UNIT 7 MANAGING FINANCIALS AND OPERATIONS PERFORMANCE

Structure

7.0 OBJECTIVES

After going through this unit, you should be able to:

- know how to plan for Profits;
- describe the asset management;
- explain the allocation of resources;
- describe the inventory management;
- discuss the credit and cash management; and
- explain the outsourcing strategy.

7.1 INTRODUCTION

Every retailer who works with long term goals and strategies need to manage its financial and operational performance in the best possible way. This facilitates the retailer in achieving the objectives of the firm in the most efficient manner. The retail firm requires to manage its operations well to provide satisfaction to its customers, employees and the management. In this unit, you will learn the financial performance like planning for profits, asset management, and resource allocation; as well as operational aspects like inventory management, credit and cash management and outsourcing that affect operational performance.

7.2 PLANNING FOR PROFITS

Profit planning is done on the basis of profit and loss statement. It is a statement which provides summary of major components of retailer's sales revenue and operational expenses for a month, quarter, and yearly basis. Based on the profit and loss statement the retailer is able to determine if it is making profit or loss, and can take corrective steps to improve upon the expenses or revenue items by formulating new strategies and goals to reach the profitable state.

Source: http://www.businessihub.com

Figure 7.1: Profit Planning on the basis of P/L Statement

By making comparative analysis of profit and loss statements for the same period, the retailer is able to decide which elements of the revenue show growth similarly by comparing elements of operating and other expenses the retailer can identify those elements which show increase or decline, and accordingly decide on the actions to be taken in the coming period of time.

A profit and loss statement consists of the following major components:

Net sales, cost of goods sold, gross profit, operating expenses, taxes, and net profit after taxes.

Look at Table 7.1 which shows the profit and loss statement of a ladies apparel firm for the six months period.

Table 7.1: P/L Expenses for a Ladies Apparel Stores Chain for the Period April to September 2011.

PARTICULARS	AMOUNT
INCOME:	**3,63,58,746.00**
INCOME FROM OERATION	3,62,83,783.00
OTHER INCOME	74,963.00
TOTAL EXPENSES:	**3,28,29,593.00**
RAW MATERIAL CONSUMED	1,04,83,913.00
OTHER PURCHASE	14,70,608.00
AQUIRED MATERIAL (EBO)	1,59,472.00
INCREASE/DECREASE IN WIP (factory)	87,23,502.00
INCREASE/DECREASE IN CLOSING STOCK (Warehouse)	-1,12,11,155.00
OTHER MANUFACTURING EXPENSES	7,37,407.00
COST OF GOODS SOLD:	**1,03,63,747.00**

GROSS PROFIT:	**2,59,94,999**
ADMINISTRATIVE EXPENSES	65,06,943.00
EMPLOYEES REMUNERATION & BENEFITS	1,00,74,278.00
FINANCE CHARGES	20,85,873.00
SELLING EXPENSES	31,98,752.00
DEPRECIATION	6,00,000.00
OPERATING EXPENSES:	**2,24,65,846.00**
PROFIT BEFORE TAX:	**35,29,153.00**
TAX:	**10,58,746.00**
NET PROFIT AFTER TAX:	**24,70,407.00**

You should learn and interpret the above profit and loss statement with respect to the main elements of revenue and expenses.

a) **Net sales:** It represents the net sales amount after deduction of state sales tax or central sales tax, discounts given to employees and customers, and customer returns due to defect in the apparel. In the above statement 'Income from operation' represent the net sales revenue of ladies apparel.

   The other income represents revenue from sale of scrap material generated during manufacturing operation.

b) **Cost of goods sold:** It represents the total expenses incurred for manufacturing of the goods (ladies apparel) as well as the cost incurred for procuring goods from other vendors. When the retailer has to decide on the cost of goods procured from other vendors it has to include freight charges less cash discounts or rebates received against the procured goods. In the above table the following expenses represent the cost of goods sold.

   - Raw material consumed (raw material like fabric and trimming material used)
   - Other purchase (packing material used for packing of goods)
   - Acquired material (this is the cost of material procured from other vendors)
   - Increase or decrease in work-in-process (this is the WIP in the retailer's garment manufacturing factory). When the value shown is in positive figure under expenses statement, it means the closing stock figure is less than the opening stock figure; thus, indicating that there is positive addition to manufacturing expenses or cost of goods sold. This is done to take effect of expenses incurred in a running operation during the period under consideration.
   - Increase or decrease in closing stock at warehouse (this is the stock at the finished goods warehouse). The negative value indicates that the closing stock is more than the opening stock and thus the increase in stock value is to be reduced from the expenses. This is done to reduce the expenses for the goods that are not part of the sales, but as part of the running operation has to be received in the warehouse, and hence, to be accounted suitably.
   - Other manufacturing expenses (this are the expenses incurred for making of merchandise or printing or embroidery etc.). It also includes the salary and wages paid to direct and indirect labour as well as staff working in the factory.

