your store, figure out what you need to do to convince them to switch.
- Ask yourself if there is truly enough room in the market for another art supply store,

As you gather this market information, decide which customer you'd like to woo. Target a specific type of customer. Don't just hope that like-minded customers will come walking in the door.

Creating the Retail Target Customer Niche

When an art material retailer successfully identifies his target customer, they then need to stock items with a sufficient mix of margins that appeal to that customer.

Now comes selecting multiple products and services that are what the retail target customer will buy. To appeal to these target customers, retailers must meet these customers' needs. Doing this means that the customer will become more dependent on their store.

On the other end of the spectrum is the retailer who attempts to stock everything for every possible customer. Unfortunately, this requires a tremendous amount of square footage, inventory and a substantial number of customers to support such a store.

Online Store Customers (e-commerce)

If you plan to sell products online, you will need to carefully consider these same issues in regards to online sellers of art supplies. You should know your competition including the small and large e-commerce players. Ask yourself if your retail customers can support your online business or will you need to build a wider audience to support online sales. Have a plan for finding your online customers and so you can begin to build an online customer base.

Carefully consider what products you need to offer in order to be competitive online and meet the needs of your target audience. Online sales are highly competitive in both product selection and price. You will need specific web and online marketing skills to build an online business in today's marketplace, so consider what resources will be required.

You may choose to be brick and mortar only, e-commerce only, or both.

CHAPTER 3

Selecting Vendors

Initially an art material retailer may have gladly ordered merchandise from any vendor that would ship ... it's important to look at additional ordering options as your business grows.

In this industry, those options would include ordering from the manufacturer, a wholesaler, and joining a co-operative or buying group. There are advantages and disadvantages to each style of ordering plus there are no absolute rules in ordering merchandise with regard to the best price, or always finding the merchandise available. Also, just as a retailer does not want customers who shop by the lowest price only, the same is true for vendors. Proper ordering requires the best efforts on behalf of the retailer.

Direct Ordering

One option is to order merchandise directly from the manufacturer for a given product. One of the first places an art material retailer should explore to find many manufacturers is the industry's annual trade show, like NAMTA's Art Materials World event. It's held in the first quarter of each year and the show floor is lined with manufacturers wanting to demonstrate their products to art supply retailers. Because manufacturers exhibiting at trade shows often feature "show only" pricing, retailers ordering directly from the manufacturer at a trade show can often expect to receive good price.

Manufacturers often establish price based on quantity ordered. As in most purchasing orders, the more you order, the lower the price. But remember that buying group, wholesalers, or cooperatives buy from a manufacturer in such large quantities that even after the manufacturer includes their profit, the purchase of inventory from them is cheaper than if the retailer buys directly from the manufacturer.

Another advantage of ordering directly from the manufacturer is that the retailer is going to see all of the products the manufacturer has to offer. While a wholesaler, co-operative or buying group offers a manufacturer's products, there is a possibility that this secondary group does not offer all of the products made by the manufacturer. That said, there could exist several challenges to a retailer buying from the manufacturer.

The first challenge the art materials retailer may encounter is that the minimum order requirement with the manufacturer may be larger than the retailer can reasonably expect to sell. Manufacturers often require that an initial order be of a certain minimum dollar amount, case quantity, or poundage, and some might enforce such requirements with every order.

Quantity Ordering

There can also be the issue of quantity ordering. The art materials retailer might see an item that they want to order in small quantity. However, the manufacturer offers the product when ordered in sizable quantities only. In this case, the retailer will have to either order the larger quantities, order through an intermediary source or simply do without the item.

Another consideration when purchasing from the manufacturer is whether a sales representative from the manufacturer will visit your store periodically. A retailer might find they prefer a face-to-face visit with the manufacturer more frequently than once a year at a trade show. This is an appropriate time for the retailer to ask the manufacturer if he will send a rep to visit his store. If this is your case, gather the contact information for the visiting representatives.

Additionally, you may be able to persuade your rep to demo their product(s) for your customers. With a little advance planning and promotion this can be a great way to bring customers to your store and differentiate you from your competitors.

Co-operative Advertising

Another consideration is co-operative advertising supplies and dollars. In some situations, the manufacturer makes available to retailers merchandising displays, sales aides, and monies to be spent in cooperation with the advertising dollars the retailer is spending. Traditionally, the available amount of manufacturer supplies and dollars is based upon the dollar amount of inventory purchased from the manufacturer.

With the co-operative advertising dollars, the manufacturer will have requirements as to when, where and how their

dollars are spent. They will also specify how their product and the name of their company is displayed or mentioned in the advertising. They will likely require documentation of the expense before they make a reimbursement payment to the retailer.

If these are important factors to you as a retailer, then you will want to make sure the manufacturer is making them available. Likewise, if the retailer is considering buying through one of the other options, they will want to ask those vendors if the cooperative advertising materials and dollars are being kept by the vendors or passed onto the retailer.

If you can make it work co-op advertising is a great way to boost your advertising budget. NAMTA's Retail Training manual on Advertising and Marketing provides more information on new and traditional advertising options for art material retailers.

Wholesalers

A close second to the manufacturer, is a wholesaler. Wholesalers often purchase products from many manufacturers. And while the wholesaler may also have a dollar amount or quantity minimum for ordering, these order requirements are spread over all of the product lines the wholesaler offers. Individual items can be available in smaller quantities through the wholesaler as compared to ordering through the manufacturer. The traditional wholesaler is often a vendor who stocks the most popular selling merchandise in his warehouse.

If a wholesaler does not stock a certain product that you want, remember that wholesaler may send out a group offering to his retailers. In a group offering, the wholesaler lists products from a manufacturer with the invitation to the retailer to order the products in the quantities needed. The wholesaler then totals all of the orders from the retailers, places the order with the manufacturer and delivers the merchandise to each retailer.

Of course, the wholesaler has negotiated to receive the best possible price from the manufacturer and then added his margin to the price the retailer will pay for the merchandise. This type of ordering is often referred to as "group," "pool" or "relay." Generally, this type of ordering is only available during certain times of the year, so retailers must calculate how much inventory they anticipate selling until

the next group, pool or relay order is offered. Delivery of merchandise ordered through this method is often made with the traditional warehouse orders.

Retailers may order merchandise through a wholesaler if the retailer does not have an account with the manufacturer. As the wholesaler will have an account with the manufacturer, the wholesaler performs the task of placing the retailer's order with the manufacturer and then will process the invoice for the retailer for a fee. The merchandise is then shipped directly from the manufacturer to the art materials retailer. This type of ordering is often referred to as "drop ship" or "direct ship."

In deciding if or when to use a wholesaler to use, the art supply retailer will want to know how the wholesaler provides sales support. Such support can be by way of sales representatives that come to the store, a telemarketing department, or a physical or electronic catalog. With that information, the individual retailer will need to decide which is the best way to work with the wholesaler.

Cooperatives and Buying Groups

A second version of the traditional wholesaler is a cooperative. The cooperative has a long and rich history retailing. Cooperatives have been created by retailers who have joined together to achieve several goals:

- To make ordering easier.
- To obtain better prices.
- To work with manufacturers that did not sell to their individual stores.
- To make their stores more profitable.

The cooperative closely follows the format of a traditional wholesaler with a distinct difference. The cooperative, instead of being owned by an individual or company (as with a traditional wholesaler), is jointly owned by the retailers that purchase from it. With the ordering of merchandise, the procedure is often most similar to that of a traditional wholesaler.

When the cooperative makes a profit from their operations, the profits are then returned to the retailers. To determine the profit, the cooperative looks at how much and what type of merchandise each retailer has purchased through the cooperative. Using a format that is established by the retailers who own the cooperative, each retailer's share of profit is often returned to them in several forms.

Because the cooperative must be well funded, as any company should, a part of each retailer's profit is retained by the cooperative in the form of shares of stock and notes. The notes are in a form of a "certificate of deposit" that is similar to that purchased through a bank or other financial institution. The cooperative will often require that the retailer have a predetermined number of shares of stock ownership as well as have notes that are in an amount that is determined by the amount of merchandise the retailer purchases through the cooperative.

As an example, a retailer might find that their share of profit for a year is \$10,000. As the retailer's business has grown over the year, their purchasing through the cooperative has increased and the amount owed the cooperative at any time has also increased. To secure this amount of money owed by the retailer to the cooperative, at the end of the year, the retailer may be required to purchase additional stock with a part of their share of the profit.

The notes, just like the "certificates of deposit" that we previously mentioned, earn interest and after a certain period of time, they are redeemed by the cooperative. The balance of the \$10,000 is given to the retailer in the form of a check. And as the amount of shares of stock and the amount of the notes become enough to meet the requirements of the cooperative, the cash payment of the profit due to the retailer increases.

Should the retailer leave the cooperative, the notes are redeemed over a pre-described period of time and the shares of stock are likely to be required to be resold to the cooperative. These two actions occur after all outstanding indebtedness by the art supply retailer is repaid to the cooperative.

Another option for vendor selection is a buying group. A buying group may or may not have a warehouse that stocks merchandise. Their efforts may instead focus on the seasonal placement of orders, joining the orders of many retailers and obtaining the best price from the manufacturer, as well as shipments of inventory from the manufacturer to the retailer in which the buying group becomes the

central billing and payment center. As mentioned before, this helps when a retailer does not have an account with the manufacturer as well as obtaining for the retailer a lower cost of inventory because of the membership in the buying group.

As with the similarity between a traditional wholesaler and a cooperative, a retailer can be a member of a buying group that is also a cooperative or a buying group that is a privately held, for-profit organization. The buying group is also likely to have requirements for membership in their organization that each retailer must meet.

When considering a cooperative or buying group – anything from a member-owned organization, or one owned by a for-profit organization, or one that's a traditional wholesaler – the assumption should not be made that a for-profit organization is going to be more expensive to buy from as compared to buying through a member-owned organization. The member-owned organization also has expenses, as does any other business.

