<u>SECTION 2</u>: Manipulating Profit Variables: Merchandising for a Profit

Part 3: Expanded Profit and Loss Statement: Calculating the P & L Components

<u>Part 3: 3-7 GMROI</u>

Gross Margin Return on Investment (GMROI) is the interrelationship of gross margin, turnover, and markup percent. It is a financial performance measure utilized to keep a check on the retailer's bottom line. In today's highly competitive marketplace, the retailer attempts to produce more profit by increasing sales on less inventory. If the retailer can reach or increase planned sales volume on "lean" inventories, then gross margin will increase. GMROI measures the amount of gross margin dollars produced per dollar of average inventory invested by the retailer.

Gross margins and markup percent have been discussed in detail in this Section; however, the formula for turnover has not been delineated. Turnover is a very important inventory measure for the retailer. Turnover is the number of times that the average inventory sells within a given period of time. Usually turnover is calculated for a six month period or year.

The formula for turnover is:

Turnover = Net Sales ÷ Average Inventory

Average inventory for a month is the beginning of the month inventory (BOM) and the end of the month (EOM) inventory for that same month divided by two (2). For the Six Month Merchandise plan the average inventory is the BOMs for seven months divided by seven (7). This concept will be explained in detail in **Section 3**: *Part 4: 4-2*.

Note that turnover is a figure and not a percent or a dollar amount. The turnover formula above is based on retail. A high turnover is desired by the retailer as it indicates that the inventory is selling quickly and is being replaced by more current or updated inventory.

When calculating GMROI, some retailers base the inventory on cost % since GMROI relates investment dollars to gross margin. If a retailer maintains a high turnover and a high gross margin, usually the GMROI is high. Ultimately more profit is realized by the retailer.

A variety of formulas is used for calculating GMROI; each formula addresses the concept with a different viewpoint. All the formulas, however, relate gross margin to turnover.

Section Summary:

In this section, **Section 2**: *Manipulating Profit Variables: Merchandising for a Profit*, all components for both the Skeletal Profit and Loss Statement and the Expanded Profit and Loss Statement were discussed. Each line entry for each statement was investigated, formulas were provided, examples were calculated, and the spreadsheet for formatting the income or operating statements was developed.

In the next section, **Section 3**: *Preparing the Six Month Merchandise Plan*, the three stages for creating a Six Month Merchandise Plan will be investigated; and, the section will culminate in the creation of a Six Month Merchandise Plan that might be utilized in a retail store.