THE PROFIT IN *Small* GOODS

Master combo retailer George Hines shares his approach for boosting profitability with accessories

The success of independent retailers is predicated on the same profitability issues as any business. Keeping our eyes glued to the ball of profit should be our primary concern in maintaining a competitive advantage against outside influences, including competition and the economy. It's not about how much we sell but how much we make that determines whether we get to keep playing the game.

There are two tried-and-true ways to boost profitability: increase margin dollars and lower costs. Each deserves its own article, but for now, we'll stick to increasing margin dollars. In particular, I would like to focus on accessories because they may be one of the easiest ways to improve your bottom line. Some say it's like picking low-hanging fruit.

MOVING FROM GUITARS TO GIG BAGS

A few years ago, my business faced downward pressure on gross margins. I wanted to not only reverse the trend but also determine a way to increase margin dollars by more than 2 percent. In other words, if sales were up 4 percent over a period, then I wanted gross margin dollars to be up 6 percent. The difference between the two figures is the "spread," and I wanted to start increasing the spread in favor of higher gross margin dollars.

In order to achieve this, I needed to better under-

stand where those profit dollars were being generated. I started by looking at the general departments. It became fairly evident our accessory departments were providing a much greater share of the company profits than large goods departments. Large goods, in fact, turned out to be the culprit of lowering our overall margins.

For sake of clarification, I should mention that I defined my large goods as guitars, basses, guitar processors, effects pedals, amplifiers, drums, cymbals, speakers, microphones, pro and portable keyboards, recording hardware, software, and similar products.

I defined my small goods as strings, picks, straps and other related guitar accessories; sticks, heads and other related drums accessories; MIDI interface boxes and other related keyboard accessories; stands; print music; cables; and other similar items.

At the time, approximately 24 percent of our total inventory balance on hand was small goods items, and about 76 percent was large goods. However, 38 percent of our total company profits were from small goods, with 62 percent from large goods.

After analyzing the return on investment (ROI) of large goods inventory vs. small goods inventory, I came up with a game plan designed to add more than $300,000 to our bottom line in one year. I now use it as a tool to control pressure on the margin spread. Let's look at how you can blend profitable accessory inventory to increase overall company profits.

GEORGE'S FORMULA

Here's how you determine how much extra margin you can generate from small goods:

1. Define your large goods and small goods departments (see above).

2. Determine your total inventory, and find the balance of inventory, large goods to small goods. My current percentage has been increased to 28 percent small and 72 percent large, and we manipulate this number as needed to increase gross-margin dollars.

3. Determine your total ROI of large goods and total ROI of small goods. Take your profit for these groups over the last 12 months and divide that by the average balance of on-hand inventory.

Consider using the *Music Inc.* definition of ROI on page 52 of the May 2006 issue ("Taking SteROIds"): "Take profit made over the past 12 months and divide that by the average inventory figure. To find this figure, add up the worth of your inventory at cost for each of the past 12 months and divide by 12."

4. Determine how much inventory you can shift from large to small. I would recommend going slowly, shifting 1- to 2-percent maximum per month. Monitor progress for a few months.

5. Monitor overall progress. Look at your monthly gross sales vs. monthly gross margin. Over a period of time, you should see the effect on the "spread" between the two numbers.

TURBOCHARGE YOUR ROI

Look to the chart below. In Example A, we have an average balance on hand of $10,000 in large goods. They turn about 2.5 times a year, costing you $25,000 in purchases. (An average balance on hand of $10,000 multiplied by 2.5 turns comes to $25,000 in annual purchases.)

They also produce $35,715 in gross sales if sold at a 30-percent average gross margin. This will generate $10,715 profit dollars for an annual ROI of 1.07. (An average balance on hand of $10,000 generating $10,715 in profit annually is an ROI of 1.07.)

In Example B, we have an average balance on hand of $10,000 in small goods. Small goods typically turn significantly better than large goods, at about four times a year, generating $40,000 in annual purchases.

They also produce $66,667 in gross sales if sold at 40 percent average gross margin. (It's typically easier to maintain margin on accessories.) This will generate $26,667 profit or a 2.67 return on the initial average balance of on-hand inventory of $10,000.

This chart shows how a shift in inventory value of just

INCREASING GMROI THROUGH ACCESSORIES

EXAMPLE A: LARGE GOODS

Average inventory B.O.H.	$10,000
Multiply by avg. turns	x 2.5
Yearly cost	$25,000
Divide by cost %, derived from avg. gross margin (if gross margin is 30%, that makes cost 70% of sales)	÷ 0.7
Gross sales	$35,715
	- $25,000
Subtract cost and divide by avg. B.O.H.	÷ $10,000
Total Profits ROI	1.07

EXAMPLE B: SMALL GOODS

Average inventory B.O.H.	$10,000
Multiply by avg. turns	x 4
Yearly cost	$40,000
Divide by cost %, derived from avg. gross margin (if gross margin is 40%, that makes cost 60% of sales)	÷ 0.6
Gross sales	$66,667
	- $40,000
Subtract cost and divide by avg. B.O.H.	÷ $10,000
Total Profits ROI	2.67

$10,000 average balance on hand inventory from large to small goods could conceivably create an additional profit of approximately $15,952, using the above assumptions. If you could shift $50,000 from large goods to small goods, you could gain approximately $80,000 in extra bottom line. These assumptions are conservative. Your results could be even greater.

