



## The Weakest Link

An examination of chain store productivity with a 4-step process to address problem stores

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Do you remember when you only had one store? Life was simple then, you knew exactly what was going on and you could control most of the components of your business. Then, you began to grow and you opened your second store, then your third and now you have over 10, 15, 20 stores or more. You quickly discovered after the opening of your second store what any parent of small children can tell you, that the second does not double your work load, it at least triples it! And parents who have more than five children will tell you that it is somewhat like organized chaos!

A challenge for any executive responsible for more than two stores is the realization that you are only as good as your weakest store. Customers judge you by what you deliver and if you have a store that is not delivering, it can affect all your stores. But what measures do you use to judge that weakest link? How much variance should there be before a red flag goes up? And, just as importantly, what do you do to strengthen that link when you have discovered that it is a problem?

There are four steps involved in the analysis of your stores:

- 1)** Identify the measures you will use to assess store performance
- 2)** Assemble that data for the past three years (or longer if you have it), rank the stores' performance and identify the weak performer(s)
- 3)** Make operational changes to improve performance and assess the results of the changes
- 4)** If no significant change occurs, decide to either close the store or change the concept (possibly make it a clearance or outlet store)

## >> 1 – Identify The Measures You Will Use To Assess Store Performance

We surveyed a number of owners of small chain stores to answer this question and the responses were very enlightening. First and foremost, every retailer surveyed identified productivity as the key measure in comparing stores to one another. The assessment of productivity was done across a number of measures:

- >> Store margin contribution
- >> Sales per square foot
- >> Net profit (store)
- >> Average transaction
- >> Items per ticket
- >> Conversion rate / traffic

Each of these measures allowed the store owners to assess the relative health of a store to other stores in the chain while giving some clues as to what was causing the poor performance. When a store was failing on three or more of these measures, it was identified as a weak performer.

The above performance measures are listed in the order of importance to the analysis with store margin contribution topping the list, according to the store owners interviewed, who identified it as the main factor in their analysis of productivity.

## >> 2 – Assemble That Data For The Past Three Years (or longer if you have it) And Rank The Stores Performance And Identify The Weak Performer(s)

It is critical that you first have these measures available to you to do the analysis. Using a simple Excel spread sheet you can list each of your stores and track performance across each measure. Then, using the data sort feature in Excel, you can rank each store for each measure. In the sample below it is clear that there is a problem with store 4.

**Example 1**

Store/Year	Sales Per Square Foot	Margin Contribution	Net Profit	Average Transaction	Items Per Ticket	Conversion Rate
1/2000	\$400	\$40,000	\$10,000	\$27.15	2.2	35%
1/2001	\$410	\$42,000	\$11,000	\$28.12	2.3	35.5%
1/2002	\$425	\$45,000	\$12,000	\$28.64	2.4	36%
2/2000	\$425	\$42,000	\$12,000	\$28.20	2.3	36%
2/2001	\$425	\$42,400	\$12,200	\$28.72	2.3	36.5%
2/2002	\$430	\$43,100	\$12,800	\$29.01	2.4	36.8%
3/2000	\$450	\$45,000	\$15,000	\$28.60	2.5	33%
3/2001	\$455	\$46,100	\$15,400	\$28.90	2.7	34.2%
3/2002	\$458	\$47,000	\$16,000	\$29.40	2.9	35%
4/2000	\$275	\$11,000	\$1,000	\$22.30	1.8	22%
4/2001	\$270	\$10,000	\$800	\$22.10	1.7	22%
4/2002	\$265	\$9,000	\$100	\$21.50	1.6	21.5%

Not only is it obvious that store 4 has the lowest sales per square foot, it is also the weakest performer in all the categories. This may not always be the case. You can have a low sales per square foot store that has high margin contribution and low occupancy costs because the rent is very low. So, you would try to increase the sales per square foot but the problem is not as critical if the contribution to overall profitability is strong. Most retailers use store margin contribution as the key measure and in some cases even if it does not exceed the break even for the total company, it may still be better to keep the store.