Thus, the total cost of goods sold works out at ₹10363747, which is arrived at by summing up all the above cost elements.

c) **Gross Profit:** It is the difference between Income and cost of goods sold.

d) **Operating Expenses:** These are all those expenses that are necessary to run a retail business. It includes the expenses as detailed here below.

i. **Administrative expenses:** These are inclusive of rentals, maintenance expenses, local conveyance, electricity charges, water charges, printing charges, carry bags, etc. The elements of the administrative expenses can be dependent on the type of retailer.

ii. **Employees remuneration and benefits:** It includes salary and wages paid to permanent and temporary staff and labour at the front end i.e. on the floor of the store (store managers and sales representatives) and those in the field (regional sales executives); as well as staff and labour at the back end like warehouse labour and staff, buying and merchandising staff, designing team, purchase team, accounts, etc.

e) **Finance Charges:** It includes company's overdraft facility with the banks, for taking short term loans as per the banking limit for meeting working capital needs. It may also include payment of interest charges to individuals providing private loans.

f) **Depreciation:** It includes depreciation as per income-tax rules on the assets of the retail company. It will include plant and machinery of the factory besides assets like fixtures and display articles, computers etc. at the store level. The rate of depreciation on different assets is as per statutory rules.

The total operating expenses covering the above elements works out at ₹ 22465846.

g) **Tax:** It is the income tax payable to the government as per statutory rules. In the above statement the same is not shown. The rate of taxation is based on the amount of net profitability after necessary adjustments.

h) **Net profit after tax:** This is the true profit of the retailer after deduction of all expenses and taxes as applicable. It may be used for payment of dividends to shareholders in case of public limited companies, or to the investors in a private firm. The balance amount is transferred to balance sheet as part of reserves and surplus.

7.3 ASSET MANAGEMENT

You have already learnt how the current operation affects the revenues and expenses of the retail business thereby determining the profit or loss of the business. This is an important indicator of the retailer's control on both the financial and operational aspect of the day to day running of the business. But, besides the current operation the retailer's strength and weaknesses are also determined by the figures given in the balance sheet of the retail business.

Balance sheet represents the corporate strength of the retail business. It comprises retailer's assets, liabilities, and net worth as on the date of the balance sheet preparation. Generally as per statutory rules every retailer must prepare balance sheet at the end of the financial year. In India the financial year is from 1st April to 31st March.

In order to understand the balance sheet. Look at Table 7.2 which shows the Balance Sheet for a specialty retail store

Table 7.2: Balance Sheet for a Specialty Retail Store

Liabilities	Amount (₹)	Assets	Amount (₹)
Current		**Current**	
Expenses to employees	300000	Cash on hand	950000
Accounts payable	1600000	Inventory	1800000
Short term loans	50000	Accounts receivable	75000
Taxes payable	650000		
Total	**2600000**	**Total**	**2825000**
Fixed		**Fixed (Depreciated value)**	
Mortgage	4850000	Property	9350000
Long-term loan	350000	Building	3100000
Total	**5200000**	Store Fixtures	750000
Equipment	150000		
Total Liabilities	**7800000**	**Total**	**13350000**
Net Worth	8375000		
Liabilities + Net Worth	**16175000**	**Total Assets**	**16175000**

From the above it will be seen that total assets are equal to total of liabilities plus net worth. It will be seen in the above statement of balance sheet that Assets consists of Current assets and fixed assets. Current assets consist of all those elements which are either in cash or can be converted into cash in the near future.

Hence, it comprises cash on hand, inventory, accounts receivable. Fixed assets comprise those assets that are meant for long term use and not so easily convertible to cash. It consists of property like offices, warehouse, store premises, etc.; factory building, independent store, etc.; fixtures used in the stores; and equipment like computers, cash registers, machines, etc. fixed assets are normally taken at the current depreciated value. Though the fixed assets are taken at depreciated value the assets like building and property may be in actuality at high value than the value shown in the balance sheet due to appreciation of real estates.

Liabilities are also divided in to two parts viz. current and fixed or long term. Liabilities represent the retailer's obligation to banks or private lenders on account of borrowings from them to run the retail business. Current liabilities represent the dues payable by the retail firm during the current financial year. It includes salaries and expenses payable to employees, taxes like TDS payable, amount payable to suppliers, and short term loans from private lenders or banks. Fixed liabilities comprises long term loans from the banks and private lenders, which are to be re-paid over a pre-decided period.

Net worth comprises the shareholders fund (for big retailers which are public limited companies), owner's fund (for small retailers), private equities (from private equity holders) plus the reserves and surplus. Reserves and surplus is an accumulated fund from the transfer of balance net profit to balance sheet over the years of retail operation.

Important Financial Parameters for Assessing Retail Business

A retailer must ensure that the investment done by various stakeholders in the retail business is managed very well, and to assess this performance retailer needs to keep under control the performance on parameters like net profit margin, asset turnover, and financial leverage. Let us understand each of these parameters.

a) ***Net profit margin:*** It is the most important and the basic parameter which not only a retailer but every kind of business is concerned of. Profit margin is defined as "percentage of net profit after taxes over net sales", as shown here below:

Net Profit Margin = Net Profit after Taxes ÷ Net Sales

Let us analyse the net profit margin per cent for the ladies wear retailer as shown in Table 7.1.