As a retailer makes decisions about how they will buy inventory for the business, they will likely find that the answer is a combination of these options and that the amount purchased through the various means will shift through the seasons and years that the retailer is in business.

So the retailer's decision should be based upon what works best for them – the right products in the right quantities, the right delivery, the right terms, the right service, the right knowledge, and the right price.

In many ways this matches the same criteria a customer would use to buy from you.

A retailer's checklist of vendor specifications, Exhibit A, can be found in the Appendix.

CHAPTER 4

Terms and Terminology of Pricing

When a new retailer orders their initial inventory, the terms of sale are quite simple: They order products and pay their vendors with a check or credit card. Sometimes, depending on the vendor's terms of delivery, the retailer would pay "COD," or cash on delivery.

Once the retailer has proven their credit, the vendor may extend traditional terms to the new retailer. By sharing a financial statement, a letter of credit from a financial institution or a personal guarantee a vendor may allow new terms, including a line of credit.

The word "terms" refers to the manner in which the vendor expects to be paid. Terms frequently refer to two aspects of an order given to a vendor. The first aspect is when the vendor is expecting to be paid for the inventory they have delivered to the retailer. The second aspect covers the responsibility for the cost of delivering the merchandise from the vendor to the retailer.

Net

At the beginning of a time frame, often the first word for terms on the invoice for the merchandise is "net," which indicates that the vendor expects the retailer to pay in full.

Following the word "net" is often a number. As an example, "net 30" indicates the vendor expects to be paid in full in 30 days. The invoice will have a date, which usually corresponds with the date the merchandise is shipped. The invoice date would be the point from which the 30 days is counted. As a retailer, in this case, you should be sure to observe that the date of the invoice and the date of shipment are close to being the same. You don't want to have a good portion of the 30 days being spent with the inventory in transit.

If the vendor is expecting the invoice to be paid in installments, the percentage of the total invoice to be paid will precede the word "net." As an example, "½ net 30, ½ net 60" would indicate that half of the invoice is due in 30 days and the balance is due in 60 days. We'll expand on the concept of installment payments later in this book.

There can be additional terms that are shown after the number value. Two examples of this are "EOM" and "ROG." EOM is "End of Month." ROG, "Receipt of Goods." "Net 30 EOM," means that the 30-day time period for paying the invoice begins at the end of the month; "net 30 ROG" implies that the 30 days to pay the invoice begin as of the Receipt of Goods by the retailers. These terms result from negotiation between the vendor and retailer, with reasons including how long it takes to ship an order.

The "X"

Another term that can be utilized is the letter "X" which would be shown after the number of days. This indicates that the number of days to pay the invoice is twice what the number indicates. An example of this would be "Net 30x" which indicates that the invoice is due in 60 days.

These terms, numbers and acronyms can be combined: "Net 30x ROG EOM" would be defined as an invoice that is due in full 60 days after the last day of the month in which the goods have been received. Merchandise that was received on March 5 would be due on May 30 as the "net" is due within 60 days of the end of the month in which the merchandise was received.

In some situations, numbers relating to the dating may appear before the word "Net." For example, a vendor may create an invoice that states "2/10 net 30." While this is the same 30-day pay schedule that we have already examined, the vendor has added an incentive for the retailer to pay the invoice before it is due. The "2/10" indicates the vendor is willing to allow the retailer to discount the invoice by 2 percent if the invoice is paid within 10 days. This additional discounting will likely only apply to the inventory on the invoice with any freight charges being owed at full value. The numbers "2/10" are only an example; these terms can be any two numbers that the vendor chooses.

CHAPTER 5

Sales Representatives

A sales rep can play an integral part in a retailer's business. Because sales representatives visit many retailers and attend many trade shows, like NAMTA's Art Materials World, they can often provide a retailer with more current information on trends and products.

It is important to remember that not all sales reps have the same responsibilities so they may not be able to provide the same support and assistance.

Manufacturer Sales Reps

Some sales representatives are employed by the manufacturer, wholesaler or vendor. Their pay comes directly from the provider of goods for whom they work. This type of representative might be salaried by the company they represent. The range of products and services they offer is restricted to those that their employer offers. Their pay may also include a commission based upon the amount of goods and services they sell to the retailer.

Product-Specific Sales Reps

Some reps exclusively represent their own products and services. These sales representatives are also restricted to the products and services of the company they represent. Their pay, or commission, is based on the amount of merchandise and services that retailers purchase through them.

Independent Sales Representatives

Independent sales representatives might represent multiple product lines or services. As time passes, the combination of product lines and services they represent might change. These might be sales representatives who are working as individuals or as a group. Their pay, also commission, is based on the amount of merchandise and services that retailers purchase through them.

As a retailer works to develop a strong relationship with the sales representative, they should ask the sales rep if they get a commission for the orders that the retailer might place directly with the manufacturer, wholesaler or vendor. Some companies will pay the representative based on the total of orders that are delivered into that representative's territory, while some companies pay the representatives a commission only on the orders in which they actively participated.

Some companies will pay commissions to representative only if the terms of payment have been successfully been met by the retailer.

NAMTA has a wide array of rep members and many attend the association's annual trade show – Art Materials World. If you have questions about sales representatives please contact NAMTA.

CHAPTER 6

Order Writing

Once the art supply retailer has established an initial list of vendors and products, the next step is to write an order. Ordering is almost always done by a computer system in the store, or by a store calculating the order and communicating it by phone or electronically to the vendor.

Developing an Order Form

When the retailer writes an order, the printed order form should be the retailer's and not the vendor's. The reason for this can be seen on a vendor's form: The terms of dating, shipping, and all the legal aspects of resolving any issues between vendor and retailer are clearly stated on the vendor's forms. The vendor's legal and accounting departments have dictated all of these and are based on the vendor's needs. Retailers don't have the time and very few could afford hiring an attorney to review each vendor form.

Instead, it's a good idea to try to use your own order form that is fair to both parties and that you understand clearly ahead of time. Be sure your order form includes blank spaces for the dating terms and freight terms, so they may be addressed with the vendor in a per-order basis.

Granted, you will undoubtedly have sales representatives that will ask that you sign their order form. Simply explain that your company policy requires that you use your own form. Doing so will protect you from potential problems. This position also implies that you are a knowledgeable business person who does not blindly accept the status quo, and who can be depended upon to offer fair terms for all parties.

Minimum Orders

As the retailer is writing orders to any of the vendors, they are likely to encounter a vendor's minimum order. The requirement is expressed in one of three methods.

Poundage Minimum

The first requirement is a poundage minimum. In this situation the vendor calculates the weight of each item and shows to the retailer that for any order placed, the total weight must be an amount that is equal to, or exceeding, the minimum freight order.

Order Minimum

In this second method of establishing a minimum order, the vendor states that a certain number of cases of products must be ordered. A minimum order might be 20 cases, so the retailer must look at how the items in question are packed (such as 12 per case) and then place an order for a number of cases that equals or exceeds the minimum requirement.

Minimum Dollar Amount

The third and most popular method is a minimum dollar amount. A vendor might state that all orders must be \$1,000 or more at cost. But there's an important caution for the retailer planning to write an order for a dollar amount that is larger than the minimum.

For example, a retailer might calculate that he needs to order at cost \$5,000 in merchandise from the vendor. But he is advised to consider whether or not he needs to have all \$5,000 in merchandise at one time. If not, then the retailer can work this situation to his advantage. Instead of writing one order for \$5,000, the retailer should write five \$1,000 orders.

If the retailer were to have these five orders of \$1,000 each delivered at three-week intervals, it's possible that after the initial order is received and stocked for sale, the retailer might find that there are items that are selling more quickly than anticipated. In this situation, the retailer would want to revise the subsequent orders to increase his quantities of these items.

Likewise, there may be items received on the initial order that do not sell as well as expected, and the retailer would want to take advantage of this new information to diminish the quantities of these items that are scheduled to arrive on the subsequent orders.

CHAPTER 7

Shipping Issues and Costs

When writing orders, it is advisable to specify when you want merchandise shipped, particularly if the merchandise sells during a specific season. Obviously the retailer does not need the merchandise delivered months before it is likely to sell, especially if they have only a short time to pay for the merchandise.

Shipping Dates

The concept of “dating” means vendor wants to ship the inventory to the retailer well in advance of the selling season while at the same time allowing the retailer an extended period of time to pay for it. By shipping the merchandise early, the vendor gains valuable space in their warehouse to make room for the coming season.

The retailer may state on the order, “Ship November 1.” This means the order is not to be shipped before November 1, and it is implied that if the order is shipped before then, that the terms of the invoice do not begin until that date.

There should also be a cancellation date applied to the order because the retailer does not want to order merchandise to be shipped on November 1 and have part of the order arriving in March. To resolve this situation, a retailer could write, “Ship November 1; Cancel as of December 30.” This means that if the order is not shipped within that time frame, all or any remaining part of the order is cancelled.

A variation of this is if the retailer writes, “Ship as ready, as of November 1.” This implies that the retailer is willing to accept early shipment of the merchandise but that the payment period for the order does not begin until November 1.

Another scenario occurs when the order contains several items that the customer purchases together. This often happens when the retailer purchases a display, or seasonal items. To prevent the possibility of this happening, the retailer will write on the order, “Ship complete only.” This instruction implies that the payment period for the order doesn’t begin until the retailer has received all of the order.

These examples are variations of what we have referred to as “terms.” Vendors will create longer periods of time to pay for merchandise to credit-worthy retailers for reasons that can benefit the vendor, the retailer and the customer.

Long before holiday or art-specific seasons begin, vendors are anxious to see the response to new items in the marketplace. They’re anxious to gauge how much inventory of all types the art-supply retailers will be purchasing for their stores.

Along with the dating terms, vendors also may offer discounted prices and special freight terms on the pre-season orders. This can work to the advantage of the retailer, as it allows him to extend his margins as well as lower the freight expenses. In this situation, the vendor anticipates that the orders from the art supply retailer may be much larger than his in-season orders. This scenario can be good for both parties if the retailer estimates the correct quantities needed for the season and their cash needs at the time the payment is due for the merchandise.

