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Key Metrics (KPI's) for Retail, Catalog, E-commerce, and Wholesale Organizations—Part Two

Key metrics are a crucial element in the management of any Brick and Mortar, Catalog, E-commerce or Wholesale organization. The metrics and their values or goals must be developed during the business planning process and then utilized in individual performance plans in order to achieve the plan. In my practice, I often see a lack of connection and understanding between the business plan, the metrics, and individual performance plans. This creates an opportunity to increase success stories for organizations and individuals.

Key metrics fall into the following categories and should be shared across functional teams with different weighting depending on the impact on the metric by function:

Sales and Demand
Productivity
Margin and Profit
Inventory

(The list below looks long but really encompasses most metrics utilized to plan and manage a business. I usually suggest no more than four key metrics for performance reviews.)

In Part #1 we talked about key metrics for traditional Brick and Mortar and we began our discussion of the direct to consumer business with Catalog organizations. Now let's talk about additional nuances for the direct to consumer E-commerce world. Overall this business operates similar to Brick and Mortar retail on the front end (a.k.a. a virtual store) although customer data is more readily available but operates like the Catalog business on the back end (a.k.a. direct to consumer logistics model):

Demand and Sales

1. **Demand—**Demand measures all potential customer sales regardless of stock outs. I believe there is an opportunity in E-commerce to capture more true Demand without risking customer dissatisfaction. Most organizations I have seen capture Gross Sales (sometimes only Net Sales) per the above. If more of true Demand was captured future sales could be more easily maximized.
2. **Gross sales @ retail—**Generally means total sales dollars prior to returns and markdowns.
3. **Returns—**Dollar amount of goods returned-often stated as a percentage of Gross Sales. A benchmark might be a 10 percent rate.
4. **Markdowns—**Dollar amount of the discount a customer receives at retail—often stated as a percentage of Gross Sales. A benchmark might be 20 percent markdowns (which is different than 20 percent off depending whether it's stated as a percentage of gross or net sales). Sometimes markdowns are taken when sold (POS) and sometimes inventory is devalued with a markdown prior to being sold.
5. **Net sales at retail—**Gross Sales after returns and markdowns are subtracted.

Productivity

1. **Traffic (visits or sessions)—**This is just like the traffic or customers entering a Brick and Mortar store except that it's online traffic. It's similar to circulation in the Catalog world. It really measures how many eyeballs are viewing or shopping your merchandise or services. Traffic in the E-commerce world is generally generated from SEO (Search Engine Optimization), PPC (Pay per Click), Affiliate Marketing, Organic Search and Catalogs. These traffic generation methods should be measured for their productivity in an E-commerce organization in order to maximize traffic profitably.
2. **Conversion—**As in Brick and Mortar or Catalog organizations this measures how many people are actually buying out of those visiting your site. In the E-commerce world this generally is a percentage of visits or sessions. Some are now measuring this as a percentage of page views per session.

3. **The following productivity metrics are the same for traditional bricks and mortar, catalog and E-commerce.**
   a. **Sales per style—**Gross sales divided by the number of styles. This gives a benchmark of what the average style produces and is a good metric to review in comparing departments and or when growing or shrinking a category.
   b. **Average order size and average units per order—**This is net sales (after markdowns) divided by the number of orders. The larger the order size usually the more profitable since logistics costs then become a smaller percentage. Average Units per order tells you that the average order size of $150 is made up of 2.5 items per order.
   c. **Average unit retail—**Net Sales (after markdowns) divided by number of units sold. It's a good metric to compare categories (i.e. average sale of a top versus an outerwear piece or a fishing rod with a piece of tackle). This really tells you what your customer is willing to pay for an item versus where it is priced. They might be willing to pay $100 for a jacket and $50 for a top. Note: sometimes organizations calculate the Average Unit Retail of on hand inventory which is not apples to apples with this figure because of markdowns. In the above example a jacket might be $120 and the top inventory may be $60.
4. **Customer productivity—**This is a key element and warrants its own discussion. Similar to the Catalog world, E-commerce easily captures customer data. Generally, this data is segmented by frequency (new vs. repeat customers) and total purchases. This data can be utilized to better market to existing customers (especially when it goes down to the product category level) or to get new customers (see traffic above).
5. **Merchandising productivity—**The productivity of space or placement of product (home page, banner etc.) has not been a standard metric in the E-commerce world like in the Catalog world. Although this is extremely fluid in the E-commerce world, there is an opportunity to better understand this type of productivity.

Margin and profit

These metrics are the same for traditional Brick and Mortar, Catalog, and E-commerce.