The profit margin for the ladies retailer works out at 6.79 percentage of the total income. The retailer will have to compare this percentage margin with other ladies wear retailers in order to understand if its performance is better than the industry norms. It is clear that for the retailer to improve on profit margin, the net profit after tax needs to be improved, which is possible only by raising the gross margin or its initial mark-up on its product range. But it is not an easy task as in the process of increasing profit margin it must not lose on the existing customer base, which may bring down its sales turnover. There is another option with the retailer to improve profit margin, by reduction in the elements of operating expenses or its manufacturing and procurement cost. But, all the reductions to be achieved without compromising on the product quality or service quality, if these are the very qualities for which reason majority of its existing customers are loyal to the retailer. Let us list down the options available to a retailer to improve its profit margin percentage:

- Purchasing at well negotiated prices or in quantity to avail price rebates or cash discounts;
- Selling private labels or exclusive products;
- Offering special promotions during weak seasons to maintain good walk-ins and sales;
- Providing good service to customers, so as to nullify competition effect;
- Having a good proportion of product range with higher margins;
- Lowering labour cost through self-service, wherever possible, and better utilization of staff;
- Lowering energy cost by use of proper lighting and cooling products;

b) ***Asset turnover:*** This measures the performance of retailer's asset with respect to the sales turnover. An asset whether fixed or current should provide certain utility to the business; and thus, it becomes important to know whether all the elements are being put to proper use. The formula for assessing the performance of the asset is as follows;

Asset Turnover = Net Sales ÷ Total Assets

For a specialty store example given in Example 7.1, and using the sales turnover of table 7.1 the asset turnover works out as follows:

Asset Turnover = 3, 63, 58,746 ÷ 1, 61, 75,000 = 2.2478 ˜ 2.25

To assess if the above turnover ratio is good or poor one needs to compare it with the industry norm or the trend. Generally for an apparel showroom the above ratio does indicate a better performance of the assets. The above figure tells us that for every rupee invested in the asset, the retailer is earning sales of rupees 2.25. To improve the performance of the asset the retailer must improve the sales turnover using the same level of assets or it should maintain the same sales turnover while reducing its asset like say, accounts receivable or inventory in the current asset and may sell-off land or building which is not in much use or rationalize its investment in fixtures and interiors.

Some of the ways in which the retailer can improve sales are as follows:

- Accepting orders on internet or introducing web based orders;
- Training of sales staff to do cross sales and upgrade the customers to high priced products;
- To keep the store open for longer hours;
- To have a tie-up with good brands for cross promotions, so as to attract new and existing customers to the store;
- Keep popular brands that may have their own promotions happening at various point of time.

c) ***Return on Asset:*** It is a measure which takes into account the profit margin as well as the asset turnover ratio. It measures the return or profit earned by the assets. Thus the measure is derived by using formulas as explained here below:

Return on Asset = Profit Margin Percentage × Asset Turnover
Return on Asset = (Profit Margin ÷ Net Sales) × (Net Sales ÷ Total Assets)
Return on Asset = Profit Margin ÷ Total Assets

In the working given above the return on assets works out as follows:

Return on Assets = 6.79% × 2.25 = .0679 × 2.25 = 0.1528 = 15.28%

We need to assess the performance of the asset in terms of earning returns with the current bank rate of interest being offered, to know if the returns are better than the bank rate or in other words the opportunity cost. Thus, from the formula given above it is clear for earning better returns either the profit margin need to be higher or the asset turnover ratio needs to be higher, as the multiplier effect of the two ratios determine the return on assets.

d) ***Financial Leverage:*** This is a measure derived from the balance sheet statement of the retailer. It measures the relationship between a retailer's total asset and its net worth. The formula for measuring financial leverage is as follows:

Financial Leverage = Total Assets ÷ Net Worth

In our example 7.1, the financial leverage is calculated as follows:

Financial leverage = 16175000 ÷ 8375000 = 1.93

From the above financial leverage value we know that the share of net worth is almost half of the total assets, thus, indicating that the liabilities are equal to net worth, thereby suggesting that the situation is under control. It is always useful to know if the financial leverage is as per the trend or norm for the given industry.

If the financial leverage is greater than two, it indicates that the debt is higher than the net worth, thus reducing the financial leverage of the retailer to take more debt for improving its business or undertaking any expansion of its business. A ratio of 1 means the debt is zero.

When the ratio is high the retailer is forced to concentrate on cost cutting measures to improve its cash flow and thereby repay interest and principal amount against the debt. Also the retailer has to take measures for generating cash flow, which is usually done by providing more discounts and mark-downs for attracting consumers and increasing the sales revenue. But such measures brings the profit margin down and further push the retailer into taking more loans for meeting its routine needs like salary payments to staff and other operational expenses including payment to suppliers. All such acts force the retailer towards bankruptcy position due to getting into a vicious circle. Hence, retailer must keep a close watch on its financial leverage and take timely action if it is going out of hand.