In later sections of this book we will discuss how to successfully calculate the amount of inventory to order to maximize inventory turn and profit.

Freight Charge

Also important are freight charges. On the same line of the invoice as the dating terms, the freight aspect usually begins with the letters, “F.O.B” or “Free on Board” which indicates how far during the delivery process the vendor is willing to pay for the freight.

Examples include “FOB dock” or “FOB vendor,” meaning that once the package leaves the loading dock of the vendor, the retailer begins to pay for the freight. Another term is “Freight Prepaid” While this is one that is often seen, it is somewhat ambiguous. It does state that the vendor has prepaid for the freight, but it does not clarify whether or not the freight bill will be added to the invoice. If this is the case, the retailer must clearly state, in writing on the order, at which point in the delivery the freight charges become the responsibility of the retailer.

“FOB: our truck” is another example of one that does not clarify whether the vendor is charging for the merchandise delivered on his own truck.

Freight can be divided, or resolved in any manner that is acceptable to both parties. And as an art supply retailer, if you are going to pay for the merchandise being delivered to your business, you have the right to specify how the inventory is going to be delivered. This could include the simple instruction of “cheapest.” If this is the case, and the vendor uses a delivery method that is not the least expensive, the retailer can charge back against the vendor any excessive charges for the delivery. Likewise, the art supply retailer can specify a certain freight carrier to deliver the merchandise to the store from the vendor if the freight bill is the responsibility of the retailer.

CHAPTER 8

Planograms

The planogram is a visual diagram, or drawing, that provides in detail where every product in a retail store should be placed. These schematics not only present a flow chart for the particular merchandise departments within a store layout but also show on which aisle and on what shelf an item is located. A planogram should also illustrate how many facings (how many spaces an item has on the shelf or rack, facing the consumer) are allocated for each SKU (stock keeping unit).

The number of product facings is what's important to manufacturers or product sellers. A company with just one box or can facing consumers on a shelf has only one facing for that brand. Two of the same brand sitting side by side equals two facings. Companies often produce various brands of products. They send sales reps in stores so they can increase their number of facings. Some stores may be smaller, however, which typically results in fewer facings.

The complexity of a planogram may vary by the size of the store, the software used to create the planogram and the need of the retailer. Planograms can be as simple as a photo of a preset section or more detailed with numbered peg holes and shelf notches showing exact placement of each item.

In writing orders, it's important for the retailer to be aware of their planogram and to know that vendor(s) can assist a retailer in displaying their merchandise to help increase sales.

Manufacturers will often show the retailer a display of merchandise that has been created to show many products from that manufacturer, a kind of "across the board" planogram. But a wholesaler or buying group can also offer the planogram that emphasizes a particular product category (brushes, for instance) or themed grouping of merchandise (art supply accessories, for example).

The planogram can help the retailer present merchandise in a manner that encourages customers to spend more time looking at the display and ultimately making a purchase. This allows an independent retailer to have their sales floor displayed like the sales floor of a mass merchant.

With planograms, manufacturers and wholesalers frequently offer the necessary display racks or counters on which to place the merchandise. Other potential advantages in utilizing a planogram are special pricing, dating terms, or freight terms offered by the manufacturer or vendor to entice the retailer to place an order.

There are many advantages to a planogram, but the retailer must give careful examination to make sure that the combination of items is right for their store. Receiving a planogram that has items that do not sell in a particular store, requiring the buyer to reduce the price of the items in an effort to move them, only decreases the retailer's margins and profit.

Some manufacturers allow retailers to pick and choose the items that are on a planogram. When selecting a planogram, if you note a product that you do not anticipate will sell well, the manufacturer may allow you to substitute one item for another.

Another consideration in making a decision to select a planogram for your business is the further availability of a product. With each of the items on a planogram, the buyer should ask the vendor about future responsibility of those items.

If the retailer orders a planogram through the manufacturer, the buyer will want to make sure he understands the minimum quantity for the reorder of an item, as well as the minimum order requirements for an order through the manufacturer.

If the buyer is ordering through a wholesaler, or similar organization, he will want to ask if the wholesaler will be stocking all of the items in the warehouse. The questions about order minimums would also be applicable.

Without gathering this information, the retailer could find themselves with a display that looks good initially, but begins to have blank spaces as items sell out.

If purchasing a planogram, the retailer must be assured that all the fixtures, signs and accessories, and his complete order will be delivered at the same time. The planogram may look good in a photograph or at a trade show, but it must look equally good on the retailer's sales floor throughout the life of the display.

When it's time for the retailer to choose vendors remember that manufacturers, wholesalers, cooperative and buying groups are all looking to have retailers as customers in a situation where each party makes a profit.

As vendors establish the minimums and requirements for the retailers they have as accounts, they are doing what the retailer will also need to be doing—looking for their target customer.

Departments and Finelines (Categories)

As the art material retailer begins to select the merchandise they are going to stock, they will likely use a computerized point-of-sale (POS) system. One feature of these systems is that they have the ability to track the purchase and sales of items with as much detail as the retailer would. This information helps the retailer fine-tune the inventory from season to season, always being aware of the target customer and how the store and website are properly taking care of the wants and needs of such customers.

Point-of-Sale System

Art material retailers that sell in a brick and mortar store and sell online with an e-commerce website, should look to use a point-of-sale system that can track both the retail store and the e-commerce store sales and inventory within the same system. This will minimize redundant data entry.

All inventory should be tracked by the point-of-sale system according to the amounts ordered and when the inventory will be delivered. Also, all inventory can be tracked according to when it was sold and for what amount. The departments, categories, and displays can be designated by an alpha code, numeric code or a combination of the two. With the tracking of this information in the point-of-sale system, you should designate where the merchandise is located in the store, or displayed on the website, so that as you experiment with the placement of the merchandise, you can easily determine where to display an item to produce the most sales.

Departments are established as broad groups of merchandise. Examples of departments could be:

- Brushes
- Canvas
- Paint
- Frames
- Paper
- Pens/Writing Utensils

These broad categories of merchandise are usually easy to see by just looking around the store, and seeing sizeable accumulations of items of each group in specific locations. Your website navigation will most likely match these categories.

With each of the departments, the tracking of ordering and selling is further defined by finelines or categories. For example within pens, a retailer may have finelines or categories of calligraphy pens, fountain pens and ballpoint pens.

By tracking calligraphy pens, the retailer will know how much sells during each month. In addition to the initial estimate, over time the retailer will gain an important insight into the sale of calligraphy pens. This information will help retailers know when to begin stocking calligraphy pens and when to have the inventory levels increase and decrease.

To have all of this information available, the retailer must track all of the ordering and selling of merchandise by the department and fineline designations.

Proper tracking of this data becomes more and more valuable to the retailer over a period of years, as most merchandise follows selling trends that repeat annually. As you initially create your tracking, implement a wide variety of finelines – more than you might think you can use. This gives you room to adapt your selling plans. You don't want to find out after a year or two that an individual fineline would provide better information than several finelines – that's lost information and possibly lost profit. Of course, if breaking a fineline into several finelines makes sense after a while, then do so.

Turn-Rate Ratio

The purpose of tracking all of this data is to have the right amount of inventory on hand at the right time to produce the maximum sales for that category. As the retailer works to increase the profitability of the store and website, the turn-rate ratio, also known as the inventory turn rate, is one of the most important factors. Increased turn can improve profitability.

The term "inventory turn" refers to a calculation performed to tell the retailer how well they are doing with regard to keeping the inventory performing at peak levels. The calculation can be performed on the store and website as a whole, as well as on individual departments, categories, or finelines.

To calculate the inventory turn rate for the store and website, you need two sets of documents from the business: the year-end profit-and-loss statement, and the 12 monthly balance sheets. If you are to calculate this information for a department or fineline, you will require information that will come from the point-of-sale system. Performing this calculation for data from any single month will provide you with an answer that is representative of that month while performing the calculation using data from a twelve-month period will provide you with an answer representative of the past year.

To calculate the turn rate for a 12-month period, take the “cost of goods sold” number from the year-end profit-and-loss statement, and divide that number by the average inventory on hand. To tabulate the average inventory on hand, you will need the 12 monthly balance sheets, taking the “inventory on hand” amount from each, adding them together, and dividing by 12.

Cost of goods sold/average inventory on hand = inventory turn rate

The resulting number is referred to as the “inventory turn rate.” If the resulting number is 3.0, this indicates that the business has purchased inventory and sold it three times

over the one-year period. Of course, not every item was purchased and sold three times; some individual items had a turn rate in excess of 3.0 and some individual items had a turn rate less than 3.0, but for the business as a whole, or the department or fineline for which the calculation is performed, the average is 3.0 turns.

Increasing the inventory turn rate also increases the profitability and the return on investment in the business. From that, you might deduce that the art supply retailer would want the inventory turn rate to be as high as possible. This is not the case, however, as an excessively high inventory turn rate could also indicate that the retailer had inadequate inventory. And if you have inadequate inventory, your customers may be walking out the door, or leaving your website, looking to buy something from another retailer. There is a proper balance between not having enough inventory on hand to meet the demand without having an excessive of inventory on hand and having the investment in the store becoming unproductive.

Inventory Control

An unfortunate situation occurs when the art supply retailer comes to the end of the selling season of an item and finds a substantial amount of inventory in a fineline still on hand. As this happens, the retailer may find that the inventory will simply sit on the shelf until the season starts again. However, inventory that is sitting on the shelf and not selling is much like taking money and stuffing it under a mattress. Money in a retail operation that is not producing repeat sales is greatly reducing its return on investment (ROI).

Additionally, the retailer might also find this out-of-season inventory sitting on a shelf that needs to be available to hold other inventory for the incoming season.

The same analysis can be made for the business with regard to the cash that is being tied up by the out-of-season inventory. Unless the retailer has adequate cash reserves, the retailer may find he does not have the necessary money to pay for the inventory that will be arriving for the new season.