1. **Initial Markup Percentage (IMU%)—**(Retail of an item-cost of an item divided by the retail of an item. ($10-$4/$10=60%)). This is the mark up that buyers are most focused on when buying product and building an assortment. 60 percent might be a rough benchmark.
2. **Gross Margin Percentage (GM%)—**This is the margin after discounts (merchandise markdowns + marketing discounts) i.e. the margin when something is sold. Sometimes referenced as maintain margin or final margin.
3. **Cost of Goods Sold (COGS)—**This one is exactly what is says which is nice. It is the inverse of Gross Margin. So in the example above $6 is the Gross Margin or Gross Profit then $4 is the inverse or cost of the goods.
4. **Operating margin $/%—**This generally refers to margin after all direct expenses of buying and selling the product have been taken into account. This would be GM% less any direct expenses such as advertising expenses.
5. **Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA %)—**This is the "bottom line" profitability of a business that many managers are rated on. A Profit and Loss statement begins with Sales, subtracts cost of goods sold to get to Gross Margin and then subtracts S, G & A expenses such as staffing, warehouse etc. to get to EBITDA. I think many businesses would be happy with a 10 percent EBITDA as a very rough benchmark.

Inventory

These metrics are the same for traditional Brick and Mortar, Catalog, and E-commerce.

1. **BOM and EOM—**Beginning of month inventory usually stated in units if you are working with styles and stated in dollars if working at the product category level. End of month inventory is the same.
2. **Average inventory—**This is usually stated in dollars for a product category or a total company and is an annual metric. Add together the first month's BOM plus 12 months of EOM's and divide by 13.
3. **Turn—**This is the rate you "turn" the inventory (like tables in a restaurant). Sales divided by average inventory. This should be apples to apples whether you are on a cost basis or retail basis. Ideally gross sales (net sales + markdowns) would be used but if you don't have gross you can use net. This is also an annual metric and often compared across companies as a key metric. A benchmark for an apparel company might be a 4 turn.
4. **WOS and DOS—**Weeks of Supply and Days of Supply measures how much inventory is on hand at a given time, usually month end. Inventory divided average sales by day (usually the forecast going forward for internal management purposes).
5. **Sales/stock ratio or stock/sales ratio—**This is simply as stated. I tend to utilize turn annually and then WOS and/or DOS by month at the category level.
6. **Sell through percentage—**This metric is often used more at the item level than at total category level and is key in reacting to business. It is the sales divided by the original on hand. As an example we initially had 100 rice cookers and at the end of the first week we sold 15 which is a 15 percent sell through—not too bad. The second week we started with 85 and sold 10 which is a 12 percent sell through. At the end of the first month we sold 40 which is a 40 percent sell through and now we have 60 left. If something isn't selling at 10 percent per week perhaps a markdown is needed or conversely if it's selling 25 percent per week then maybe we should get a re-order assuming it's not seasonal or no longer the fashion.
7. **Gross Margin Return on Investment (GMROI)—**This is gross margin dollars (often for a year) divided by average inventory. This measure the marginal profit as a return of the inventory invested. A number like 350 percent or 3.5 is GMROI.

Now let's shift gears a bit and talk about **wholesale** organizations:

Demand and Sales

1. **Demand—**Demand measures the sales and potential sales for an item even if it's out of stock and the customer did not get it. "Lost demand or true demand" is sometimes captured in the wholesale world but not consistently. My position is that this is crucial to know in planning for the future, maximizing sales and also for understanding customer satisfaction.
2. **Forecast error (as opposed to forecast accuracy)—**The most common metric is called MAPE (mean absolute percent error). It is the sum of the absolute errors (over forecast plus under forecast) divided by the sum of the actual and is stated as a percentage. This calculation is usually based on COGS (cost of goods sold). Depending on the business a 40 percent MAPE may be a good benchmark. While all organizations can continue to improve forecast error (or accuracy) what's important is that an organization acknowledges that there will always be a fair amount of error (or inaccuracy) and that processes and contingencies are put in place to manage the results of the error (or inaccuracy) such as inventory excess and/or stock outs.
3. **Fill rate—**This measures how much of the demand (or many cases customer orders) the organization is able to fill for the customer and is a key metric for management, sales, and customer satisfaction. Depending on the business a 95 percent fill rate may be a good benchmark.

Backorders are orders that may not be filled initially but filled somewhat late so it's a good idea to state fill rate as initial (prior to backorders) and final (after backorders are filled) sales.

4. **Gross sales**—Generally means total sales dollars prior to returns and discounts.
5. **Returns**—Dollar amount of goods returned-often stated as a percentage of Gross Sales. A benchmark might be a 10 percent rate.
6. **Discounts**—Dollar amount of the discount a customer receives often stated as a percentage of Gross Sales. A benchmark might be 10 percent discount (which is different than 10 percent off depending whether it's stated as a percentage of gross or net sales)
7. **Net sales**—Gross Sales after returns and discounts.

Productivity

1. **Sales per style**—Gross sales divided by the number of styles. This gives a benchmark of what the average style produces and is a good metric to review in comparing departments and or when growing or shrinking a category. Often startup costs of an item are utilized to determine the breakeven point on sales of an item to determine when/if to develop new items.
2. **Average order size and average units per order**—This is net sales (after discounts) divided by the number of orders. The larger the order size usually the more profitable since logistics costs then become a smaller percentage. Average Units per order tells you that the average order size of $150 is made up of 2.5 items per order. Often wholesale companies have minimum order size/units to insure profitability.