It must be also noted that a low financial leverage is also not good as it indicates a conservative approach of the retailer, which may push the retailer into non-expansion and stagnation mode. Such retailer tends to remain satisfied with the current growth rates, and do not take any proactive measures to make improvements in the current business or venture into expansion of the present business or get into new business. Thus, providing clear path to competition to take a leadership position or invite more number of competitors to eat into its share of the business, which may lead to drop in sales revenue and profitability over a period of time. A financial leverage of around 2 to 3 is considered reasonable.

e) ***Return on Net Worth:*** It is also known as strategic profit model. Berman B and Evans R J (10th edn., 2008) have explained the model vide Figure 7.1:

Net Profit Margin	X	Asset Turnover	X	Financial Leverage	=	Return on Net Worth

Figure 7.2: The Strategic Profit Model

Return on net Worth (RONW) is very useful in planning of assets as well as for taking timely action with respect to different financial ratios. For example if the RONW is poor as compared to the industry norm or as compared to the bank rate of interest on long term deposit; then it can immediately check the different ratios vis-à-vis industry norms or average and can make relevant conclusion about the reasons for the same and take suitable steps for improving the same. The main reason for poor RONW is either due to weak asset turnover ratio or low financial leverage. For improving the RONW the retailer can take measures as follows:

Improving the profit margin by taking steps as discussed in the profit margin section.

Improving asset turnover ratio as explained in the section on asset turnover; or

Improving financial leverage, by taking suitable steps, while not crossing the limits.

Let us calculate the RONW for the specialty retail showroom using the data of example 7.1 and Table 7.1.

Return on Net Worth ratio × Financial leverage	**=**	**Net Profit margin percentage × Assetturnover**
	=	6.79% x 2.25 x 1.93
	=	0.2949 = 29.5%

So by checking the above return on net worth with the apparel industry norm, we can come to conclusion if the performance is above average or below average.

It is being observed that the profit margin percentage of general merchandise is higher as compared to that of food retailers; but food retailers have better asset turnover ratio as compared to that of general merchandise retailers. Apparel retailers normally have higher net profit margins and better financial leverage compared to other retail businesses. It is important while analysing RONW, which component of the ratios have contributed majorly to the poor or good performance.

Other Key Financial Ratios

Following ratios need to be also understood by the students of retail management in order to know how these ratios affect the retailer's performance in financial terms.

1) ***Current ratio:*** It is calculated by dividing total current asset (cash, accounts receivable, inventories, marketable assets or securities) by total current liabilities (those due within one year). A ratio of 2 or more is considered good.

2) ***Quick ratio:*** It is calculated by dividing total of cash in hand plus account receivable by total current liabilities or short term debt. It is also called liquid ratio because it indicates the ability of the retailer to dispose off current liabilities in a given time period. A ratio of 1 or more than 1 is considered good.

3) ***Accounts receivable period:*** It is calculated by dividing accounts receivable or outstanding dues from customers by net sales and then multiplied by 365 days to calculate the equivalent period of collection for a store. If the retailer is taking more days than the required credit period, then it will affect its turnover ratio.

4) ***Accounts payable to net sales***: It is calculated by dividing accounts payable amount by the net sales. If the percentage is higher than the industry norm, then the retailer needs to take care as the suppliers may then spread a word around about retailers capability to pay, and this may result into suppliers jacking up their prices to cover up for delays in payment as well as security risk.

Check Your Progress-A

1. Briefly comment on the following statements.

a) Profit planning is done on the basis of profit and loss statement.

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b) Gross Profit is the difference between income and cost of goods sold.

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c) Operating expenses are necessary to run a retail business.

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d) The rate of depreciation on different assets is as per statutory rules.

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e) Balance sheet represents the corporate strength of the retail business.

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2. **Fill in the blanks with the appropriate word given in the brackets**

   a) Retailer must prepare balance sheet at the end of the _____________ year. **(Financial / Assessment)**

   b) Apparel retailers normally have _______net profit. **(Higher / Lower)**

   c) To improve the performance of the asset the retailer must improve the __________ turnover. **(Sales / Profit)**

3. **State whether the following statements are True or False**

   a) Return on net Worth (RONW) is not useful in planning of assets.

   b) When the ratio is high the retailer is forced to concentrate on cost cutting measures.

   c) Low financial leverage is not good as it indicates a conservative approach.

7.4 ALLOCATION OF RESOURCES

It is important for a retailer to understand the quantum of the resources being allocated to a particular form of asset and the productivity of the asset, because these two factors have important impact on the asset management and budgeting.

i) ***Magnitude of Expenditure:*** Spending are of two types: a) ***"Capital expenditure"***, which involves investment in long term investment in fixed assets and b) ***"Operating Expenditure"***, which are administrative and operating expenses meant for running the business, also called as working capital. As mentioned above the retailer must have good understanding of the ***magnitude of these costs.***

Due to the limitation of resources many a times the retailer has to decide between the operating expenditure and the capital expenditure. For example it may have to decide between renovating the existing stores, which involves capital expenditure; and expenditure on inventory, extra space on rent and personnel in the existing stores, which are part of its operating expenditure. The retailer feels both the expenses are necessary for improving its present turnover but does not know which one is to be prioritized. For this purpose the retailer may be required to estimate the additional turnover that may be generated from each of the expenditures, which he may have to assess against the opportunity cost (the possible benefit the retailer forgoes if it invest in one opportunity vis-à-vis the other), for knowing which of the expenditures is giving him better returns as compared to the opportunity cost.