Dating orders, as previously discussed, can be of some use at this point. Dating will allow a retailer to have the inventory on display much earlier than they could if the terms of the purchase were “Net 30.” However, the key to becoming a successful retailer is having the out-of-season inventory diminish in quantity by having properly ordered it to begin with, and then reordered the appropriate quantities.

Creating an Open-to-Buy System

This concept of controlling the inventory in departments and categories is referred to as “open-to-buy.” The phrase describes the series of calculations necessary to tell a retailer how much money is “open” to purchase inventory, and when. It also helps the retailer to determine when to stop buying inventory so that there is not too much inventory at the end of the selling season for that category.

Calculating open-to-buy is most often done monthly as compared to quarterly or even longer time period. This is because so many of the categories have a peak selling season that lasts only one or two months. If the retailer were to calculate open-to-buy on a quarterly basis instead of monthly, the time before the peak, the peak month and the declining month could easily occur in the same quarter. If that is the case, trying to track all three in a single time period is extremely difficult. Instead, having these three occur in three separate time periods gives the retailer better control of the sales and inventory.

To be able to create an open-to-buy for a category of products, the retailer must track sales according to categories and tabulate the purchase orders written according to the same categories. This way the retailer knows how much inventory, at cost, is coming in and how much inventory, at retail, is going out in the form of sales.

Calculating the Open-to-Buy

Open-to-buy for a given category of products is calculated using the following process:

The retailer should have the net sales from each of the last 12 months in the specific category or fineline. Looking at the past sales from that category, they can determine their estimate for what they think the sales for that category will be in the coming year – call this estimate “A.”

This exercise is much like the exercise that we did when we were first creating a budget for the business. (I don’t see where we did this exercise earlier ... it may just be me missing something) Like the budget exercise, this is not a once-a-year exercise. The retailer should review these trends at least quarterly so that all of the most-current information is aiding his decisions about anticipated sales. (There is not enough time for a monthly review of every category. Also, because orders are often written so that the merchandise arrives within a multiple-month period, or because merchandise often arrives earlier or later than anticipated, a monthly review of every product category isn’t always possible, time-wise. The retailer should expect to look at the remaining open-to-buy over a two to three month period.)

The next step to creating the open-to-buy is to estimate the maintained gross margin for each of the categories for each month. Call this “B.” Remember that “Gross margin” is the initial margin as merchandise is received in the store. “Maintained gross margin” is the margin at the point of sale.

With these first two numbers we then calculate how much inventory the retailer plans to sell from that category for the month. As an example, if a retailer anticipates a 40-percent gross margin, it will take 60 percent of those anticipated sales in inventory to produce those sales—the sales referred to above by the letter “A” (taking 100 percent and subtracting the 40 percent gross margin, we are able to calculate the 60 percent).

To clarify, we started with actual previous sales and created estimated sales for the coming year. The second number, “B,” is where we anticipated the gross margin. We have estimated sales that are stated at “retail” and by using the percentage, we are stating inventory purchased at “cost” by way of the gross margin.

See Chapter 12 for an explanation of the difference between the initial gross margin and the maintained gross margin.

Now that we know how much inventory the retailer anticipates selling during the month (60 percent of inventory in this given category), we need to calculate how much the retailer can spend to produce those sales. This multi-step calculation requires that we know how much inventory, at cost, is on hand on the first day of the month.

The next number for the open-to-buy is not one that the retailer locates on one of the financial documents, but is instead one that the retailer has to estimate, much like they estimate the anticipated sales. The number the retailer has to determine is how much inventory at cost, if any, they want to have on hand for the last day of the month.

The dollar amount for inventory-on-hand for the end of the month would be higher than the dollar amount for inventory-on-hand at the beginning of the month if the retailer anticipates that sales for the next month will be higher. Likewise, if the retailer anticipates that the following month will be lower in sales than this month, he’ll likely want to see the inventory levels drop.

Determining Inventory Quantity

Determining the desired ending inventory level, beginning-of-the-month inventory, and anticipated sales-at-cost, the retailer can now calculate how much inventory he needs to have that month. The math goes like this: From the inventory beginning-of-month figure, subtract the anticipated sales at cost. The resulting number is then compared to the amount of inventory at cost that is the desired ending-inventory number.

If the desired ending inventory is higher than the number from the calculation, then this is the amount of inventory that is needed to be received during that month so that the desired sales are produced. (*See Exhibit B in the Appendix for an illustration of this calculation.*) When the desired end-of-the-month inventory is lower than the resulting calculation, there is sufficient inventory on hand to produce the desired sales for the month. Of course, the open-to-buy gives answers in dollar amounts.

When the retailer creates their open-to-buy system, they need to address the issues we discussed earlier in this book – that departments and finelines/categories be established with enough detail to help the retailer to make the decisions about his business with as much information as possible.

Variables of the Open-to-Buy

One universal aspect of retail sales management is that not all decisions can be reduced to a set of mathematical equations. While the open-to-buy is a useful tool, there will undoubtedly be situations in which the sales and ordering of merchandise will go outside the parameters of the open-to-buy tool.

With the open-to-buy calculations, there will be many finelines in which you anticipate sales of products to continue throughout all twelve months. With these, you will see inventory levels that are high during certain months of the year, and lower in others. There are also going to be finelines in which you anticipate you will have no sales during the off months. However, it will be difficult to have your inventory reach a zero-dollar amount at the completion of the season.

Your goal with open-to-buy calculations is to diminish the inventory on hand to as little as possible by carefully controlling the inventory levels at the end of the season. One way of diminishing the inventory will be with end-of-season clearance sales.

An area that bears careful attention in the usage of an open-to-buy plan is that of seasonal merchandise. The retailer can expect that some customers will use calligraphy pens any time of the year, while others will use them during wedding season. Creating the open-to-buy for either of these finelines would mean that you would have diminished inventory for the pens during the spring and summer, but you would not plan for your inventory levels to reach zero dollars.

As you create the open-to-buy for either of these finelines, you would also likely expect that the gross margin for the fineline would decrease as the end of the prime season for the product approaches. This is because you would expect that you would have a clearance sale to reduce the amount of inventory on hand.

Creating an open-to-buy plan for either of these two finelines of merchandise will be done based on your prior sales experience or by your best estimate. *The open-to-buy chart is Exhibit C in the appendix of this book.*

Clearance Merchandise and Markdowns

In many businesses, the expression “clearance merchandise” simply refers to leftover merchandise, discontinued merchandise and merchandise that did not sell. The businesses may bring merchandise in for the start of a season, and as the end of the season approaches, the retailer can begin to take small incremental markdowns in the expectation that customers will make a purchase.

Strategies for Clearance Merchandise

Some businesses go so far as to create a “clearance corner” within the store. The clearance corner often becomes a location for merchandise that does not require security, with a marked down price in the hope that customers will make a point to visit the corner and spend additional dollars on these items. Some businesses may also create a “clearance” category on their website.

While this clearance strategy may make sense on first glance, there are several challenges with this method of clearing old merchandise. The first challenge is that a clearance corner often attracts a customer who is primarily price-oriented. This means that this customer comes exclusively looking for merchandise on sale and does not purchase regular-price merchandise.

The second challenge of a “clearance corner” is that it implies that the retailer always has old merchandise that has been around for too long.

The concept of “clearance merchandise” paints an unpleasant image when the retailer participates in a community sales event or when the retailer advertises a “clearance sale.” The image of leftover merchandise is shown prominently to customers, and the customers who are shopping for the leftover and discounted items don’t look at the other merchandise.

Instead, clearance merchandise can be “designed,” meaning that the art materials retailer works with their vendors to order merchandise that will specifically be used as a part of the clearance sale. Tell the vendor your plans for a clearance sale, and ask the vendor to provide you with a list of items you could consider including in this event. Just as the retailer is working on a reduced margin, the vendor would also have a reduced margin.

From previous experience with a clearance sale, the retailer might know, for example, that a certain kind of paper is often the first merchandise purchased by customers. By letting the vendor know that you specifically want to include paper in the sale, the vendor can review their inventories to provide you with several selections. By having the more desirable items in the clearance sale, the retailer is likely to gain a reputation of having a clearance sale that consumers will want to shop because of the excellent selection and sizable markdowns.

Planned Purchasing of Clearance Items

This idea of ordering merchandise for a sales event becomes an integral part of an art materials retailer’s annual planning for merchandising and advertising. The first aspect of participating in such events is to create an annual advertising plan. In this exercise, the retailer determines the events for advertising throughout the year. Events would include an art gallery opening, an anniversary sale, Father’s Day, and Christmas. Many communities also host sidewalk sales during certain months. NAMTA’s Retail Training Manual – *Advertising and Marketing* – provides much more information on developing an advertising plan. Additionally, NAMTA provides a downloadable (and free to members) annual retail promotion calendar on the Resources page of our website at www.namta.org.

Ordering event-specific merchandise is not unlike purchasing most merchandise: Many retailers will take a percentage of the open-to-buy for a season in each category, and reserve it for the special merchandise to be ordered by vendors.

When the retailer sits with their vendor to place his seasonal orders for merchandise, the retailer outlines the advertising and promotional events that will occur and will ask for co-operative advertising dollars, advertising supplies such as banners and door prizes, and special-price merchandise that will be used in the advertising for the event.

For example, as the seasonal orders are placed for fall merchandise, the retailer will tell the vendor that during that season, the store will be promoting its anniversary sale, Father’s and Mother’s Day sales, and the Christmas gift selection. The retailer might ask the vendor to provide

a prized pen at a special price that the retailer can use as a lead item in advertising. Performing this task with all of the vendors, the retailer can create a well-rounded selection of merchandise for all of the fall advertising efforts.

Planned Markdowns

In some retail operations, a buyer is often assigned the responsibility of determining the overall margin for the seasonal order of a category of merchandise before the merchandise has arrived in the store. This strategy is called a planned markdown, which differs from the buyer solely making a decision as to what the initial margin of the merchandise will be.

