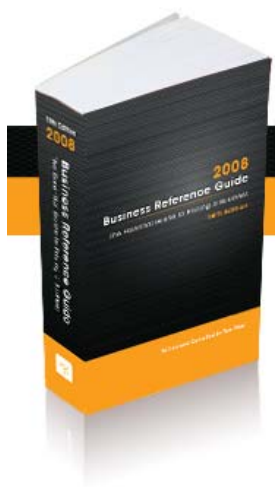


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Retail Businesses (In General)

SIC: Unavailable**NAICS:** 44**Number of Businesses / Units:**
Unavailable

The Sector as a Whole

The Retail Trade sector comprises establishments engaged in retailing merchandise, generally without transformation, and rendering services incidental to the sale of merchandise.

The retailing process is the final step in the distribution of merchandise; retailers are, therefore, organized to sell merchandise in small quantities to the general public. This sector comprises two main types of retailers: store and nonstore retailers.

1. Store retailers operate fixed point-of-sale locations, located and designed to attract a high volume of walk-in customers. In general, retail stores have extensive displays of merchandise and use mass-media advertising to attract customers. They typically sell merchandise to the general public for personal or household consumption, but some also serve business and institutional clients. These include establishments, such as office supply stores, computer and software stores, building materials dealers, plumbing supply stores, and electrical supply stores. Catalog showrooms, gasoline services stations, automotive dealers, and mobile home dealers are treated as store retailers.

In addition to retailing merchandise, some types of store retailers are also engaged in the provision of after-sales services, such as repair and installation. For example, new automobile dealers, electronic and appliance stores, and musical instrument and supply stores often provide repair services. As a general rule, establishments engaged in retailing merchandise and providing after-sales services are classified in this sector.

The first eleven subsectors of retail trade are store retailers. The establishments are grouped into industries and industry groups typically based on one or more of the following criteria:

(a) The merchandise line or lines carried by the store; for example, specialty stores are distinguished from general-line stores.

(b) The usual trade designation of the establishments. This criterion applies in cases where a store type is well recognized by the industry and the public, but difficult to define strictly in terms of commodity lines carried; for example, pharmacies, hardware stores, and department stores.

(c) Capital requirements in terms of display equipment; for example, food stores have equipment requirements not found in other retail industries.

(d) Human resource requirements in terms of expertise; for example, the staff of an automobile dealer requires knowledge in financing, registering, and licensing issues that are not necessary in other retail industries.

2. Nonstore retailers, like store retailers, are organized to serve the general public, but their retailing methods differ. The establishments of this subsector reach customers and market merchandise with methods, such as the broadcasting of "infomercials," the broadcasting and publishing of direct-response advertising, the publishing of paper and electronic catalogs, door-to-door solicitation, in-home demonstration, selling from portable stalls (street vendors, except food), and distribution through vending machines. Establishments engaged in the direct sale (nonstore) of products, such as home heating oil dealers and home delivery newspaper routes are included here.

The buying of goods for resale is a characteristic of retail trade establishments that particularly distinguishes them from establishments in the agriculture, manufacturing, and construction industries. For example, farms that sell their products at or from the point of production are not classified in retail, but rather in agriculture. Similarly, establishments that both manufacture and sell their products to the general public are not classified in retail, but rather in manufacturing. However, establishments that engage in processing activities incidental to retailing are classified in retail. This includes establishments, such as optical goods stores that do in-store grinding of lenses, and meat and seafood markets.

Wholesalers also engage in the buying of goods for resale, but they are not usually organized to serve the general public. They typically operate from a warehouse or office and neither the design nor the location of these premises is intended to solicit a high volume of walk-in traffic. Wholesalers supply institutional, industrial, wholesale, and retail clients; their operations are, therefore, generally organized to purchase, sell, and deliver merchandise in larger quantities. However, dealers of durable nonconsumer goods, such as farm machinery and heavy duty trucks, are included in wholesale trade even if they often sell these products in single units.

Rules of Thumb

30 to 35 percent of annual sales plus inventory

1.5 to 2 times SDE

General Information

"Visual appearance and merchandising trends are in constant need of updates and modernization to enhance sales."

Expert Ratings

▶ Competition	1	(1=Lot of : 4= Not Much)
▶ Amount of Risk	1	(1=Very : 4= Not Much)
▶ Historical Profit Trend	3	(1=Down : 4= Up)
▶ Location & Facilities	4	(1=Poor : 4= Excellent)
▶ Marketability	2	(1=Low : 4= High)
▶ Industry Trend	2	(1=Declining : 4= Growing)
▶ Ease of Replication	2	(1=Easy : 4= Difficult)

Pricing Tips

"Occupancy—Lease terms"

Benchmarks

No business lends itself more to benchmarking than retailing. Two important benchmarks for retail operations that may measure profitability, or just how a particular business may stack up against its peers, are Sales per square Foot and Sales per Employee.

Pat O'Rourke, the creator of BizStats, has written a very interesting—and informative —article titled "Why Sales per Foot is the critical benchmark for Retailers." Here are a few excerpts.