As mentioned by Berman B and Evans J (10^{th} edn., 2008), the average capital expenditure covering investments in building, air-conditioning, electrical fittings, floorings, fixtures, ceilings, interiors, signage and roofing for an apparel specialty store in 2005 was about US$ 1.8 million and that for a department store was US $ 11.8 million. These costs do not include the investment in building and merchandise.

The operating expenses, expressed as a percentage of sales, covering selling, general, and administrative expenses ranges from 20 per cent or so in super markets to over 40 per cent in some specialty stores. The retailer needs to understand that he has to keep his operating expenses in line with the industry average and possibly better than that of competitors'; and must closely keep them under check for business success.

ii) ***Productivity of Expenditure:*** For measuring the efficiency of the expenditure made in various elements of costs, retailer needs to have an effective method for doing so. One of such effective methods is to measure the productivity of the expenses that helps to determine the efficiency of the given expenditure. The productivity can be expressed in terms of a) costs as a percentage of sales, b) profit margins earned, c) sales per square feet, d) sales to stock ratio or inventory turnover, and so on.

While measuring productivity of resources, the retailer needs to do so on like to like basis. For example when the retailer is measuring the profitability per square feet for a department store then it must compare with another department store selling similar kind of merchandise to measure the effectiveness of its retail strategy, and not with a full line discount store or a store using a different format of retailing. Similarly while measuring increase in sales; the same should be measured for the same period vis-à-vis same stores, because measuring with different seasonal periods and stores will not give a comparable measure either due to seasonal effect or difference in selling square footage.

Retailers can use the following measures, among others, to improve productivity of its resources:

- Improving employee performance by regular training programs;
- Improving sales per square feet through advertising and sales promotion;
- Reducing costs through automation in ware-housing processes and billing methods;
- Keeping employee costs under control by way of complementing permanent staff with temporary employees during peak selling periods or part of the day;
- Taking help of suppliers in doing certain tasks like price labeling, keeping track of replenishments, offering discounts on slow moving merchandise and so on;
- Closing non-profitable or less efficient old stores and opening new stores with better trained staff, automated systems, and efficient check-outs and security methods.

7.5 INVENTORY MANAGEMENT

Inventory management is the heart of store operations as the right type of merchandise assortment ensures that the retail store is able to achieve maximum sale possible, any mistakes in the right monitoring and management of inventory may result in loss of sales, result into higher proportion of slow moving merchandise, more mark-downs, and finally loss of profit margins.

The issues that need to be tackled in managing inventory can be listed as below:

- It is important that the merchandise from different suppliers or brands need to be co-ordinated into a proper assortment that will ensure that consumers needs are covered to the fullest. Even if a particular item/brand with certain attributes is unavailable the merchandising team will have to ensure that there is an alternative substitute is available, thereby the consumer do not have to go empty handed.
- The retailer or its merchandising team's one of the major task is to ensure that the available space is put to proper and best use so as to give maximum returns on the investment in space. This is possible only when there is balance between the quantum of merchandise on the sales floor and the back-room, and the ware-house. The balance must ensure that there are immediate replacements are available in the back-room, when any particular SKU is sold out, so as to ensure the proper range is available without any size breaks or missing colours or with any other important feature. The ware-house should ensure that the movement of fast moving merchandise is made in reasonable time to the store's back-room.

- The number of times the inventory is to be moved from the back-room to the front area during the day. This becomes particularly important for super-markets where certain times of the day are very busy, and any non-planned way of replacement of inventory may cause disturbance and hurdle in the free movement of customers, thereby causing irritation to customers. In case of apparel stores the merchandise has to be moved to the sales floor area and may have to be either displayed in the show window or on the mannequin or on the shelves. Thus, all such actions call for a well-planned system of replenishment.
- Many a stores keep the store closed for certain hours during the day, so that these hours could be used for other non-selling activities like taking physical count of inventory, replacing the sold out SKUs, arranging the displays, changing the visuals, cleaning the sales floor, and other house-keeping activities. Some stores also use such time for training of sales staff or appraising the staff about the performance of the day and task ahead. The management may also do check on stock turnover ratio of the day and apprise sales staff about the same, and decide on tactics or strategy to be used for the remaining part of the sales hours of the day.
- The merchandising team may have to decide on the just in time delivery vis-à-vis the shipping cost and thereby come to a conclusion on how much stock to be held in the ware-house or the back-room of the store. The merchandising team also have to decide on the logistics involved in the delivery of merchandise and thereby determine the frequency of supplies and the quantity to be supplied per such delivery for optimizing on the delivery cost without losing on sales opportunity. For some states like West Bengal the merchandising team have to take into account the weigh-bill processing time for deliveries to be received in West Bengal from suppliers located in other states. Similarly, the team must plan the deliveries for goods imported from other countries.
- Many a suppliers have a policy of providing certain essential services free of cost like setting up the visual merchandising and merchandising displays on the sales floor. Hence, it is advantageous for the retail team to involve the supplier's team wherever possible to save on personnel cost, without compromising on the store's standards on visual displays. The supplier's team due to its understanding of consumer choices may be in a better position to ensure that right type of merchandise assortment is highlighted in the display plan. Some suppliers also provide fixtures at their own cost to ensure proper merchandise display – the fixture design could be provided by the retail team.
- Certain items are delivered after booking of orders from the customer, in such cases the retailer has to plan for delivery of items to customer's house or any other location. The retailer may take help of the supplier for making such delivery and installation of the item in case such items need professional services – both for delivery and installation. Merchandise like Refrigerators, Computers, Home-Theatre, Digital TVs, Heavy furniture items, etc. needs to be delivered in good condition and then installed properly to the satisfaction of the customer. The retailer may have its own staff providing such services, and will have to schedule timely deliveries and installations even during peak selling seasons.