This exercise requires more from the buyer. In addition to calculating the total cost, total retail and initial gross margin of the order, a planned markdown calculation requires that the buyer anticipate when markdowns will be taken as well as the size of the markdown.

The buyer begins with the quantity ordered of an item, the total cost and the total retail. They then estimate the date that would be the end of the selling season for that item. Over that period of time, the buyer determines if the retailer wants to take one or more markdowns of that item.

As an example, the buyer may order 60 units of an item that should arrive in the store on September 1. Further, the buyer anticipates that the end of the selling season will be some ninety days later on November 30. On that date, the buyer determines that having 6 units of the item on hand at the close of the season will be acceptable.

The buyer needs to determine how much a markdown should be taken between September 1 and November 30, and when to take it. Making the decision is likely to involve selecting both dates and quantities on hand. The buyer may have decided to re-evaluate the item on October 1. If, at that point, 40 percent of the merchandise is sold, the buyer may defer taking any markdowns, because the retailer might be sufficiently pleased with a 40-percent sell-through of the merchandise.

However, the buyer may have a goal of a 50-percent sell-through by October 15. If that amount is not achieved, the buyer may have preset a price reduction, also referred to as a markdown, of 20 percent from the initial retail price. And at November 1, if the sell-through has not reached 70 percent, the buyer might have a preset price reduction of 40 percent from the initial retail price.

With these two price reduction amounts and dates established when the order is written, the buyer is able to calculate how much the total dollar amount of markdowns will be. This also allows the buyer to determine what the overall margin will be for all of the sales from this order.

While it appears complicated, this exercise prevents a buyer from being caught off guard at the end of an item's selling season and having excessive inventory or an overall margin that is too low.

In the appendix, the mathematics of planned markdowns are illustrated and explained as Exhibit D.

Managing the Product Mix

Selecting the merchandise for a retail or online store is much like creating a recipe for a cake; each of the ingredients bring specific aspects to the finished product. There is not a single recipe that is correct. There can be many different recipes, each producing a cake that is tasteful. We would likely find that we would not all agree as to which cake was the most delicious.

In the most profitable art supply stores, the cake concept applies: there is a combination of components of product mix. But instead of developing the recipe that is most tasteful for the owner of the art materials store, the successful “recipe” for each store is the one that best addresses the target customer upon whom the store is focusing.

Determining the Product Mix

As we discuss techniques for determining the product mix, there’s no surefire way to come up with one recipe that works for each store. So let us look at the recipe from several perspectives. These will include:

- Maintained gross margin
- Sales rate (velocity coding)
- Dollar contribution
- Consumable products

Maintained Gross Margin

Looking first at the maintained gross margin, we should first explain the difference in the initial gross margin and the maintained gross margin.

If a product costs \$6 and is tagged \$10, the initial gross margin is 40 percent. This calculation is performed by taking the selling price and subtracting the cost of the item. The resulting number, \$4, represents the gross profit from the sale of the item.

Dividing the \$4 gross profit by the \$10 selling price results in 40 percent, which is also known as initial gross profit. However, if the product does not sell at \$10 and the retailer decides to sell it for \$8, then the gross profit drops to \$2. Dividing the gross profit of \$2 by the selling price of \$8 gives a gross margin of 25 percent. This gross margin is also known as the maintained gross margin because this is the amount that is actually produced.

You might expect that the retailer would naturally gravitate toward stocking those items that have higher margins. Unfortunately this doesn’t always work, as it represents a single strategy that will not attract enough customers to the business. To obtain higher margins, the retailer has to look at doing so in several ways.

One method of obtaining a higher gross margin is by examining the method and the quantity in which an item is ordered. As we discussed earlier, there are multiple ways to find product. There’s a tendency to think that as a retailer orders a higher quantity, the cost per item is lower. Many items, however, have a cost that does not decrease as the quantity ordered increases.

When the retailer does find that increasing the quantity ordered will reduce the cost of the item, then the inventory turn rate has to be considered. Inventory sitting on the shelf will reduce the profitability of the business in spite of a lower individual item cost.

Exhibit E, in the Appendix, illustrates the calculation necessary to determine true cost of any item, as well as the most profitable way to order merchandise.

The Sales Rate

Another consideration in product mix is the rate at which an item sells. Retailers using point-of-sale computer systems may find their computer performs an evaluation of each item listed and rates them according to a system known as “velocity coding.” Items that have the higher turn rate are assigned a higher number or perhaps a letter code such as “A.” Products that have a much lower turn rate are assigned a lower number or a letter code of “E.” Therefore all items are rated between 100 and 1, or “A” and “E.”

An item with a higher turn rate is one that customers are coming into the business more frequently to purchase. Again, these are items are more likely to be found on the shelves of the competition. However, many of the items that have a higher turn rate have a tendency to have a lower margin, because as the customer buys the item more frequently, the customer is more likely to be aware of the retail price because the items are seen in multiple stores and online.

The higher velocity code (turn rate) and lower gross margin as compared to a lower velocity code and higher gross margin do not cause conflict with the store. Instead the two go hand-in-hand, as the retailer will want to have a combination of the two as well as all the combinations between these two extremes.

Of course, as a retailer looks at this situation, he might ask, "If I lower my price to a new amount, will I sell more of the item?"

Even if you believe that you'll sell more if you lower the price, the true question would be to ask if the lower price, reduced gross margin and increased quantity sold will allow you to have increased gross sales dollars or increased gross profit dollars. Exhibit F, in the Appendix, outlines the calculation to help the retailer to determine how to make the decision about reducing the price. And the calculation could be performed in a reverse situation, in answer to the question, "If the price is increased and the retailer anticipates a decrease in sales, will the gross sales dollars or gross profit dollars also increase?"

While the mathematics will easily give the retailer the answer to the number of units necessary to produce these dollar amounts, the actual decision to make the price change becomes a best-guess situation.

Dollar Contribution

Also consider products that produce a higher dollar contribution. Envision an item that sells for \$8 with a cost of \$4. While you may be happy to have a 50 percent gross margin, when you have completed the sale, you have a gross profit of \$4. With a product that produces a high-dollar contribution, imagine an item that sells for \$500, and has a cost of \$400. The gross margin is only 20 percent, but the gross profit is \$100. With the first item, you will have to sell 25 units to produce the same gross profit as the second item, even when the gross margin is 2.5 times higher.

In light of these three considerations discussed so far in this section, you might wonder which of the three offers the best results. The answer is that the successful art material retailer's business requires some of all these items so that the right products are available for the target customers.

Consumable Goods

Offering consumable products is another consideration within the product mix. A consumable product is one that the customer purchases, and as the product is used, it either goes away or becomes useless. Example of a consumable product would be items like chalk or paint or cleaners.

The consumable products often have lower margins. This is because the rate of sale of these items increases as customers return time and again to purchase more of the product. However, the fact that the customer has to make repeated visits to purchase more of the consumable product is the very reason many retailers like to stock many consumable products. The retailer then hopes that the customer will also look at other merchandise when coming to purchase their consumable items.

Private-Label Merchandise

In addition to offering items that are not stocked by the competition, another way to increase the gross margin and distinguish a business from another is by the offering of private-label merchandise.

Private-label merchandise is the process by which a manufacturer produces a product that does not have their label on it, but instead is labeled as a product that is sold exclusively at a given retailer.

Of course, to make this concept work for the retailer, the product has to be packaged in a way so that it is not identifiable as being from that manufacturer.

With private-label merchandise, the retailer is attempting to establish a level of loyalty from the customer by having an item that is not available from any other retailer. In having a private-label program that works successfully, there must be several conditions that are fulfilled:

First, the customer has to see the private-label product as being the same or better quality than the name-brand product the customer is used to seeing. If the quality of the private-label product is the same as a name-brand product, the customer has a right to expect that the private-label product is priced lower than the name-brand product.

Second, while a private-label product program can increase customer loyalty, it has a negative factor if it causes the retailer to stock multiple items that do the same thing, increasing the amount of inventory in the retailer's store.

Third, the gross margin on private-label items should be larger than that of name-brand merchandise, but this should be a benefit to the retailer.

Reorder Availability of Merchandise

As products are ordered, retailers should ask their vendors about the availability of the merchandise on a reorder basis. The task of selecting which merchandise to stock in the store is hard enough, and becomes even harder if there is no opportunity to reorder the merchandise as the season progresses.

When placing both seasonal and basic merchandise, the retailer must be sure to ask if the opportunity exists to reorder the merchandise.

If the item is not available for reorder, buyers shouldn't panic and order excessive quantities of the item. Ordering additional quantities because reorders are not possible can set the retailer up for excessive markdowns if the item does not sell. The lack of a reorder possibility does not imply that the item will be a good seller.

Special Ordering

Most every retailer will hear a customer ask for a product that the retailer does not stock. This gives the retailer a chance to learn and profit.

Such a request is, first of all, a sign that the customer wants to do business with this retailer. It might also indicate that the product is not available from the competition.

Multiple requests should convince the retailer that his customer base expects him to be stocking the item.

Special ordering of merchandise is also a way for a retailer to increase customer loyalty and determine which products he might be missing. This is another important subject to discuss with the vendor.

Ask a vendor if he will accept special orders that are outside his normal order requirements. This could include ordering less than dollar minimum, quantity minimum and freight minimum. Retailers should ask his vendor how often he'd accept special orders.

Return Merchandise Authorization

Every retailer needs to ask a vendor to authorize a return occasionally. Perhaps an ordering error has occurred. Or maybe you placed a special order for a customer, only to have the customer decide not to buy the item. Other situations include damaged or defective items that a retailer must return.

The right time to ask about your vendor's return policy is during the vendor-selection process. Ask the vendor if you have to ask for approval before sending an item back, and find out how long it would take for him to credit his account.

Some vendors may charge a service fee for any returned items. Some may have a policy that will allow the retailer to destroy the product instead of returning it to the vendor. While no retailer anticipates having an excessive amount of product returns, it is better for the retailer to have an understanding of what happens with the vendor in this situation.