### Margin Contribution

Each store should be evaluated based on what is called the store operating margin. This is calculated by taking the gross profit of the individual store and subtracting the operating expenses of that store. Head Office overheads are not considered in this calculation, only the direct expenses that are associated with the store itself. These would include rent (and percentage rent, all HVAC and common area charges for the location, staff costs, including benefits, local advertising and all related store expenses).

The concept of store contribution margin is not used by all retailers. Some just track total sales, total cost of goods sold, total expenses and get a total net profit figure for the entire company.

The proper way to account for store performance is to have a separate profit and loss statement for each store that tracks the sales, gross profit and direct store expenses but with no company overheads (such as administration, buying, distribution and other head office expenses). This is called store contribution as it is the amount of profit that the store contributes to the company. It is a very useful number as it allows us to look at the store operations independently from the total company. Although it is true that each store benefits from the work of the head office and would have very different results if buying, administration and delivery was included, it is beneficial to look at the stores performance without these overheads to compare their performance.

Sample P&L		
Net Sales	\$4,000,000	100.00%
Minus Cost of Goods Sold	\$2,200,000	55.00%
Equals Gross Profit	\$1,800,000	45.00%
Store Payroll	\$425,000	10.63%
Store Occupancy	\$275,000	6.88%
Store Utilities	\$55,200	1.38%
Store Maintenance	\$20,800	0.52%
Store Telephone	\$40,800	1.02%
Store Insurance	\$20,400	0.51%
Store Supplies	\$37,000	0.93%
Store Advertising and Promotion	\$55,000	1.38%
Minus Store Expenses	\$929,200	23.23%
Equals: <b>Store Contribution Margin</b>	<b>\$870,800</b>	<b>21.77%</b>
Head Office Expenses		
Payroll	\$220,000	5.50%
Occupancy	\$40,000	1.00%
Utilities	\$15,000	0.38%
Maintenance	\$10,000	0.25%
Telephone	\$22,000	0.55%
Insurance	\$5,000	0.13%
Supplies	\$7,000	0.18%
Advertising and Promotion	\$100,000	2.50%
Administration	\$55,000	1.38%
Professional Services	\$25,000	0.63%
Accounting and Data Processing	\$28,000	0.70%
IT	\$45,000	1.13%
Interest Expense and Banking	\$24,000	0.60%
Depreciation	\$58,000	1.45%
Miscellaneous	\$22,000	0.55%
Total Head Office Expenses	\$676,000	16.90%
Total Expenses	\$1,605,200	40.13%
Net Profit	\$194,800	4.87%

## Sales per Square Foot (SPSF)

Sales per square foot was identified as another measure used to identify weak performing stores. The formula is simply total sales of the store divided by selling area in square feet. So, if the store had sales of \$350,000 and had a selling area of 1,500 square feet, the sales per square foot would be \$233.33. What SPSF tells you is the sales productivity of the store. A few factors must be kept in mind when calculating this number. Selling area is the area in the store that is used for customer purchasing. To calculate selling square footage you need to measure all the area of the store except the area directly behind the cash register (where your sales associate stands), stock rooms, receiving area, window areas and dressing rooms (unless the dressing room contains mirrors. If it does, it is considered selling area). It is not uncommon for a 1,200 square foot store to contain 200 or even 300 square feet of “non-selling” area. Why it is important to measure this way is that all stores do so and if you want to compare productivity to other stores in your industry you have to use the same definitions of selling area. However, for internal measures that compare one store to another in your own chain it can be more realistic to use total square footage to do the calculation as you pay rent on total square feet not just selling square feet.

Sales per square foot also will eliminate store size comparisons insofar as it does not matter if the store is 1,000 or 10,000 square feet: the measure is for the average so you can compare different store sizes. What the analysis may show, however, is that there is a minimum size that you may need to efficiently operate. For example, if most of your stores are above 1,500 square feet and you have one store that is 1,000 square feet and it is consistently at the lower end of the productivity measure, it may mean that your concept simply does not work in a smaller footprint. This is valuable information to have so you do not make the same mistake with a new store. Most concepts work best in an optimal amount of space and if there is too much variance in your chain you will find that both the smallest and the largest stores may not be the best performers.