The retail team, for better management of inventories, need to be well trained on issues like stock assortment, pricing, category management, mark-downs, replenishments, sourcing etc. The correct understanding of inventory issues will ensure the most efficient and effective management of inventories, which will result in the best use of working capital and higher return on investment.

7.6 CREDIT AND CASH MANAGEMENT

Credit management has become the important part of retail organizations, because more than 70 per cent of the billing transactions at the billing counters in organized retail stores is done through credit card transaction. In case of credit management following decisions need to be made as highlighted by Berman and Evans (10th edn., 2008), and suitably elaborated here below:

- Retailer will have to clearly state whether credit cards are acceptable, and if yes, then whose credit cards (whether Visa or Master or American express etc.) are acceptable. In the Indian scenario in many of the organized retail stores, retailers normally allow payment by Cash or Credit card or Debit card. In foreign countries retailers may accept cheques too.
- As mentioned above it is important for the retailer to have clear understanding with major credit service providers like Visa or Master or American express and specify the same near the billing counter as well as near the entrance point, so as to make the policy clear to the consumers entering the store for purchases.
- Many retailers in foreign countries have their own credit card services and provide the same to customers who are found eligible on factors such as age, type of employment, income, residential proofs, bank reference etc. in India too retailer like Croma (the large format electronics merchandise retailer belonging to TATA group) has also started offering its own credit card to customers who can satisfy certain eligibility criteria. The customer using such credit cards, offered by the retailer itself, gets dual benefit of credit plus bonus points which can be redeemed in the next purchase.
- In case where the retailer offers its own credit card needs to determine the credit terms like free credit period, rate of interest chargeable, when interest charges begin to accrue, and minimum payable amount against the credit purchases. The retailer will also need to decide on method of handling late payments and their collection. Retailers may use the services of outside collection agency for such collection of due payments.
- Retailers also specify the minimum amount for which the credit card transaction is valid. This is done to avoid use of credit card processing for a small amount transaction thereby saving retailer's processing time and related hassles.

The retailer has to weigh the benefits of using credit card facility in terms of increase of sale vis-à-vis the processing and follow-up necessary for reconciliation of payments received or credited to its account. Normally, the retailer who accepts credit cards need to link all such card transactions/swiping of cards to its account opened with a bank especially for credit card transaction facility. The retailer receives every day a statement from the bank or can link to bank website through a special password for directly viewing the credit transactions entered into the system and amount credited to its account after due deduction of credit transaction fee (about 1.5 per cent of billing transaction against credit card). The retailer needs to reconcile such bank account statement with its day-to-day retail billing against credit card transactions/swiping.

In case of cash transaction against billing, retailers as they are located far and wide have arrangement with the main banker to provide cash collection facility from the security point of view. This is particularly true for retail network of franchisee and exclusive business outlets directly under the control /owned by the brand-company. The store manager of such retail stores need to maintain proper register of day to day cash transactions, the number of such bills, the amount collected, the amount deposited with the bank, and the amount balance in the store locker for providing cash change to customers and meeting cash expenses as per company policy.

Sometimes the retailer also needs to manage the manual billing operation if the POS (point of sales software used for billing purpose) system is not working either due to system failure or power failure. In case of manual billing the transaction is done against cash payment only, and such manual billing needs to be verified by company auditor during monthly inspection and need to be entered into the system for proper updation of billing record and cash transaction.

7.7 OUTSOURCING

In retail industry outsourcing is being practiced extensively, as more number of retailers is finding outsourcing certain tasks which they used to do it previously themselves as being more economical and being better managed by outsourced parties. Under outsourcing the retailer pays to an outside party for doing certain tasks that form part of its operating functions. The tasks that are currently being outsourced to an outside party by retailers are as follows:

- Security operation: Many large and small format stores use an outside agency to maintain security check both on the staff movement as well as consumer movement. This task also frees the internal staff from conducting security check on its own staff or on consumers, which in tricky situation may escalate into feud or bias among the retail staff, or in case of provoking situation the retailer is in a better situation to diffuse the situation by claiming the security being with an outside party will have to make a check about the situation. Troublemakers will be much wary about an outside security as compared to that of an internal security.
- Internal maintenance operation: Retailers have started using outside parties for maintaining electrical installations and equipment, as well as air-conditioning equipment. Thus, freeing the internal staff from such a technical function, requiring well qualified staff. The retailer whose stores are widely spread may not find economical to have its own staff performing the said function – like appointing separate technically qualified staff for each of its stores. The outsourcing party, since it undertakes the maintenance responsibility of more than one retailer, will find the same much more economical to do so.
- POS system and computer maintenance: Many retailers go in for private point of sales (POS) softwares for their billing operations along with maintenance of computer and billing machines. Such an integrated service from an outsourced party ensures that the billing operation, which is the crucial part of retailing happens non-stop, thereby ensuring satisfaction to consumers.
- House-keeping: This is another activity which needs to be performed on daily basis without fail to maintain cleanliness on the shop-floor. Again the retailer would find it burdensome if it has to employ separate staff on its pay-roll.
- Visual merchandising: Specialty retailers of a particular category like apparels, jewellery, life-style merchandise etc. may find employing a separate staff to do the visual display including window display uneconomical, because the staff would be free once the display work is finished in the morning hours. Thus, using an outsourced agency with better experienced staff in the visual merchandising operation will be able to perform the task at a reasonable cost and with much more finesse and expertise.
- Sales staff training: Retailers have also started outsourcing sales staff training to human relations experts, as the outsourced expert agency will be in a better position