Sales Per Square Foot for Brick and Mortar

As we look at all of these considerations for the product mix in the brick and mortar store, retailers need to think about the occupancy costs for their building as they determine the product mix. The retailer will determine the cost per square foot for their business by looking at the rent expense or mortgage cost, property taxes, rent overage for leased space situations, common area maintenance (CAM) for a store in a shopping center, and could also include factors such as the various utilities.

When all of these amounts are added together and divided by the total square footage occupied by the business, the resulting number is the "occupancy cost per square foot." Keeping this expense number in mind, the retailer is going to next think about the amount of sales that same store will be able to produce.

One of the measurements used to gauge the success of the business is “sales per square foot.” This measurement compares the total of the sales of the store to the amount of space the business occupies. To tabulate this measurement, the annual sales total is divided by the total amount of square footage occupied. This space would include the sales floor, offices, restrooms, storage and service areas.

The retailer has to look at the occupancy cost per square foot and the sales per square foot to make sure there is a substantial enough difference in the two so that the store will produce enough funds to pay the rest of the operating expenses and return to the owner of the business a fair profit for the investment they have made.

Total annual sales/total square footage = Sales per square foot

Rebates

In the art supply industry, a rebate occurs within two segments – one for the customer and one for the retailer.

In an effort to move more merchandise, manufacturers will create a rebate offering on one or more items. With this promotion, the manufacturer also will likely create materials for the retailer to use in the store to attract customers to the display of merchandise. The manufacturer will also provide materials for the retailer to use for television, radio, newspaper and direct-mail advertising efforts. They may also include materials and processes for online rebates.

Most “mail-in” rebate programs are for a specific item or items produced by a manufacturer and for a limited period of time. Most rebates require the customer to provide the manufacturer or a rebate fulfillment company with a copy of the purchase receipt and a component of the package.

The customer then receives a check or debit card from the manufacturer or fulfillment company.

As the retailer advertises the rebate promotion, they will often list the selling price of the item, with a second line of information indicating the amount of the mail-in rebate. The third line, often shown in the largest type, shows the net cost to the customer. A similar method of stating the final cost to the customer is used for television and radio advertising.

A variation of the rebate promotion is the “instant rebate.” The instant rebate may be used in conjunction with the rebate previously explained. With the instant rebate, advertising lists the selling price of the item, with a second line of information in the print or televised advertising listing the instant rebate, the third line listing the amount of the mail-in rebate, and the final line being the final price to the customer.

With the instant rebate the amount of the rebate is deducted from the selling price of the item. The manufacturer of the item will reimburse the retailer for the instant rebate by deducting the amount from the price of the item as the retailer pays the invoice, or by a rebate check as the retailer sells the item.

A second type of rebate, called a “spiff,” occurs between the manufacturer and retailer as an enticement for the retailer to order specific items, a certain amount of inventory or a planogram. These rebates are often given to the retailer in the form of cash at a trade show or as a discount on an invoice as it is paid to the manufacturer.

Selecting Pricing Strategies

How much? In merchandising how much to charge is one of the most important questions to making a sale. And yet, clarifying that question is simple: the question behind the question is, “How much can you get for it?” The retailers that maintain the highest gross margins are those that utilize careful strategies to determine the prices for the products and services they sell.

The first aspect of determining the price for a product is knowing what is not a factor. Surprisingly, the cost of the item is not a factor. That’s because a successfully priced store has products that have high-margin items, low-margin items, and sometimes items for which the business does not have any margin. It’s the desirability of the item to the customer, not the base cost or margin, that is your essential factor.

Unfortunately, too many stores look at the cost of the item from a manufacturer, wholesaler or other vendor, and apply a predetermined margin to that cost. This strategy fails when a retailer that has been purchasing an item from one particular source purchases that same item from a second source at a different price. Because the cost has changed, should the retail price should also change? No. A retailer obtaining a better price from a vendor does not imply that the savings should be passed onto the consumer. The better buyer has higher margins, not just more sales than the lesser buyer.

Then there is the consideration of the freight. In determining the true cost of an item, should the freight, if any, to get it to the store be considered part of the cost? There is not a hard and fast rule for this aspect. Although we often see situations in which the freight cost for an item is so high in relation to the cost of the item that the retailer does attempt to recover the freight cost in the price of the product. There is also the consideration of freight cost when shipping to the customer from an e-commerce website. Will the retailer charge for the shipping or will it be free?

So, how does a business develop a strategy for pricing? The first is to recognize that most art material retailers will have thousands of items for sale. There is not a one strategy that is appropriate for each item. Instead, they will have

several strategies for identifying and pricing various groups of items.

There are many products stocked in an art materials store. Let’s first identify a sizable group of items that we refer to as blind-price products. The blind-price items are those that the customer is highly unlikely to have any idea as to what the price should be.

Blind-Price Merchandise

It is more and more difficult to find blind-price merchandise, given the ability for consumers to research product data and pricing on the internet. Ask yourself these questions. If you answer yes to them, the product fits into the blind-price category.

- Is the product seldom seen in advertising of competitors?
- Does the product appeal to customers as a “luxury” or “status symbol” item?
- Is the product not sold by a mass merchant?
- Is the product a seasonal item?
- Is the product seldom used by customers?
- Is the product seen as an “add-on” sale item?
- Is the product a repair or replacement item?
- Is the product one that requires additional handling because of its size or shape?

Because the best of the art material retailers will have some of all the pricing strategies we are outlining within their store, the blind-price items are essential to offset those that have very low or zero margins.

With the blind-price items, it is common to see margins that are in the 60- to 90-percent range. Unfortunately, many retailers see these numbers as unreachable. However, if these same questioning retailers see and understand products that offer little or no margins, then why not understand and have products that have margins that are potentially high and thus necessary to offset the items on the other end of the range?

Promotional-Price Items

The next group of products is those we will identify as the “everyday promotional price” items. Margin-wise, these products are on the opposite end of the scale from those we have just described. When you visit a mass merchant selling art materials and related products, you will undoubtedly see items displayed that you have also seen prominently in their advertising.

These are the products by which mass merchants work to establish an image with the customer as being a low-priced store. When we first discussed the product mix, these products were among those that would have a higher velocity code, and are the ones that customers are aware of the retail price.

The successful independent art material retailer visits their competitive mass merchants frequently and watches their advertising, so that they are aware of the products that fit into this category.

Observing the competition, the art material retailer is likely to notice two important aspects of these “everyday promotional price” items. The first is that the list is fairly small. It is especially small when compared to the list of blind-price items.

Secondly, the products that are in this category at one mass merchant will likely be the same as all the other mass merchants; the variation of products on this list from one store to another will be small.

To price their products competitively, the independent art material retailer must be able to recognize these products and competitively price the identical products in his store.

Of course, as the independent art material retailer is going to have many more of the blind-price items than the mass merchant, the opportunity to make up for the lost margin on the everyday sale price items increases.

The Benefits of Promotional Products

A third category of products, called promotional products, has already been discussed as we outlined the product mix and the need for a retailer to solicit from vendors products to be used for advertising. The retailer who selects these items for advertising benefits greatly.

The first benefit is that the margin on items purchased for advertising, as compared to simply taking the vendor's leftover merchandise and marking it down, will allow the retailer to maintain a higher gross margin. The second benefit is that when the advertising products are planned, as compared to simply being the leftovers, the customer is more likely to respond to the advertising because of the quality and selection of the products.

Sideline Items

The fourth and final category of products is “sideline items,” which afford the independent art supply retailer an additional opportunity for increased margin. This group of products is identified by a “yes” to these questions:

- Is this product the same as an everyday sale price item with the exception of being a different size or color?
- Are there additional benefits or features to this product, as compared to an everyday sale price item, that can be easily explained or demonstrated to the customer?
- Is this product stocked by the competition, but not advertised by them?
- In the event of the mass merchant carrying a private label item, is the independent art supply retailer stocking a brand name product?
- As the customer asks for a particular product, does the sideline item do a better job of satisfying their want or need?

The art material retailer who has products that fit this category can extend his margin by several percentage points by being able to provide the appropriate answers to the customer's questions.

Minimum Advertised Price (MAP)

In an effort to maintain a level of profitability (MAP) for the retailers offering their merchandise, some manufacturers will create a program for some of their products that establishes a minimum price for those products when advertised by the retailer. As a retailer decides to sell merchandise by a manufacturer with a MAP program, an agreement is signed in which the retailer agrees that all of his advertising

involving the specified products will not show a price lower than that established by the manufacturer.

While this program does not allow an art material retailer to create an advertising message of “lowest price in town,” the MAP program does protect the integrity of the gross margin for the products from the manufacturer.

The Digits of Pricing

The last component that helps retailers price products is establishing the actual price numbers. As we have already observed, many retailers make the mistake of simply applying a multiple factor to the cost of the product.

For example, the retailer may have an item with a cost of \$7.21. But instead of determining the selling price of the item by asking what they could get for the item, many retailers simply believe that a keystone margin is appropriate when selling it.

Hence, the item that costs \$7.21 is marked \$14.42. While many art material retailers would be happy to achieve a maintained gross margin of 50 percent, in this case, and in many others, the retailer is missing out on potential profit. Here's why:

The first component of maximizing profits and rounding a price is to determine what numbers are utilized in the price. As an example, some art material retailers choose to end everything on the even dollar amount. Their prices are \$10, \$25, or \$32.

Some retailers choose to have the ending numbers in the amount of .95 or .99; so they price their merchandise at \$9.95 or \$9.99, \$24.95 or \$24.99, and \$31.95 or \$31.99.

Perhaps you have read of “pricing barriers” that can be summarized by this question: “If the customer is willing to pay \$14 for an item, would they as easily pay \$15 for the same item?”

