



20 Nugent Dr., Suite 1B

Clifton, NJ 07012

Phone: 973-777-1053

Fax: 201-225-7689

<http://gapent.com>

E-mail: [georgem@gapent.com](mailto:georgem@gapent.com)



## OTB

What is it?

Why OTB?

Calculating OTB.

Markdown planning.

Inventory levels.

On order

### NEED HELP?

Call:

+1 551-655-2000

[georgem@gapent.com](mailto:georgem@gapent.com)

## OPEN-TO-BUY

By George Matyjewicz, PhD

### *“How to Use Open-To-Buy in Retailing”*

**What is Open-To-Buy?** It is a financial budget for retail merchandise structured to assist retailers manage and replenish their most significant asset, their inventory investment. Open-To-Buy is really an easy concept to understand, and one that all retailers should use if you want to improve your bottom line. I could never understand why it was called the Open-To-Buy. Rather I think it should be the Open-To-Receive, as you are calculating how much merchandise you can receive based on inventory levels and sales for a period.

Every retailer needs to use Open-To-Buy. The small retailer cannot afford any mistakes because his sales volume and cash flow are critical. The large retailer needs it due to his very size, which makes planning and control all the more critical. Open-To-Buy planning will help retailers do a better job of buying (which helps increase sales, reduce markdowns, increase gross profit and increase inventory turn rate).

Many retailers have never been educated as to how to effectively use Open-To-Buy and the benefits of its use.

When asked how they determine how much inventory to buy some retailers will tell us that they look at what they bought last year and adjust it upward to take care of any sales increases. This can just perpetuate an already over-stocked situation. When there is too much inventory purchased and there is too much merchandise in inventory a number of things happen, none of them good:

- Poor cash flow
- Excessive obsolescence of merchandise causing higher markdowns
- Stale merchandise which needs to be marked down
- Sales decline because the store is too full of old merchandise the customers have seen before (or several times) and they stop shopping there
- Interest expense is higher (if the retailer can get financing)
- Lower Initial Markup because there is no cash available to take advantage of in-season buys
- Which results in lower Gross Profit because of the lower Initial Markup and higher Markdowns
- Higher operating expense, which results in...

## LOWER NET PROFIT!

**Why Open-To-Buy?** You must learn how to use your Open-To-Buy to buy more effectively. It requires some work and a lot of discipline but it will be well worth it in better cash flow and higher profits.

Let's look at your operation. Do you overstock when sales increases are good, and under stock when prospects are bad? Is so, a relatively small increase in sales often leads to excessive buying - then when sales slow down high markdowns are taken to clear out this excess supply of merchandise. This, in turn, leads to lower gross profit.

Years ago my wife's uncle was VP sales for a record distributor. I happened to see a concert by Jazz pianist Junior Mance and wanted to get a CD. So I went to four stores and couldn't find it. Uncle Richard was at our house one evening and I mentioned my plight. "You're the one", he said. "We had four stores call and ask if we had him in stock, and were about to do a new run thinking sales were booming!" So, here's one person who almost created a major overrun, which would have meant overstocking of inventory at four stores and a distributor.

The goal of good merchandising is to maintain the level of inventory that provides adequate assortments when sales are low and not excessively high assortments when sales pick up. This is where the Open-To-Buy comes into play. It tells you how much inventory should be on hand at the beginning of any given month and how much new merchandise should be received during the month.

An Open-To-Buy system will able you to estimate in advance the amount of cash that will be required to be invested in inventory from month to month for the coming season. It also helps to ensure an adequate amount of inventory will be on hand to support the level of planned sales - controls merchandise commitments so you don't receive too much new merchandise too early in the season, or not enough.

Your Open-To-Buy can be prepared at the company level (for multi-store operation), store, department, classification or buyer level, or a combination of any of these. And it should be prepared on a monthly basis, which can be combined into a seasonal open-to-buy.

Traditionally the Open-To-Buy is prepared at retail. Sales are made at retail and inventory is needed to meet sales plans; therefore, it makes sense that inventory should be managed at retail and buying plans to meet sales goals should be made at retail. A good buyer will attempt to minimize cost and maximize initial markup with a retail Open-To-Buy.