to conduct the training of staff at different locations on a regular basis, with better training inputs based on its experience with different types of retailers and formats.

Earlier retailers used to outsource certain functions to an outside agency because they were not experienced in the said function or were finding it uneconomical. But nowadays retailers are doing outsourcing from a positive perspective, as they find concentrating on their key tasks like buying, merchandising, category management, marketing, sales promotion, service, etc. much more advantageous as it helps the retailers create distinction and differentiation for themselves through their expertise in one or some of these functions, which they would like to keep it with themselves.

There are other functions like accounts; ware-housing operation, logistics, transportation, recruitments, personnel administration, etc. are being increasingly outsourced by retailers.

7.8 LET US SUM UP

- The retail firm which manages its operations well by effective and efficient implementation of tasks and policies so as to provide satisfaction to its customers, employees and the management is also able to manage its financial and operational performance in the best way.
- Based on the profit and loss statement the retailer is able to determine if it is making profit or loss, and can take corrective steps to improve upon the expenses or revenue items by formulating new strategies and goals to reach the profitable state.
- Balance sheet represents the corporate strength of the retail business. It comprises retailer's assets, liabilities, and net worth as on the date of the balance sheet preparation.
- A retailer must ensure that the investment done by various stakeholders in the retail business is managed very well, and to assess this performance retailer needs to keep under control the performance on parameters like net profit margin, asset turnover, and financial leverage.
- Net profit margin is the most important and the basic parameter which not only a retailer but every kind of business is concerned of. Profit margin is defined as "percentage of net profit after taxes over net sales".
- It is clear that for the retailer to improve on profit margin, the net profit after tax needs to be improved, which is possible only by raising the gross margin or its initial mark-up on its product range.
- In the process of increasing profit margin retailer must not lose on the existing customer base, which may bring down its sales turnover.
- Asset turnover measures the performance of retailer's asset with respect to the sales turnover.
- An asset whether fixed or current should provide certain utility to the business; and thus, it becomes important to know whether all the elements are being put to proper use.
- To improve the performance of the asset the retailer must improve the sales turnover using the same level of assets or it should maintain the same sales turnover while reducing its asset like say, accounts receivable or inventory in the current asset.
- Return on Asset is a measure which takes into account the profit margin as well as the asset turnover ratio. It measures the return or profit earned by the assets.

- Financial Leverage is a measure derived from the balance sheet statement of the retailer. It measures the relationship between a retailer's total asset and its net worth.
- It is always useful to know if the financial leverage is as per the trend or norm for the given industry.
- If the financial leverage is greater than two, it indicates that the debt is higher than the net worth, thus reducing the financial leverage of the retailer to take more debt for improving its business or undertaking any expansion of its business. A ratio of 1 means the debt is zero.
- It must be also noted that a low financial leverage is also not good as it indicates a conservative approach of the retailer, which may push the retailer into non-expansion and stagnation mode.
- Return on net Worth (RONW) is very useful in planning of assets as well as for taking timely action with respect to different financial ratios.
- It is important for a retailer to understand the quantum of the resources being allocated to a particular form of asset and the productivity of the asset, because these two factors have important impact on the asset management and budgeting.
- For measuring the efficiency of the expenditure made in various elements of costs, retailer needs to have an effective method for doing so. One of such effective methods is to measure the productivity of the expenses.
- The productivity can be expressed in terms of a) costs as a percentage of sales, b) profit margins earned, c) sales per square feet, d) sales to stock ratio or inventory turnover, and so on.
- Inventory management is the heart of store operations as the right type of merchandise assortment ensures that the retail store is able to achieve maximum sale possible, any mistakes in the right monitoring and management of inventory may result in loss of sales, result into higher proportion of slow moving merchandise, more mark-downs, and finally loss of profit margins.
- Credit management has become the important part of retail organizations, because more than 70 per cent of the billing transactions at the billing counters in organized retail stores is done through credit card transaction.
- The retailer has to weigh the benefits of using credit card facility in terms of increase of sale vis-à-vis the processing and follow-up necessary for reconciliation of payments received or credited to its account.
- In retail industry outsourcing is being practiced extensively, as more number of retailers is finding outsourcing certain tasks which they used to do it previously themselves as being more economical and being better managed by outsourced parties.

Check Your Progress-B

1. Briefly comment on the following statements.

a) Inventory management is the heart of store operations.

