



RVAA 2008 Meeting Agendas: Frequently Asked Questions

Q: *Regarding the Pricing Standard, we cannot signify what item “S”, “Distributor Quote per Unit” stands for. Could you explain?*

A: That is what the distributor cost on an item should be. The per unit is just to be sure the vendor is not giving the price in a case pack with 12 units in it.

Q: *We are a new member and on the agenda, in the "metrics" section - year-to-date sales is all we can supply, will this suffice – being it's our first year?*

A: Sure if that is all you have. It just makes the discussion less meaningful but you can not invent numbers you do not track.

Q: *Again in the "metrics" section, " could you define "inventory turnover?"*

A: Inventory turnover:

From Wikipedia, the free encyclopedia

The **Inventory Turnover** is an [equation](#) that equals the cost of goods sold divided by the average [inventory](#). Average inventory equals beginning inventory plus ending inventory divided by 2.

Inventory Turnover Equation

The formula for inventory turnover:

$$\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$$

The formula for average inventory:

$$\text{Average Inventory} = \frac{\text{Beginning inventory} + \text{Ending inventory}}{2}$$

Application in Business

A low turnover rate may point to overstocking^[1], obsolescence, or deficiencies in the product line or marketing effort. However, in some instances a low rate may be appropriate, such as where higher inventory levels occur in anticipation of rapidly rising prices or shortages. A high turnover rate may indicate inadequate inventory levels, which may lead to a loss in business. Assume cost of sales is \$70,000, beginning inventory is \$10,000, and ending inventory is \$9,000. The inventory turnover equals 7.37 times ($\$70,000 / \$9,500$).

It should be noted that some compilers of industry data (e.g., [Dun & Bradstreet](#)) use sales as the numerator instead of cost of sales. [Cost of sales](#) yields a more realistic turnover ratio, but it is often necessary to use sales for purposes of comparative analysis. Cost of sales is considered to be more realistic because of the difference in which sales and the cost of sales are recorded. Sales are generally recorded at market value, i.e. the value at which the marketplace paid for the good or service provided by the firm. In the event that the firm had an exceptional year and the market paid a premium for the firm's goods and services then the numerator may be an inaccurate measure. However, cost of sales is recorded by the firm at what the firm actually paid for the materials available for sale. Additionally, firms may reduce prices to generate sales in an effort to cycle inventory. In this article, the terms "cost of sales" and "cost of goods sold" are synonymous.

Q: *Also in the "metrics" section, could you define "GMROI?"*

A: The Wikipedia is confusing on Gross Margin Return on Inventory - see the attached formula below:

Alternative Formulas for GMROI

Other formulas that are often given for GMROI are the following (note that all of these are mathematically equivalent because all can be reduced down to $\text{Margin} / \text{Avg_Inventory_cost}$):

$(\text{Margin}\% / (100\% - \text{Margin}\%)) * \text{AnnualInventoryTurns}$

$(\text{Margin} / \text{COGS}) * \text{AnnualInventoryTurns}$

$\text{Margin}\% * (\text{Sales} / \text{AvgInventoryCost})$