THE CUSTOMER WHISPERER | BY GREG BILLINGS

How Much Is Too Much?

I remember being 15 years old and looking at a seemingly endless supply of guitars and amps for our new rock 'n' roll department. And I was the first person to touch them — every one of them. I remember grimy shipping dust on the cardboard, the smell of lacquer when guitar cases were opened and the ions in the air when the amps were turned on for the first time.

My father's display reflected the conventional wisdom: customers buy from the store with the biggest selection and the most brands. Unfortunately, there has never been an iota of statistical evidence to prove the highly unlikely proposition that inventory drives sales. Could it be a myth?

CHOICES, CHOICES, CHOICES

As we learn more about how people make decisions, we are discovering that too many choices can cause confusion and may make it harder for customers to decide. So, large inventories might be costing us more than just interest. They could be costing us sales.

The history of musical instrument retailing is littered with the corpses of fully stocked dealers. Do you remember Hale Piano, Holcombe-Lindquist, Fields, Biasco or Mars Music? Neither their massive square footage nor their impressive inventories saved them from the harsh realities of the marketplace. On the other hand, I can't think of any dealers who failed because they didn't have enough inventory. Many of us are nostalgic for our early days in business when the shortage of capital forced us to sell one before we could buy one. Those were the days of fast inventory turn and the profits that funded growth.

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It's not just the musical instrument industry that's enthralled with inventory. Auto dealers advertise 1,000 cars in stock, furniture dealers offer the biggest selection in the Tri-State area, and I understand there's a grocer on the West Coast that keeps 100 varieties of olive oil on hand. But things have changed, and today, it's virtually impossible to have the biggest selection. What book or DVD merchant could possibly compete with the choices on Amazon?

Some retailers present the illusion of a large selection when their displays are a mile wide but really an inch deep. Big-box electronics stores may have a whole wall of flat-screen TVs, but there are probably just a dozen different models. Most of the products in these stores have only one or two options. Wholesale clubs offer massive quantities but often only one choice, unless the choice is between the house brand and the major brand. Elite retailers, such as Apple and Bose, have very narrow product ranges, and the designer boutiques on Rodeo Drive and Fifth Avenue deliberately offer a limited selection.

These retailers know something we don't. Too many choices only serves to confuse customers. Research suggests three options are about the most people can handle. In his intriguing book, *Predictably Irrational*, Daniel Ariely makes a convincing case that the ideal options for both seller and buyer consist of the one they want to buy; one like it with a minor difference, such as color or finish; and a decoy they can easily disqualify.

MAKE THE TURN

Of course, too many choices means too much inventory, and too much inventory eats profit. Nonetheless, we cling to the dream that we can buy our way to success. The old-timers used to say, "You can't sell from an empty cart," as they reached for their order pads. Gerson Rosenbloom candidly attributes buying inventory with credit cards as one of the contributing factors in the demise of his former dealership, Medley Music.

One major manufacturer recently published a stocking requirement that is 50 percent of its dealers' annual sales target. It would be pretty hard to find a CPA or banker who's impressed with a two-time inventory turn. Maybe the reason inventory turns are so anemic in our industry isn't because sales are too low. Maybe our stocking levels are too high. Grocery stores turn their inventory 20–30 times a year, and bakers and fish mongers turn it once a day. Is three times a year too much to ask for guitars?

Calculating an inventory turn is actually easy. Just divide the total cost of goods sold by the total inventory on hand. If the year-end inventory isn't a fair representation, the average inventory level at the end of each quarter will do.

My colleague and financial guru Alan Friedman has an exquisite formula for calculating inventory turn as part of a purchasing decision:

"Take the gross profit percent you expect to achieve and multiply it by 360 (days in a year). The result is how many days you have to sell all quantities of that item. If you can't sell them in that time frame, reduce your order until the answer is yes.