Applying this strategy to as much of the pricing of products as possible, the art material retailer will likely find that additional profit can be had by simply rounding up the prices determined after first answering the question of

“How much can I get for this item?” With the price-barrier concept, as you establish the price you believe is appropriate, you then “round up” the price for the item to the next highest price point. Using this strategy, you will maximize the gross margin the business achieves.

The amazing aspect of this strategy is that you will find that the maintained gross margin not only increases on each individual item, but on each fineline, department, and the store as a whole.

As an example, for products selling for more than \$200, there would likely be little resistance to a price variance of \$10. Thus, any product that would have a price between \$200 and \$210 would just as easily be sold for the \$210 as \$200. Using the ending numbers we just outlined, the final price would be \$209.95, or \$209.99 or \$210.

Taking this price barrier consideration to the next level lower, for the range of products selling between \$100 and \$200, likely price barriers would occur in \$5 increments. Items in the \$100 to \$200 range would sell in increments of \$104.95, or \$104.99 or \$105. The next increment would be \$109.95, or \$109.99 or \$110.

At the next lower level, the range would be only \$50 lower and the number of price-point considerations would increase. While each art material retailer will have to do his own experimentation with pricing, a suggested pricing level for the \$50 to \$60 range would be at the \$52.95, \$52.99 or \$53 point followed by a \$54.95, \$54.99 or \$55 point, followed by the \$56.95, \$56.99 or \$57. price point, followed by the \$59.95, \$59.99 or \$60 price point.

The next lower price barrier example is for items in the \$20 to \$50 range. Examples for this range would be \$21.95, \$21.99 or \$22, followed by \$22.95, \$22.99 or \$23, and then \$24.95, \$24.99 or \$25. Continuing, the price barrier in the \$20 range would be \$26.95, \$26.99 or \$27.99, and lastly \$29.95, \$29.99 or \$30.

There is also a range for products in the \$10 to \$20 range. A suggest price barrier for this range is for all prices to end in either .95, .99 or at .00. The idea behind this example, as with all others is that if a customer is going to pay \$17.29 for an item, they are not likely to notice or object to a price that is \$17.95, \$17.99 or \$18.

The lowest range for pricing barriers begins at \$2 and goes to \$10. With this range of prices, the price barrier concept applies on to the amount of cents charged with these suggested amounts: .25, .29 or .30, followed by .45, .49 or .50, then .75, .79 or .80, and lastly .95, .99 or .00.

An example of how to create this pricing is shown in Exhibit G in the Appendix. In creating this strategy for pricing barriers, these numbers are offered as examples and guidelines. But the art materials retailer must experiment with these strategies. While it may require time and intensive efforts, the reward to the successful art materials retailer is an increase in the profitability of their business.

The Internet

For many art material retailers the internet has had a significant impact on their pricing strategies, and often has rewritten the way in which they do business. Some retailers continue to be brick and mortar, while others may choose to offer online shopping through their own e-commerce website or by using amazon.com. E-commerce websites now offer an inventory and pricing structure that allows the consumer to get whatever they want ... whenever they want it ... often at a discounted price.

Even if the art material retailer is not offering online shopping, they will need to have a digital presence via their website, social media and email marketing. They should understand and appreciate the evolving digital marketplace and its ongoing impact on their business. NAMTA's second Retail Training series book – *Advertising and Marketing* – is a great tool to help you learn more and accomplish your online goals.

Art material retailers know that they may not always be able to compete on price with online competitors, but their retail stores do have some competitive advantages. Here are a few to consider:

Focus your selection: Know what your customers want and stock for them. Stock and merchandise your store to allow your customers to solve their problems.

Differentiate products: Stock more items that are unique or even locally produced. Doing so will prevent direct price comparisons. Avoid price comparisons by slightly modifying the SKU number for electronics.

Stress Customer Service: Most Internet companies make it easy to return an unwanted product, but only local retailers can provide face-to-face customer service. When consumers have a problem, they need to talk to a person – not type in their complaints. Make sure your staff is educated about your products. Consumers value this person-to-person contact. Be sure your customers know that simpler doesn't mean less. If you and your staffers are truly there for them, customers will appreciate your service and come back for more.

Touch and Feel: Never forget how important it is for your customers to be able to see, touch, feel, and test products they want to buy. They can't do that online, only in your store.

Make delivery times a priority: Internet companies can get consumers their product in 24 hours, but cannot satisfy the desire of today's consumer for immediate satisfaction. Customers can walk out of your store with their purchase in their pocket. Or if the desired product is not in the store, local retailers can still offer same-day pickup or use courier services to offer same-day delivery.

Attending a Trade Show

The trade show, be it sponsored by an association like NAMTA, a buying group or a cooperative, is an integral part of the formula for success in any art materials retailer.

At NAMTA's Art Materials World trade show, for example, the retailer gets to see manufacturer's newest products and have the opportunity to attend classes on current issues and receive technical product training.

In addition to seeing the new products, the art supply retailer might find that orders placed at the trade show will receive additional considerations such as special prices, dating on the invoice, special terms for freight, additional cooperative advertising and rebates.

Additionally, the retailer will probably receive many show-only special pricing offers. As shows take time away from the business, the retailer needs to prepare for attending a show.

The retailer should review all of the special offers that will be available at the show to determine which might be appropriate for their store. The retailer should then take a look at their sales history for previous years to establish an estimate of how much of the product should be ordered.

As previously discussed, the retailer will allocate a percentage of their budget to merchandise for sales events, seasonal and basic items. Part of the time on the trade show exhibit floor should be spent looking for new lines and products to add to the mix of merchandise carried in the store and on the website.

Many retailers have found that the best results come from developing a step-by-step plan for using their time at a trade show. One of the most popular formats is to walk the show initially without writing any orders and look at the entire floor, taking the time to make note of the location of vendors you plan to visit.

Many shows, like NAMTA's Art Materials World, provide attendees with free, downloadable apps for their mobile devices that can help efficiently plan an attendee's time.

The second walk through of the sales floor occurs when the retailer writes the planned orders. After writing the orders and with their minds a little more free, the retailer should consider taking a third trip around the show floor to see if there are any product lines they might have previously missed.

CONCLUSION

Is the successful merchandising of an art materials store or e-commerce website a science or an art?

For the best retailers it's some of both.

Successful merchandising comes from the retailer's understanding of the community, the competition, and their customers. Maintaining and growing a successful retailer operation requires knowing how to blend products and services to increase your market share by attracting new customers to art, capturing those artists who have strayed, and taking some business from the competition.

Art and science properly applied together result in sales and profitability.

EXHIBIT A [APPENDIX]

A Retailer Checklist of Vendor Specifications

	Vendor A	Vendor B	Vendor C	Vendor D	Vendor E
Type of vendor*:					
Sales representative calls on store					
Multi-line sales representative calls on store					
Tele-marketing					
Catalog only					
Minimum order requirement (dollar amount)					
Minimum order requirement (poundage)					
Product exclusivity					
Provides planograms					
Preseason special buys					
Discounted specials on consistent basis					
Offers private label merchandise					
Reordering of merchandise allowed					
Special orders allowed					
Less than case lot orders allowed					
Terms of payment					
How freight shipped					
Freight charges					

*Type of vendor refers to wholesaler, manufacturer, stocking co-operative, non-stocking cooperative, or buying group.

EXHIBIT B [APPENDIX]

Inventory Markdown Calculations

Inventory purchase amount	\$10,000	Sales in period 2 (before discount)	\$4,545
		Sales in period 3 (before discount)	\$6,818
Inventory balance remaining @ end of period 1	\$7,000	Sales in period 4 (before discount)	\$2,273
Inventory balance remaining @ end of period 2	\$5,000	Total sales	\$20,455
Inventory balance remaining @ end of period 3	\$2,000		
Inventory balance remaining @ end of period 4	\$1,000	Sales in period 1 (net of discount)	\$6,818
		Sales in period 2 (net of discount)	\$3,636
Inventory sold during period 1	\$3,000	Sales in period 3 (net of discount)	\$4,091
Inventory sold during period 2	\$2,000	Sales in period 4 (net of discount)	\$909
Inventory sold during period 3	\$3,000	Total sales	\$15,455
Inventory sold during period 4	\$1,000		
		Amount of discount in period 1	\$0
Original gross margin	56%	Amount of discount in period 2	\$909
		Amount of discount in period 3	\$2,727
Discount (% of retail) offered in period 1	0%	Amount of discount in period 4	\$1,364
Discount (% of retail) offered in period 2	20%	Total amount of discount	\$5,000
Discount (% of retail) offered in period 3	40%		
Discount (% of retail) offered in period 4	60%	Gross margin dollars in period 1	\$3,818
		Gross margin dollars in period 2	\$1,636
Gross margin % (net of discount) in period 1	56%	Gross margin dollars in period 3	\$1,091
Gross margin % (net of discount) in period 2	36%	Gross margin dollars in period 4	-\$91
Gross margin % (net of discount) in period 3	16%	Total gross margin dollars	\$6,455
Gross margin % (net of discount) in period 4	-4%		
		Total gross margin % (based on retail)	32%
Sales in period 1 (before discount)	\$6,818	Total discount % (based on retail)	24%

The planned-markdown calculations require that a buyer examine not only their initial gross margin but also be aware of their total gross margin and total discount based on all sales.

As the buyer determines how much they are going to buy, they also have established four points of time in which to reexamine the inventory purchased. For each of these dates, the buyer has a goal of how much inventory has been sold as well as a plan as to how much of a discount is placed on the inventory for the next period of time.

As the buyer adjusts the figures to give the correct amount of sales in each period, the calculator tells the buyer how much of a discount has been given and how these sales, and discount, affect the total gross margin for this purchase.

If the buyer believes that the total gross margin is too low, then the situation can be corrected in several ways. One is to simply not order as much merchandise, meaning there will be less merchandise on hand to receive the largest discounts. A second way to improve the total gross margin is to start with a higher initial gross margin. Of course, the margin would have to be one that causes the merchandise to be reasonably priced.

