NRHA
North American Retail Hardware Association

TOPIC 3

Understanding Gross Margin Return on Inventory

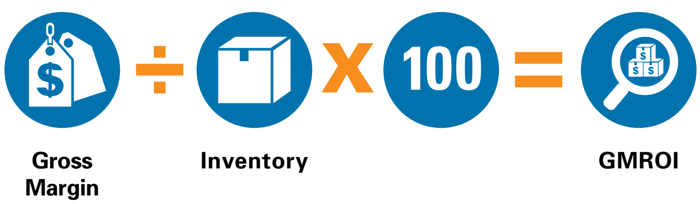
Learn How to Use Financial Metrics From the *Cost of Doing Business Study* to Improve Your Business

Understanding the Metric

WHAT IS GROSS MARGIN RETURN ON INVENTORY?

Gross margin return on inventory, or GMROI, is a percentage you can calculate using your sales and inventory numbers to determine what your margin is for every dollar you spend on products. You can use GMROI to assess store, department and product line profitability and identify areas in your business where you can make improvements to increase your return.

To calculate your GMROI percentage, divide your gross margin dollar value by your at-cost inventory value, and then multiply that number by 100. You can pull the gross margin and inventory numbers from your point-of-sale system.



WHY IS GMROI IMPORTANT?

Paying attention to GMROI helps you watch for dips in store, department or product line performance, or identify areas you can reassess to find ways to improve margins.

GMROI shows you how profitable your investment in inventory is by allowing you to compare total store numbers from month to month and compare departments' performance to each other at a specific moment in time, as well as over time.

If you use GMROI to identify an inventory area that needs to improve, you can consider doing the following:

1. Check your pricing against competitors' and look at price recommendations from your cooperative or distributor. Do you have room to raise prices?
2. Look for ways to reduce the number of SKUs you stock. Do you have duplicate products that you don't need to keep recording? How much dead inventory do you have wasting space? What strategies can you use to manage inventory sprawl better?
3. Rethink whether specific product lines or categories are good fits for your store. Can you stop stocking some items because they don't sell well? Can you update your product mix with items or niche categories that are better fits for your market?
4. Identify ways to increase margins. Can you replace some big brand-name products with private-label items? Are there products that have to be name brands, and others that you can switch to private labels without your customers noticing a difference?

HOW DOES YOUR STORE MEASURE UP?

Use the *Cost of Doing Business Study* from the North American Retail Hardware Association (NRHA) to benchmark your business against industry norms. NRHA has conducted the study annually for 99 years and, in the study findings, provides detailed financial analyses of hardware stores, home centers and lumber and building material outlets. The study also breaks out typical and high-profit store data so you can see the differences in performance. The high-profit company numbers come from the top 25 percent of stores in each of the three business types studied.

You can use the numbers from the *Cost of Doing Business Study*, which are featured below, to see if your store is above or below high-profit retailers' GMROI for your business type.

GROSS MARGIN RETURN ON INVENTORY PER STORE

	Typical	High-Profit
Hardware Store	**134.1%**	**198.1%**
Home Center	**149.7%**	**168.6%**
Lumberyard	**162.8%**	**193.9%**

Source: 2016 Cost of Doing Business Study, *NRHA*

The financial information NRHA uses in the 2016 study came from owners and managers at 1,077 independent home improvement stores. Those business operators voluntarily contributed their detailed financial and operational information from 2015 to help make the *Cost of Doing Business Study* the best benchmarking tool for the industry. Visit **hardwareretailing.com/2016-codb** to obtain the complete study.

Then, read the following case study to gain ideas from a retailer who has been progressively improving the metric for his business. You can also go to **TheRedT.com/gmroi** to watch an NRHA video on understanding how to use GMROI.

Connolly's Do it Best Hardware & Rental

Four locations in Fort Wayne, Indiana

HOW CONNOLLY'S USES GMROI

Looking at gross margin return on inventory (GMROI) is part of Michael Connolly's routine. The owner of Connolly's Do it Best Hardware & Rental looks at the percentages monthly, pulling individual numbers for each of his four stores, as well as breaking out department data to check on performance.

GMROI helps Connolly identify underperforming departments or product lines and then find areas where he can boost margins by changing his product offering or prices.

"It's a starting point, but it's also a gauge that you hope to get to an end point," he says.

Connolly relies on the accuracy of his staff's daily and weekly business tasks, such as taking inventory and making sure shipments are correct when the stores receive them, to ensure the GMROI numbers he looks at are as valuable as possible.

When he uses GMROI to identify a potential problem department or product line, he can look at dead items and inventory turns, check his cooperative's recommended pricing and do his own competitor price shopping. He and his employees have worked hard to keep inventory evolving and improving.

"Hardware is an inventory intensive investment," he says. "You want to have the right inventory and the right product counts, so you're not missing sales. We're constantly trying to have the right items, the right selection."

BECOMING PART OF THE ROUTINE

Connolly has made changes based on what he's learned from GMROI, and he has seen results. Taking a close look at product areas, such as tape measures, adhesives, gas cans and utility knives, has revealed opportunities to cut SKU counts by 10 to 25 percent, he says.

"We're doing it on an ongoing basis now. In a few categories of merchandise that we have changed, we've noticed that we're saving ourselves a lot of inventory dollars by reducing our product offering," he says.

He noticed, for example, that his stores were carrying multiple manufacturers' versions of the same tape measure.

He replaced some name-brand tape measures with private-label brands, which now earn him higher margins. He also decreased the number of different tape measures he stocks, while keeping the must-have items from popular brands and continuing to offer a similar variety of sizes and price points. Those changes have helped improve sales while cutting back on Connolly's inventory investment.

THE RESULTS

The results include higher inventory turns for a smaller number of products and simpler orders because Connolly Do it Best stores are stocking fewer total SKUs. In addition, Connolly can order ahead better because he can buy larger quantities of fewer products.

He has also made his employees' jobs more efficient because they don't have to keep track of or display as many different products.

Plus, Connolly's assortment looks neater and is easier for customers to shop because they aren't confused by a vast array of nearly identical products. That has helped improve sales, he says. "It's a game," Connolly says.