"For example, consider buying a trumpet that sells for $400 and costs $300, producing $100 of gross profit. One hundred dollars represents a 25-percent ($100/$400) gross profit. Multiply 0.25 times 360, and you'll get 90. Ask yourself: Can I sell all of these trumpets in 90 days? If the answer is 'yes,' buy it all. If the answer is 'no,' reduce the quantity until the answer is 'yes.' This formula considers profit and time (or turns) in determining what and how many to buy."

Simply stated: The lower your gross profit is, the faster you must sell the items and vice versa.

AVOID PITFALLS

Alan's formula is a great place to start, and his discipline would improve the bottom line of most music retailers. It's hard to imagine that a music store that turns inventory three times a year wouldn't be highly profitable with excellent cash flow. But even this formula may be too liberal for the selling environment we find ourselves in today. A two-time turn of a 50-percent gross item may be acceptable on paper, but I think we can do even better if we realize that customers neither need nor want as many choices as we are offering. Presenting too many options is probably why our prospects so often tell us they're confused.

Nothing plumps up inventory like carrying competing brands. The allure is that having both lines guarantees a sale, but it doesn't. Too many lines kill turns, confuse staff and customers, and erode vendor relationships. Sometimes, the best thing to do is just decide which product offers the best customer value and profit potential, and commit to it.

Most of us are obsessed with gross margin as the path to net profit, but increasing inventory turn can also generate cash. Let's say you invested $4,000 in a sousaphone that you hope to sell for $7,995 within six months. You'd have a $3,995 gross profit and $4,000 to reinvest. However, if you could sell one unit at $4,995 in one month, generating a $995 GP, and repeated that each month for six months, you would generate $5,970 in GP on the same $4,000 investment. (If you reinvested the profit as you went along, the return would be even greater.)

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Granted, there's a limited demand for sousaphones, and there would have been a few other expenses, but turning inventory fast generates cash. Holding on to slow-moving product, hoping to make a big GP, is a losing strategy. Often the best course with old stock is to take your lumps, get some or all of your original investment back, and reinvest in something that will sell more quickly.

BITE THE BULLET

Managing inventory turn is largely a matter of purchasing discipline and coldhearted realism when it comes to disposing of old stock. Buying on terms is the most dangerous trap we fall into. (Free freight is the other.) Suppliers don't offer terms because they're nice guys. They offer terms because they want to move stock from their balance sheets to yours.

Every morning, the first thing I see in my gallery is a piano I bought two and a half years ago with 180-day terms. (I always keep my oldest item in view from my desk as a reminder not to do anything stupid.) The cost of holding this unit has wiped out whatever gain there might have been. Never buy on terms.

The human brain has a remarkable capacity for rationalization and pain avoidance. In his book, *Why We Make Mistakes*, author Joseph Hallinan states the obvious: "We are really good at BS'ing ourselves." Rather than endure the pain of loss, we procrastinate, making matters worse. The same motivations that prevent amateur investors from accepting a loss also cause us to cling to our old inventory. While a professional stockbroker will sell a falling stock the moment it reaches the stop-loss price, many people will ride it all the way to the bottom. I know I have.

Here's my stop-loss system for inventory: If it's more than 180 days old, keep marking it down until it sells. Also, use the "if it was in my refrigerator, would I throw it out" rule. Bite the bullet, and sell the old inventory for anything you can get and reinvest in something that will sell. The first offer is bound to be your best offer. The longer you wait, the worse it will be.

As we emerge from a painful economic era into a more normal business environment, let's be careful not to abandon the difficult business disciplines we imposed on ourselves to survive. If you spruced up your balance sheet by reducing inventory and debt, keep a tight rein on purchasing, and keep your inventory lean. Take a pass on free freight and special terms offers, and buy only what you really need. Your banker and your bottom line will be pleased, and you'll sleep better. **MI**

Greg Billings whispers to customers at the Steinway Piano Gallery in Bonita Springs, Fla. He welcomes questions and comments at greg@steinwaynaples.com.