Another way to improve the gross margin is to decrease the amount of discount as each new time period is entered. Of course, the buyer will have to have a reasonable expectation of how this smaller discount is going to affect sales. And another way to improve the gross margin would be to make each of the four time periods to be longer.

This exercise can be performed in several ways. One way is to perform it on each individual item. A second method is to perform the exercise on the total of a season's worth of inventory from a vendor, and yet another method would be to perform

EXHIBIT C [APPENDIX]

Open-to-Buy Calculations

			MONTH 1	MONTH 2	MONTH 3
Open-to-Buy Chart					
Inventory -					
Beginning of Month			\$8,500	\$8,140	\$8,402
Anticipated sales			\$2,400	\$1,700	\$1,900
	P.O.#	P.O. Written to:			
Purchase Order #1	101	Acme Supply	\$1,200		
Purchase Order #2	102	Baker Ammo		\$1,000	
Purchase Order #3	103	Acme Supply		\$350	
Purchase Order #4	104	Charlie's Accessories			\$650
Purchase Order #5	105	Charlie's Accessories			
Purchase Order #6	106	David's Supply			
Purchase Order #7					
Purchase Order #8					
Purchase Order #9					
Purchase Order #10					
Purchase Order #11					
Purchase Order #12					
Purchase Order #13					
Purchase Order #14					
Purchase Order #15					
Total Purchases			\$1,200	\$1,350	\$650
Inventory Available for Sale			\$9,700	\$9,490	\$9,052
Gross Margin			35.00%	36.00%	35.50%
Cost of Goods Sold			\$1,560	\$1,088	\$1,226
Inventory (Actual) – End of Month			\$8,140	\$8,402	\$7,827
Desired Inventory – End of Month			\$8,500	\$8,600	\$8,400
Open-to-Buy for this Month			\$360	\$198	\$574

The open-to-buy represents a mathematical calculation that assists a retailer in determining how much inventory to order for each category of merchandise in each month of the season.

The calculation begins by estimating the amount of sales, at retail, that are anticipated for each of the months of the season. The second step is to determine the estimated amount of inventory, at cost, needed for each of the months of the season. The next step is to estimate the maintained gross margin for the category in each month. As these estimates are made, it is likely that the inventory on hand and the maintained gross margin will diminish as the season progresses.

The mathematics of the open-to-buy begins by multiplying the anticipated sales by the reverse of the gross margin (a gross margin of 35 percent would mean a multiplier of 0.65), which will establish the amount of sales at cost for the month.

The second step of the calculation is to take the anticipated inventory for the first day of the month, subtract the sales at cost for the month, and then compare that number to the desired inventory for the end of the month. If the resulting number is positive, it represents the amount of inventory that should be ordered for that month.

The determination of an open-to-buy is a constantly moving calculation as an art materials retailer should expect that their estimation of sales, maintained gross margin and inventory received will only be best-guess efforts.

EXHIBIT D [APPENDIX]

Cost-of Inventory Calculator

Selling price of the item	\$2.00
Cost of the item - method 1	\$1.00
Cost of freight for the item	\$0.10
Total landed cost	\$1.10
Number of days to pay for item	30
Initial gross margin of item	50%
Cost of the item - method 2	\$0.80
Cost of freight for the item	\$0.00
Total landed cost	\$0.80
Number of days to pay for item	90
Initial gross margin of item	60%
Quantity of item purchased - method 1	12
Quantity of item purchased - method 2	60
Average quantity sold per month	12
Interest rate of money	4.25%
Cost of item after 1 month - method 1	\$1.10
Cost of item after 1 month - method 2	\$0.80
Cost of item after 2 months - method 1	\$1.10
Cost of item after 2 months - method 2	\$0.80
Cost of item after 3 months - method 1	\$1.10
Cost of item after 3 months - method 2	\$0.80
Cost of item after 4 months - method 1	\$1.10
Cost of item after 4 months - method 2	\$0.803
Cost of item after 5 months - method 1	\$1.10
Cost of item after 5 months - method 2	\$0.807

The cost-of-inventory calculator helps a buyer understand the actual cost of inventory when considering different ways of ordering merchandise.

In this example we have two consistent factors: the retail price of the item is \$2 and the rate of sale of the item is 12 per month. The variances begin as the buyer considers purchasing in one of two ways. The first method is one in which the item is ordered 12 units at a time, and the payment is due in 30 days. As you look at the cost of the item in each five months, you will notice that the cost of the item remains consistent at \$1.10. The cost of \$1.10 is calculated by taking the cost of the item plus the freight. The gross margin of the item is 50 percent as freight is not traditionally considered in making the calculation.

In the second method of buying, the retailer has the opportunity to place an order with a substantial savings. There is first a savings of 20 cents per item in the actual cost of the item. There is a second savings as the vendor is offering to pay the freight, saving the retailer an additional 10 cents per item. So with an item that sells for \$2.00, the retailer will have a "landed" cost of only \$.80 per item as compared to \$1.10 in the first situation. The term "landed" refers to the cost of the item at the store as compared to the cost of the item at the vendor's facility.

Looking at the cost-of-inventory calculator, you see that the cost of the item in the second situation begins to change after the third month. This is because the vendor offered 90 days dating with the order. As the retailer is selling 12 items per month, at the end of 90 days, there have been 36 sold and 24 remain on the shelf. In the fourth month, the slight increase in the cost of the item is due to the fact that the retailer now has his money invested in the item. The cost of the item will continue to increase each month that inventory from this order continues to sit on the shelf.

Even if the retailer is not going to a bank to borrow money, the "cost of money" is a necessary consideration in determining the true cost of inventory. The same is true for the fifth month as the item is now costing slightly more. However, the cost of \$.807 is still lower than the \$1.10 so the idea of buying the item in the second method is more profitable. In performing this series of calculations, the chart could be extended to include any number of months as the quantity ordered, rate of sale, and terms offered by a vendor will vary. The important consideration is that the

EXHIBIT E [APPENDIX]

Price Change Calculation

Retail price per unit	\$10.00
Number of units sold	12
Cost per unit	\$6.00
Gross profit per unit	\$4.00
Gross sales amount	\$120.00
Gross margin percentage	40%
Gross profit	\$48.00
New retail price per unit	\$9.00
New gross profit per unit	\$3.00
To make the same gross sales dollars	\$120.00
I must sell this number of units	13.33
To make the same gross profit dollars of	\$48.00
I must sell this number of units	16

In the price-change calculation, the retailer first determines the retail price of the item, and observes the current rate of sale. In this example, with a retail price of \$10 and a sales rate of 12 units per month, the gross sales is \$120. With a cost of \$6 per unit and a gross margin of 40 percent, the gross profit is \$48.

When the retailer considers dropping the price by \$1 to \$9 per unit, there are two questions asked. The first is, "How many do I now have to sell to hit \$120 in gross sales?" The math is a simple dividing of \$120 by \$9 with a resulting answer of 13.33. To determine how many units have to be sold at \$9 to create the same \$48 of gross profit dollars, divide the \$48 by the \$3 in gross profit to produce the resulting answer of 16 units.

Now the decision before the retailer is to determine if they think they can sell the 13.33 or 16 units of the item at \$9 as compared to selling 12 units at \$10.

EXHIBIT F [APPENDIX]

Price-Changing Schedule

	10%	15%	20%	25%	30%	35%	40%	50%
5%	33.3%	25.0%	20.0%	16.7%	14.3%	12.5%	11.1%	9.1%
6%	37.5%	28.6%	23.1%	19.4%	16.7%	14.6%	13.0%	10.7%
7%	41.2%	31.8%	25.9%	21.9%	18.9%	16.7%	14.9%	12.3%
8%	44.4%	34.8%	28.6%	24.2%	21.2%	18.6%	16.7%	13.8%
10%	50.0%	40.0%	33.3%	28.6%	25.0%	22.2%	20.0%	16.7%
11%	52.4%	42.3%	35.5%	30.6%	26.8%	23.9%	21.6%	18.0%
12%	54.5%	44.4%	37.5%	32.4%	28.6%	25.5%	23.1%	19.4%
15%	60.0%	50.0%	42.9%	37.5%	33.3%	30.0%	27.3%	23.1%
16%	61.5%	51.6%	44.4%	39.9%	34.8%	31.4%	28.6%	24.2%
18%	64.3%	54.5%	47.4%	41.9%	37.5%	34.0%	31.0%	26.5%
20%	66.6%	57.1%	50.0%	44.4%	40.0%	36.4%	33.3%	28.6%

In this chart, we examine the results of price changing on any given item in an art materials store. As you read across the top row of information, the bold-font number, expressed as a percentage, represents the current gross margin of an item.

The bold numbers represent the percentage in increase of the gross margin as a result of applying the pricing strategy to any given item. As you read down, and across, as a result of the calculation being performed on any item, the resulting number answers a unique question:

“If the store were to lose business as a result of having increased your prices, how much business could you afford to lose without losing any of your profit?”

As an example, if your gross margin is 40 percent and you were to use the pricing strategy to increase your margin by 10 percent, you could lose up to 20 percent of your sales without losing any of your profit. Of course as you properly experiment with the pricing strategy, and successfully apply all aspects, you diminish the chances of your price changes being detected.

EXHIBIT G [APPENDIX]

Price-Barrier Rounding

\$2	\$10	\$x.29	\$x.49	\$x.79	\$x.99			
\$10	\$20	\$1x.99						
\$20	\$50	\$x1.99	\$x2.99	\$x4.99	\$x7.99	\$x9.99	\$50	\$100
\$x2.99	\$x4.99	\$x7.99	\$x9.99					
\$100	\$200	\$1x4.99	\$1x9.99					
\$200	+	\$xx9.99						

Exhibit G details the application of the price-barrier rounding technique. The first column represents the lower dollar amount of a range, while the second column represents the higher dollar amount of that same range.

The columns to the right indicate the price point suggested with x representing the appropriate missing dollar amount. The method of rounding to a 0.99 used here. But changing the 9 to any chosen digit, a 5, or a 1, is also functional.