## Net Profit

Many companies maintain a net profit by store. This number uses the store contribution margin and adds on a pre-determined share of company overheads to derive a net profit for the store. Using this measure can give a different picture depending on how the corporate overheads are assigned. For example:

### Example 2

	Example A	Example B
	Store 1 with weighted overheads	Store 1 with un-weighted overheads
Store Contribution	\$45,000	\$45,000
Corporate overhead assigned to individual store	\$30,000	\$40,000
Net Profit	\$15,000	\$5,000

Corporate overheads can either be assigned by taking the total overheads for the company (administration, buying, distribution, head office expenses) and dividing by the number of stores. This is a simple assignment of costs and assumes that all stores will equally bear the overhead costs. The weighted method, on the contrary, assumes that higher volumes or sizes mean higher costs (buying, replenishment, distribution etc.) and assigns overheads at the same percentage as sales or in some cases square footage. So, a store that is 5% of sales will pay 5% of overheads or a store that is 5% of total square feet will incur 5% of total overheads. An argument can be made for both the weighted as well as un-weighted system although most stores will use a weighted system as it more fairly reflects the usage of corporate overheads.

## Average Transaction/Items Per Ticket and Conversion Rate

These three measures are used to give an indication of what may be the root cause of the problem in the under-performing store(s). Many companies rank store performance against these measures along with the store contribution margin, SPSF and net profit. The average transaction (total store sales divided by total store transactions=AT), items per ticket (total items sold divided by total store transactions=IPT) and conversion rate (total store traffic divided by total store transactions=CR) will give a good indication of the performance of the staff. If the AT, IPT and CR are all at or above company average that will indicate that the staff in the store is doing a good job and the likely cause of the lack of contribution margin is in operating overheads (such as, rent being too high) or in an overall lack of sufficient traffic in the store. Underperformance on these measures, however, often points to a lack of training and emphasis on suggestion selling and trade up skills.

## >> 3 – Make Operational Changes To Improve Performance And Assess The Results Of The Changes

Once you have done your analysis and identified the weak performer(s) action has to be taken to change the performance of the store(s). Here are some suggested tactics based on what measures are below standard. Many owners have identified the largest contributor to store problems is often the Store Manager! You have to involve the Store Manager in all of the suggestions and as a last resort, you may want to replace the Store Manager to see if that improves results before you consider closing the store.