**Calculating Open-To-Buy.** The formula for calculating the Open-To-Buy is:

$$\text{OTB} = \text{Planned Sales} + \text{Planned Markdowns} + \text{Planned Inventory} - \text{Actual Inventory} - \text{On Order} - \text{Actual Sales}$$

Sales planning is the most critical decision you must make. Expense budgets are always planned in relation to sales. If sales are planned too low they become a self-fulfilling prophecy. The store will be merchandised for the lower sales level, and will not have sufficient goods on hand to meet a higher demand. Conversely, if sales are planned too high, too much merchandise will be bought and the retailer may find himself unable to pay the bills when the planned sales level is not achieved.

The sales plan must take into account sales history plus other factors like local economic conditions, changes in competition, fashion changes, plans to expand customer credit, changes in selling personnel, etc.

**Markdown Planning.** Markdowns need to be planned and included in the OTB calculation. Why? Markdowns reduce the retail amount of inventory on hand, just as sales do. Therefore, if they are not included in Open-To-Buy planning the store would not bring in enough new merchandise for any particular month.

Although markdowns do not occur evenly throughout the year, they should be planned as a static percent of planned sales for each month. This then acts as a markdown reserve and ensures adequate levels of inventory each month.

**Planning Inventory Levels.** Too much inventory on hand spells a poor return on investment and high markdowns. Too little means missed sales. Ideally, beginning-of-month inventory should be higher in the months sales will exceed the average and less in the months you plan less than average sales. However, it doesn't take twice as much inventory on hand at the beginning-of-the month to do twice as much volume. Don't discard that age-old logic that most retailers use in store operations - gut feeling! If you have been successful in the past with your "gut" then continue to do so, or at least add to your inventory levels based on gut. Your knowledge gained from past mistakes, and from talking with others is irreplaceable.

**On Order.** The Open-To-Buy for each month must be reduced by the amount of merchandise on order scheduled for delivery during that month. Open-To-Buy can not be used effectively to control inventory unless a purchase order is generated for every order placed. If all orders are not recorded as soon as they are placed, the Open-To-Buy amount will be overstated and overbuying will occur, leading to future high markdowns and lower profits.

**Summary.** Open-To-Buy is not for fashion retailers only. Any retailer could, and should use an Open-to-Buy system in order to improve the bottom line.

**Need Help?** If you need help or would like an analysis of your operation, please contact us via e-mail to [georgem@gapent.com?Subject=Help\\_Open-To-Buy](mailto:georgem@gapent.com?Subject=Help_Open-To-Buy) and tell us:

Your URL

What do you do?

What are your objectives?

What is your target market?

E-mail:

Name:

Title:

Company:

Address:

Telephone:

Fax:

Comments:

Sincerely,

GAP Enterprises, LLC

###

About the author. George Matyjewicz, PhD is Global Strategist and Managing Principal at GAP Enterprises, LLC. His dissertation "Just In Time Payments And The New Global Currency For Conducting Business In A Global Economy" was compiled from 3+ decades experience in the business world. He was formerly President/General Manager of a global digital currency company with customers in 120 countries and Chief E-Commerce Officer for a global giftware company where selling the big ones was critical. He was a Principal/Partner at a top 50 U.S. CPA/Consulting firm. He is regularly published as an expert on global business, finance, technology and implementation.

For further information, please contact:

George Matyjewicz, PhD,  
GAP Enterprises, LLC,  
20 Nugent Dr., Suite 1B, Clifton, NJ 07012  
Tel: 551-655-2000 Fax: 201-225-7689  
<http://www.gapent.com> [georgem@gapent.com](mailto:georgem@gapent.com)



Bridging the GAP between *SUCCESS* and *FAILURE*

20 Nugent Dr., Suite 1B

Clifton, NJ 07012

Phone: 973-777-1053

Fax: 201-225-7689

<http://gapent.com>

E-mail: [georgem@gapent.com](mailto:georgem@gapent.com)