# Every Retailer Needs a KPI Strategy

Part 2 of 3: **Tactical KPIs**


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***Key performance indicators** only tell you how well you are performing. And you can track KPIs in your point of sale solution. To actually **improve** your performance you first have to know what KPIs mean and how to use them. In Part 1 of this three-part series we looked at the role KPIs play in answering the big questions successful retail companies ask themselves to achieve outstanding results. In Part 2, we examine the tactical KPIs these retailers focus on every day and every week.*

## Rarely does a huge business success or a complete business failure occur overnight.

Either result usually happens because of day-to-day decisions that add up to one of these outcomes — or something in between — over time. On any given day or week, you probably can't decide to change a store's location or to redesign your sales floor. Why not? Because it is unlikely that you'll collect enough data in such a short period to wisely guide such far-reaching decisions. And even if some of these longer-term factors were hurting you, you must still make the most of what you've got today. Nothing limits long-term options like poor short-term decision-making. That's especially true in retail, where success is all about the difference between what cash comes in the door today minus what goes out.

So what should you do — and what should you know — today or this week to maximize cash on hand? Select daily or weekly KPIs that match three criteria:

**Only select KPIs that are:**

- Significant
- Available
- Actionable

1. The KPI's impact on business is significant. In other words, scoring poorly against this KPI means your business is in trouble. Alternatively, you could be scoring okay, but a better score could mean much greater success. Again, words like "too low" and "better" are decided by comparison against one of the "clues" discussed earlier, such as a business objective, industry benchmark or a difference (e.g., year-to-date now versus year-to-date last year).
2. The KPI's information is *available* within the timeframe. Some information simply takes longer than a day or a week to collect if it is to be meaningful. Take shrinkage. A day or a week's worth of data probably won't tell you whether you have a shrinkage problem. You could be the victim of a major theft on a given day, let's say, but you would not have a shrinkage problem overall if no one ever steals from you again.
3. The KPI is *actionable* within the timeframe. Even though you have the information, you still may not be able to do anything about it — or at least as much as you should. Take labor costs. Achieving an optimum labor mix can take months if not years. Comparing your labor expense-to-sales ratio every week against industry norms therefore may take more time than it's worth.

Some KPIs, however, are never actionable, at least not by themselves. Many retailers, for example, like to check their "best sellers" report frequently even though it's not very actionable. Knowing what your best sellers are is good. But simply knowing which items are selling best is not enough. Why not? Because it doesn't tell you what you should do. Should you buy more of these best sellers? How many? Should you raise prices? What would be more actionable is if you also knew the best sellers on which you risk a stock-out (e.g., low on-hand and low on-order). Or you might want to know which items are selling too slowly (based on your clue criteria), with excessive on-hand and on-order.

Both sets of criteria should be considered when managing KPIs — the "clues" and the selection criteria. If you do that, it's likely you will track your KPIs as big questions — like those raised at the start of this paper — rather than just isolated statistics.

## Here, then, are the big questions you want to ask every day or every week.

### DAILY

**What are daily sales and margins versus plan by location and for the whole company?** What's the trend? How does this compare against last year? How does this compare against comparable stores or industry benchmarks?

**Are customer returns excessive by item, location or for the company as a whole?** How do locations or items compare against each other for this KPI? Does one location or item stand out based on a preset benchmark?

**Do I have enough stock on-hand, committed and on-order based on sales plans?** Purchases (and perhaps other factors, like prices) may need to be adjusted if you are either exceeding or not meeting sales plans by a preset amount. One tool to adjust purchasing is open-to-buy (OTB), as in the formula:

*OTB = closing stock - opening stock - on order + sales*

When OTB is negative, retailers are said to be overbought and have too much stock.

### WEEKLY

**What is my sell-through rate overall, by item and by location, compared to my industry?** The point here is to find out the rate that your stock is "selling through" from the supplier to the customer. The formula for sell-through rate is:

$$\text{Sell through rate} = \frac{\text{units sold}}{\text{units sold + on-hand inventory}} \times 100$$

If you're not achieving your benchmark sell-through rate, you may wish to consider taking an early markdown, especially on seasonal goods. A 20% markdown now may clear out the goods much faster than a 50% markdown later.

**What are my conversion rates and transaction counts compared to last year by item or location and per employee?** Low conversion and transaction rates mean that people are shopping but not buying. They are at least coming into the store, but may be put off by price, the way merchandise is displayed, interaction with sales associates or by other factors.

**What is my expense percent to sales versus plan or budget?** Cutting expenses is one way to increase profits (the others are raise prices and reduce cost of goods). Expenses typically run 20-45% of sales although warehouse clubs are much lower. So it's important to take your industry into account when tracking this KPI. The formula for expense percent is:

$$\text{Expense \%} = \frac{\text{total non–merchandise expenses}}{\text{net sales}} \times 100$$

Suppose, for example, your non-merchandise expenses for utilities, rent, insurance and so forth were $7,000 per month with net sales of $30,000. Your expense percent would then be 7/30 x 100 = $23.3%

Compare this week this year to the same week last year, and then year-to-date this year to year-to-date last year.

**What is my expense percent to sales versus last year?** Compare this week's performance against this week's planned performance and this year's performance versus plan for this year.

Look at both total expense as well as each line item expense in the P&L, which fall mainly into four categories: labor, space, marketing and distribution. On each one compare this week's performance to industry benchmarks and to your performance.

- ✓ Versus plan for this week
- ✓ Versus this week last year
- ✓ Year-to-date versus last year year-to-date

**Tactical KPIs such as these let you know how close your business is currently operating. Just as important, however, are strategic KPIs, i.e., those that tell you what that business potential might be over the long term — and how to increase it. We discuss strategic KPIs next, in Part 3 of this series.**

# KPI Strategy

This is Part 2 in a 3-part series about KPIs or Key Performance Indicators. Look for Part 3 in mid-February in your inbox.

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