The **EASY** way to put together a Purchase Budget for Your Hardware Store that Works

In my last article I explained how you can never be overstocked again and eliminate one of the major reasons why Hardware Stores go bust.

The cornerstone for the open to buy system is a purchase budget. To put together a purchase budget you need to make three decisions.

1. What will happen with my sales for the next twelve months?
2. What gross profit margin do I want to aim for?
3. What stockturn do I wish to achieve?

Let's use a case study to show how easy it is to put the budget together.

Background

A Hardware store with a predominance of retail sales is overstocked. Its sales, margin and stock performance for the last 12 months is as follows:

Sales	$3,000,000
Cost of Sales	$2,100,000
Gross Profit	$ 900,000
Closing Stock	$ 700,000

A quick analysis of this rural merchandise store will give the following results.

Gross Profit Margin

$$\text{Gross Profit Margin} = \frac{\$\,GP}{\$\,Sales} \times 100$$

$$= \frac{\$900{,}000}{\$3{,}000{,}000}$$

$$= 30\%$$

Stockturn	=	Cost of Sales ------------------- *Closing Stock
	=	$2,100,000 -------------- $ 700,000
	=	3 times per annum (xpa)

* Note I have used closing stock in this example. It is more accurate to calculate stockturn using an average stock total.

GMROI	=	Margin x Stockturn
	=	30 x 3
	=	90

A brief summary of the Key Performance Indicators show that the store is not achieving a good margin, given its sales mix. It is overstocked given the level of sales being generated. The GMROI is under 100 and needs to be improved. The optimum target is 150-200.

Given this quick analysis it is simple to put together an accurate and achievable budget.

Step 1

Set a GMROI target that is achievable. Note it would be difficult to get to 150 in 12 months. So for the purpose of this case study, I will set it at 120.

Step 2

Set a margin target. 30% is too low. I would aim for 31%.

Step 3

The stockturn target will simply be the GMROI target of 120 divided by 31 which equals 3.87 times per annum.

Now we have our Key Performance Indicators set, we can put together our budget.

Step 4*	Sales		$3,150,000

Less Cost of Sales

	Opening Stock	$700,000	
Step 9*	Budgeted Purchases	$2,035,130	
Step 8*	Available Stock	$2,735,130	
Step 7*	Closing Stock at **3.87 xpa**	$561,630	
Step 6*	Cost of Sales		$2,173,500
Step 5*	Gross Profit at **31%**		$976,500

* See notes below

Step 4

Set a sales target that is realistic. In our case study a 5% increase is targeted.

$$\$3,000,000 \times 1.05 = \$3,150,000$$

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Step 5

Multiply target sales by target gross profit margin.

$$\$3,150,000 \times 31\% = \$976,500$$

Step 6

Subtract from Budget Sales, budgeted Gross Profit to get Budgeted Cost of Sales

$$\$3,150,000 - \$976,500 = \$2,173,500$$

Step 7

Divide Budgeted Cost of Sales by Targeted Stockturn to get the Target Closing Stock

$$\$2,173,500 \div 3.87 = \$561,630$$

Step 8

Adding Budgeted Cost of Sales to Targeted Closing Stock will give you Budget Available Stock for the next 12 months.

$$\$2,173,500 + \$561,630 = \$2,735,130$$

Step 9

Subtract from Budgeted Available Stock the Actual Opening Stock Figure

$$\$2,735,130 - \$700,000 = \$2,035,130$$

Thus if the store can achieve a 5% increase in sales, increase its margin to 31% and purchase approximate $2,035,130 in stock, it will achieve a stockturn target of 3.87 xpa, and a GMROI of 120.

In the next issue I will show you how to extend the purchase target we have just put together into a monthly purchase and stock budget and complete the components of the Open to Buy Inventory System that will ensure you should never be overstocked ever again.

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