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b) Many a suppliers have a policy of providing certain essential services free of cost.

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c) Credit management has become the important part of retail organizations.

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d) Retailers used to outsource certain functions to an outside agency.

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2. Fill in the blanks with the appropriate word given in the brackets

a) Net profit margin is the most important and the __________ parameter. **(Basic / Advance)**

b) Retailers also specify the _____________ amount for which the credit card transaction is valid. **(Minimum / Maximum)**

c) Retailers used to ____________ certain functions to an outside agency. **(Outsource / Offshore)**

3. State whether the following statements are True or False

a) Balance sheet represents the corporate strength of the retail business.

b) Return on Asset is not a measure which takes into account the profit margin.

c) Credit management has become the important part of retail organizations.

7.9 KEYWORDS

Net Sales : It represent the net sales amount after deduction of state sales tax or central sales tax, discounts given to employees and customers, and customer returns due to defect in the apparel.

Cost of Goods Sold : It represents the total expenses incurred for manufacturing of the goods (ladies apparel) as well as the cost incurred for procuring goods from other vendors.

Gross Profit : It is the difference between Income and cost of goods sold.

Operating Expenses : These are all those expenses that are necessary to run a retail business.

Inventory management : Inventory management is above all about specifying the outline and proportion of stocked goods. It is

	required at divergent locations within a capability or within many locations of a supply network to pave the way the usual and planned course of production and stock of materials.
Credit and Cash Management :	It is an imperative part of retail organizations, for the reason that more than 70 per cent of the billing transactions at the billing counters in organized retail stores is done all the way through credit card transaction.
Asset management :	It is often used as the synonym of investment management or fund management. Asset manager is a person that usually specializes in discretionary or advisory management and works with private investors.
Outsourcing :	The contracting or subcontracting of noncore activities to free up cash, personnel, time, and facilities for activities in which a company holds viable benefit. The mandate behind outsourcing is to contracting a business function to someone else

7.10 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress-A

FIB

a) Financial b) Higher c) Sales

T&F

a) False b) True c) True

Check Your Progress-B

FIB

a) Basic b) Minimum c) Outsource

T&F

a) True b) False c) True

7.11 TERMINAL QUESTIONS

1. Explain profit planning with suitable example.
2. What are the main elements of revenue and expenses? Explain briefly each of them.
3. What is the significance of asset management in retailing?
4. Define profit margin and its significance in retail business. List down the options available to a retailer for improving profit margin of the store.
5. Explain the concept of asset turnover.
6. How does one measure return on asset?
7. What is financial leverage? Explain the same with suitable examples extracted from retail business.

8. How does one calculate return on net worth? Explain its importance.
9. Explain the concept of allocation of resources.
10. How does one improve the productivity of the asset? Why it is important?
11. What issues need to be tackled in inventory management?
12. What is the significance of credit management?
13. Why do you think outsourcing has gained importance? Explain with some examples of outsourcing.

7.12 FURTHER READINGS

Books

- Bodie, Kane and Marcus, " Investments", 8th Edition, Irwin, 2009
- Maginn, John L., Donald L. Tuttle, Jerald F. Pinto, and Dennis W. McLeavey, Managing Investment Portfolios: A Dynamic Process, 3rd edition. Hoboken: Wiley, 2007.
- Buffett, Warren E. and Lawrence A. Cunningham, The Essays of Warren Buffett: Lessons for Corporate America, 2nd edition. Carolina Academic Press, 2008.
- Schroeder, Alice, The Snowball. New York: Random House, 2008
- Rappaport, Alfred, and Michael J. Mauboussin, Expectations Investing. Boston: Harvard Business School Press, 2001.
- Bodie, Zvi, Alex Kane, and Alan J. Marcus, Investments, 7th Edition. New York: McGraw-Hill, 2008.

Journals

- Leire San José , Txomin Iturralde and Amaia Maseda "Treasury Management Versus Cash Management" International Research Journal of Finance and Economics ISSN 1450-2887 Issue 19 (2008) , © EuroJournals Publishing, Inc. 2008, http://www.eurojournals.com/finance.htm
- http://cluteonline.com/journals/index.php/JABR/article/viewFile/5907/5985
- http://www.eurojournals.com/ejefas_11_11.pdf
- http://media.wiley.com/product_data/excerpt/03/EHEP0000/EHEP000003.pdf
- http://findarticles.com/p/articles/mi_hb6182/is_2_10/ai_n29454553/pg_6/

Websites and Online Resources

- http://www.bentleycg.com/stuff/contentmgr/files/b94c52c23b9316158d 77981819c 51107/misc/how_to_assess_your_company.pdf
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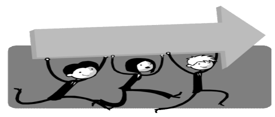
- http://theiam.org/knowledge
- http://www.toolkit.com/small_business_guide/sbg.aspx?nid=P06_7100

Activity 

Visit a HR Department of any hypermarket and explore how the employee performance can be enhanced by regular training programme.

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Note : These Terminal Questions/Check Your Progress/Activity will help you to understand the unit better. Try to write answers for them. But do not submit your answers to the University for Assessment. These are for your practice only.