Margin and Profit

1. **Initial Markup Percentage (IMU%)**—(Sales of an item-cost of an item divided by the sales of an item. ($10-$4/$10=60%)). This is the mark up that produce managers are most focused on when developing product and building an assortment. 60 percent might be a rough benchmark.
2. **Gross Margin Percentage (GM%)**—This is the margin after discounts i.e. the margin when something is sold. Sometimes referenced as maintain margin or final margin.
3. **Cost of Goods Sold (COGS)**—This is exactly what is sounds like. It is the inverse of Gross Margin. So in the example above $6 is the Gross Margin or Gross Profit then $4 is the inverse or cost of the goods.
4. **Operating margin $/%**—This generally refers to margin after all direct expenses of buying and selling the product have been taken into account. This would be GM% less any direct expenses such as advertising expenses.
5. **Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA%)**—This is the "bottom line" profitability of a business that many managers are rated on. A Profit and Loss statement begins with Sales, subtracts cost of goods sold to get to Gross Margin and then subtracts S,G & A expenses such as staffing, warehouse etc to get to EBITDA. I think many businesses would be happy with a 10 percent EBITDA as a very rough benchmark.

Inventory

1. **WOS and DOS**—Weeks of Supply and Days of Supply measures how much inventory is on hand at a given time, usually month end. This seems to be the most common metric in the wholesale world. Inventory (COGS) is divided by average sales by day (COGS). Finance and auditors most often refer to WOS/DOS looking backward because it has actually happened. Internal management must look forward and base WOS/DOS on a forecast since that is what they are managing inventory to. In a highly seasonal business this number fluctuates. Depending on the type of business 60 days of supply can be a good benchmark. I like to always talk about the Yin and Yang of inventory management. If DOS are too low fill rate will be too low. If DOS is too high fill rate will probably be good (depends

what the inventory is in) but excess DOS will be too high creating excess inventory-see below.

2. **Excess inventory—**Excess inventory is defined as the difference between the forecast for some determined number of days in the future (i.e. 90) and the amount of supply or inventory on hand (or in the pipeline).
3. **BOM and EOM—**Beginning of month inventory usually stated in units if you are working with styles and stated in dollars if working at the product category level. End of month inventory is the same.
4. **Average inventory—**This is usually stated in dollars for a product category or a total company and is an annual metric. Add together the first month's BOM plus 12 months of EOM's and divide by 13.
5. **Turn—**This is the rate you "turn" the inventory (like tables in a restaurant). Sales (COGS) divided by average inventory (COGS). This is also an annual metric and often compared across companies as a key metric. Depending on the type of business a 5 time turn would be a good benchmark.

I hope you will utilize this comprehensive resource on metrics for education, planning, and management purposes within your organization. I'd love to hear about your successes and needs in the area of metric utilization. I can be reached at Janice@JLSearsConsulting.com or at 206.369.3726.

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More about us

ABOUT THE AUTHOR | Janice Sears has served as **Principal** of JL Sears Consulting, Inc. based in Seattle, since 2004. She is also a Principal of Tag Team Business Solutions.

Janice brings more than 20 years of **broad multichannel retail and wholesale experience** in merchandising, planning, marketing, finance, and operations to her clients. She is a Certified Management Consultant (CMC), and received her **MBA in Finance** from the University of Colorado.

As a former **Vice President at Eddie Bauer**, she was accountable for $1.6 billion in annual sales, which included 400+ stores in the US and Canada, catalog and internet sales, along with margin and profit. Janice directed strategic business planning, merchandise planning, inventory and margin management, and led the cross-functional business teams by channel to manage the P&L. She also drove system and business process improvement projects and was integral to marketing, assortment planning and organizational development initiatives.

She served on the **Board of Directors for Big Brothers Big Sisters of Puget Sound** for more than 10 years while being a Big Sister herself. Janice continues to serve on a variety of professional and non-profit boards and is currently a University of Washington Business School Mentor.

Janice is an avid skier and cyclist who writes a travel blog about her quest to visit all 58 National Parks. She enjoys northwest urban living and time with family and friends from her Seattle home.

ABOUT J.L.SEARS | **JL Sears Consulting, Inc helps organizations and business teams boost profitability and productivity through strategic business planning, development of merchandise strategy and implementation of key execution tools.**

We specialize in working with multi-channel retail and wholesale clients to craft a roadmap to success in an ever-changing business environment.

Clients include: Belkin, Branders, Charlotte Russe, Crosstown Traders, evo, Griot's Garage, Lucy, Nasty Gal, Outdoor Research, and Sur La Table.

JL Sears Consulting, Inc. is a former member of 1% for the Planet and continues to focus its one percent donation on saving Puget Sound and supporting our National Parks.

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