If This Is Low	Examine This	Try This
<b>Store Contribution Margin</b>	<ul style="list-style-type: none"> <li>&gt; <b>Occupancy cost</b> <ul style="list-style-type: none"> <li>· Rent</li> <li>· Percentage rent</li> <li>· HVAC charges</li> <li>· Maintenance contracts</li> <li>· Telephone/communication charges</li> </ul> </li> <li>&gt; <b>Payroll</b> <ul style="list-style-type: none"> <li>· Staff hours</li> <li>· Staff salaries</li> </ul> </li> <li>&gt; <b>Other expenses</b> <ul style="list-style-type: none"> <li>· Bank charges</li> <li>· Insurance</li> <li>· Supplies</li> <li>· Advertising</li> <li>· Donations</li> </ul> </li> <li>&gt; <b>Excessive markdowns or allowances at POS</b></li> </ul>	<ul style="list-style-type: none"> <li>&gt; <b>Challenge each cost and speak with the Store Manager about trying to reduce costs such as maintenance, HVAC and communication costs</b></li> <li>&gt; <b>Examine the markdown log<sup>1</sup> to see if this store is above others on markdowns</b></li> <li>&gt; <b>Talk to the landlord and try to get a rent reduction or a change to pure percentage rent</b></li> <li>&gt; <b>Reduce full time staff and increase part time staff</b></li> <li>&gt; <b>Convert to a commission plan that will fix payroll costs at a known percentage of sales</b></li> <li>&gt; <b>Convert the store into a clearance or outlet concept</b></li> <li>&gt; <b>Sub-let the store if all else fails</b></li> <li>&gt; <b>Will “walking away” from the lease be less expensive than staying?</b></li> </ul>
<b>Sales Per Square Foot</b>	<ul style="list-style-type: none"> <li>&gt; <b>Is the store too big?</b> <ul style="list-style-type: none"> <li>· What is the comparison to other stores in the company?</li> <li>· Does the store always look half full?</li> <li>· Are there constant out of stocks?</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>&gt; <b>Prepare a core inventory list and test the store in stock rate</b></li> <li>&gt; <b>Consider re-setting the store fixtures</b></li> <li>&gt; <b>Consider reducing the size of the selling area</b></li> </ul>
<b>Net Profit</b>	<ul style="list-style-type: none"> <li>&gt; <b>Are you assigning corporate overheads equally or on a weighted basis?</b></li> <li>&gt; <b>Are there any overheads that should not be assigned to this store?</b></li> </ul>	<ul style="list-style-type: none"> <li>&gt; <b>If you are not using weighted assignment of overheads then use it</b></li> <li>&gt; <b>Only assign direct overheads that can be rightfully charged to the store</b></li> </ul>
<b>Average Transaction</b>	<ul style="list-style-type: none"> <li>&gt; <b>Are you giving staff information on AT performance on a daily basis?</b></li> <li>&gt; <b>Do you have any incentives in place to increase AT?</b></li> </ul>	<ul style="list-style-type: none"> <li>&gt; <b>Increase training on suggestion and trade up selling</b></li> <li>&gt; <b>Make AT a critical performance measure</b></li> <li>&gt; <b>Post it every day in back of store and incent staff with contests/bonuses to increase</b></li> </ul>
<b>Items Per Ticket</b>	<ul style="list-style-type: none"> <li>&gt; <b>Are you giving staff information on IPT performance on a daily basis?</b></li> <li>&gt; <b>Do you have any incentives in place to increase IPT?</b></li> </ul>	<ul style="list-style-type: none"> <li>&gt; <b>Increase training on suggestion and trade up selling</b></li> <li>&gt; <b>Make IPT a critical performance measure</b></li> <li>&gt; <b>Post it every day in back of store and incent staff with contests/bonuses to increase</b></li> <li>&gt; <b>Make sure you are stocking the store with related items</b></li> </ul>
<b>Conversion Rate</b>	<ul style="list-style-type: none"> <li>&gt; <b>Do you measure traffic?</b></li> <li>&gt; <b>Do you measure the conversion of traffic to buyers?</b></li> </ul>	<ul style="list-style-type: none"> <li>&gt; <b>Install traffic counters</b></li> <li>&gt; <b>Balance peak traffic times to peak staff times</b></li> <li>&gt; <b>Establish a customer/associate ratio (i.e., ideal is no more than 5 customers for each sales associate at peak times)</b></li> <li>&gt; <b>Conduct exit interviews with non-buyers to find out reasons for not buying</b></li> </ul>

<sup>1</sup>A Markdowns log is the list of reasons for each markdown taken as well as amount of markdown.



## >> 4 – If No Significant Change Occurs, Decide To Either Close The Store Or Change The Concept (possibly make it a clearance our outlet store)

Sometimes the decision to close a store will be made based on the low contribution to total company operating expenses that the store has delivered. However, it may not be a wise option.

Here is an example of a low contribution store and the impact of closing it.

**Example 3**

	Before	After Closing 1 Store
<b>Total Sales</b>	<b>\$10,000,000</b>	<b>\$9,500,000</b>
<b>Total Contribution</b>	<b>\$4,000,000</b>	<b>\$3,900,000</b>
<b>Total Company Overheads</b>	<b>\$3,850,000</b>	<b>\$3,825,000</b>
<b>Net Profit</b>	<b>\$150,000</b>	<b>\$75,000</b>

In the above example, even though the contribution of the store that is now closed was not great, it still contributed to company overhead and without that contribution of both sales and margin, the net profit was reduced. So, the decision to close a store should be measured against the impact on total company net profit if the store contribution goes away. If the store is not contributing at all or is operating at a loss, the decision to close it if intervention does not increase contribution is the right one.

In conclusion, it is crucial to the health of your company that you critically and constantly examine the performance of all of your stores and identify those stores that are not meeting minimum profit goals. The best measures to keep an eye on weekly are SPSF and the AT, IPT and CR measures. Often these will begin to turn bad long before you can see it on the store contribution report. So, look at these measures on a weekly basis and take action before the store cannot be saved.

Ignoring the problem or hoping that it will solve itself is simply not an option.



## WINNING STRATEGIES FOR **THE RETAIL INDUSTRY**

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