



Adjust Margins to Measure Profitability

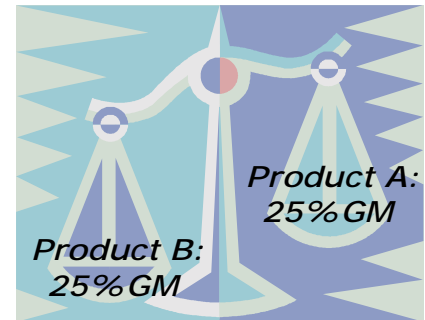
Is your Gross Margin telling you whether you're really profitable? The size of the inventory investment and the inventory carrying costs are often neglected when calculating the gross margin of a product. As shown below, two products may have the same Gross Margin, though one is actually losing money. The *adjusted gross margin* percentage moves toward a more true assessment of the actual profitability of a product, product line, branch inventory, or entire company.

WONDERMENT® Project Steps:

- Identify three products that you sell and get the following data for each:
 - The annual gross profit and sales
 - The size of the inventory investment
 - The carrying costs of inventory (averages 20-30% of the value of the inventory)
- Use the following equation to determine the *Adjusted GM*

$$\frac{\text{Annual Gross Profit Dollars} - \text{Annual Carrying Cost Dollars}}{\text{Annual Sales Dollars}}$$

Visit us online at www.jacquard.com/wonderment.htm for an interactive exercise.



The Profitability Scale

Example: Brian's Bottling Company

BBC carries two product lines, Beer and Soda. Beer has a GP of \$3,000 with sales of \$12,000. Soda has a GP of \$5,000 and sales of \$20,000. Both products have a 25% GM. The average inventory investment in Beer is \$4,000, while in Soda it is \$12,500. With an annual inventory carrying cost of 25% we get the following adjusted margins: 16.7% for Beer and 9.4% for Soda!

In Your Company ...

Conduct this exercise on all your product lines and examine the opportunities to increase your adjusted GM%.

Annual Figures	Beer	Soda			
GP Dollars	\$ 3,000	\$ 5,000	\$	\$	\$
Sales Dollars	\$ 12,000	\$20,000	\$	\$	\$
Avg. Inventory	\$ 4,000	\$ 12,500	\$	\$	\$
GM %	25%	25%	%	%	%
Inventory Carrying Cost	25%	25%	%	%	%
Adjusted GM %	16.7%	9.4%	%	%	%

What questions does this raise?

- Which product lines require a substantial investment in inventory?
- Do you include inventory-carrying costs when pricing your products?
- What opportunities do you have to reduce inventory carrying costs?
- Are you losing money on any of your products after you figure the adjusted GM?
- Are there any other factors that affect your pricing strategy?

If you have questions or comments please contact us. Log on to www.jacquard.com or call us at 847.945.8700.