Of course, there must be a rational balance between large and small goods. The opportunity lies in finding that perfect balance, and many of us need to look at the profitability of accessories and restate what we want that mix to be. A good rule of thumb is a range of 25–35 percent in small goods to 65–75 percent in large goods.

HOW TO ACCESSORIZE

We also need to consider which accessories can help us get the highest return on investment for our purchasing dollar. Start by asking your small goods suppliers for a list of their top sellers.

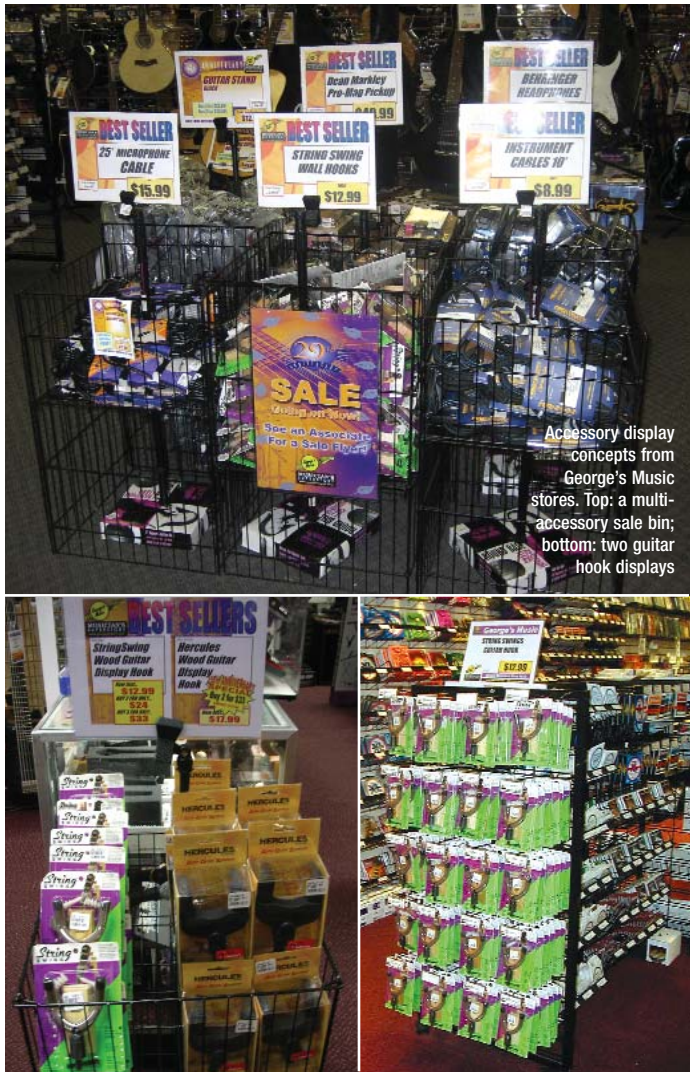
Consider the following guidelines when increasing dollars for purchasing accessories:

• Increase accessories that can be cross merchandised. These include stands, cables, cases, batteries, straps, books, DVDs, mic clips and similar items.

• Increase products that can be merchandised to sell in quantities. Strings, sticks, reeds and similar items that can be sold in quantities of three for X amount of dollars.

• Increase products that can be displayed and sold from sale bins so attention is drawn to them. Boxes of strings or 10-foot cables and similar items. (See the photos above.)

• Increase products that have a natural up-sell potential, like gig bags, guitar stands, guitar tuners, keyboard stands and other similar items. Here, you should consider a "good, better, best" approach to boost the average ticket price and profitability. For example, if the only keyboard stand you offer is the "good" price point of $19.95, you're not likely to sell many $39.95 (better) or $59.95 (best) stands. In many cases, the good, better, best approach can more than double the average ticket price on your small goods sales.



Accessory display concepts from George's Music stores. Top: a multi-accessory sale bin; bottom: two guitar hook displays

A shift in inventory value of just $10,000 from large to small goods could create an additional profit of approximately $15,952

ADDITIONAL THOUGHTS

There are endless possibilities for selling accessories, but the following considerations are important.

• Not every customer can afford a large-good purchase over $200, but almost everyone can afford $20.

• Accessory items are not as price sensitive as large goods. For example, a 10-percent difference in your price of a $500 item is $50. On a $20 accessory, it's $2.

• Accessory items are the items that help customers enjoy the large goods they buy. Think D'Addario EXP or Elixir strings, Evans drum heads, Planet Waves tuners, Music People stands and so on. These companies produce an excellent value for the customer along with profitability for the dealer.

• Some of us have five guitar lines but only one cable line. If you look at the ROI of guitars vs. cables, you would wish you could open a cable-only store! What's wrong with having two to five cable lines? Again, think Hosa, Rapco, Monster, etc.

• Running sales contests in profitable accessory product categories makes great sense. If you want to boost profits during the holiday season, consider a sales contest on items per transaction. Teaching our sales associates the value accessories bring to our customers and company profitability is critical to our financial health.

We owe it to ourselves, our customers and our vendors to remain profitable. Our large goods vendors want us to stay in business, and many are doing their part to offer more accessories to support their larger goods sales. We need to realize that although accessories don't seem as sexy as large goods, they are necessities. They allow our customers to truly enjoy their instruments. Profit is good! Long live accessories and accessory profit margins. **MI**

George Hines is the owner of George's Music, a 10-location chain of music retail combo stores based in Berwyn, Pa.