"Think of Sales per Foot in terms of sun protection factor—SPF—a healthy SPF will help prevent you from getting burned in a retail business. SPF is one of many retail benchmarks, but I believe it's the best gauge of a retailer's efficiency, and, ultimately, its profitability. It's also easy to compute—just divide sales by the store's gross square feet. Some retailers calculate SPF based on selling feet (excluding in-store administrative, storage and other space), but this can be subjective and impair meaningful comparisons.

"SPF differs among industries. For example, a big box discounter with high inventory turnover (such as Costco) is going to have a much higher SPF than a clothing chain or sports equipment outlet. Another key element is location, SPF is typically much higher for merchants in a destination mall, than for similar stores in a local shopping center—of course you pay much higher rent in the big mall.

"An upward trend in SPF is almost always a positive sign of a retailer's health, whereas a downward trend in SPF is often a warning sign that business performance is suffering—even if the company's total sales are increasing.

"There can be many reasons for a low SPF. The first reason is obvious—the retailer simply has too much space. By having excessive space, a retailer will be adversely impacted by high fixed costs:

- ▶ Rent costs are excessive
- ▶ Labor costs are excessive, since additional floor space requires additional personnel
- ▶ Flooring costs are excessive, since additional space requires additional merchandise
- ▶ Insurance utilities and theft costs all increase with additional floor space

"Assuming the store size is reasonable, there are many reasons for a poor SPF relative to competitors. Here are 10 primary reasons for a low SPF—these are considerations for retailers of all sizes:

1. Poor product/merchandising mix
2. Insufficient floor inventory (e.g., empty shelves, missing sizes)
3. Un-competitive pricing
4. Poor location
5. Poor sales and customer service personnel
6. Non-optimal store hours
7. Poor store layout and design
8. Cannibalization of nearby owned stores
9. Insufficient/poor marketing
10. Fixed consumer perception"

Also from the BizStats site are some average sales per square

foot based on information from U.S. shopping malls. Since the data is based on shopping malls, keep in mind that rents, and related costs, are generally higher than most "main street" locations. Although the following data is dated, it does provide some interesting benchmark figures.

Type of Business	Sales per Square Foot
Jewelry	\$880
Restaurants - Food courts & kiosks	\$648
Shoes - Men's	\$514
Accessories - Women's	\$478
Restaurants - Fast food	\$453
Shoes - Children's	\$439
Specialty food stores	\$430
Personal care & health	\$411
Restaurants	\$369
Electronics	\$355
Sporting goods	\$246
Stationery & card shops	\$229
Toys & hobbies	\$221
Automotive parts	\$210
Books	\$199

Source: Newspaper Association of America, as shown at www.bizstats.com

And, for comparison purposes, BizStats also provides the following for Neighborhood Shopping Centers, defined as strip centers under 100,000 square feet, typically built around a supermarket.

Type of Business	Sales per Square Foot
General merchandise	\$100
Clothing & accessories	\$201
Shoes	\$145
Automotive	\$136
Hobby/special interest	\$163
Gifts/specialty	\$149
Jewelry	\$280
Liquor	\$217
Drugs	\$241
Other Retail	\$143

Another of the important benchmarks is employee productivity. The number of employees includes both full-time and part-time employees. The following sampling of employee productivity will provide some rough rule of thumb for comparison purposes.

Type of Retailer	Payroll as % of Sales	% Sales per Employee
Automotive parts & accessories	15.6%	\$129,024
Tire dealers	18.1%	\$137,821
Floor covering stores	14.9%	\$171,250
Camera & photographic supplies store	14.4%	\$128,609
Nursery & garden centers	10.0%	\$198,428
Children's & infant's clothing stores	10.2%	\$99,699
Family shoe stores	11.0%	\$112,517
Athletic footwear stores	10.5%	\$118,111
Sporting goods, hobby & musical instrument stores	11.6%	\$114,100
Hobby, toy & games stores	09.5%	\$128,746
Book stores - general	11.8%	\$103,517
Florists	21.3%	\$52,359
Gift, novelty & souvenir stores	14.2%	\$69,574
Used merchandise stores	19.9%	\$61,692
Pet & pet supplies stores	12.9%	\$89,763
Vending machine operators	19.4%	\$103,763

The data above gives you an idea of the information that is available. We have found that BizStats, <http://www.bizstats.com/>, has lot of valuable information. *Nation's Restaurant* has a lot of data on restaurants. For subscription information, go to www.nrn.com.

Expenses as a Percentage of Sales

▶ Cost Of Goods	25%
▶ Payroll/Labor Costs	20%
▶ Occupancy Costs	18%
▶ Profit (pretax)	28%

Industry Trend

"Difficult. Big box retailers and Internet sites are crimping margins."

"Small retailers around the country are using a host of marketing tactics, from the usual extra emphasis on customer services to putting out free cider and cookies. But their most important step may be that they are trying to make the most of their inherent advantages over larger competitors.

"The ability of small stores to react quickly and directly to customers may be one of the most effective weapons they have, Mr. Friedman said. They can easily determind what is selling, and then place orders without wading through a cumbersome bureaucracy. 'They don't have to go to the corporate office, wait for their request to be analyzed and then shipped to them, by which time Christmas is over,' he said." Source: "Small Shops See Smallness as Their Big Selling Point" by Anne Field, *The New York Times*, December 15, 2007

Advantages

- ▶ "Quality operators can have impact on sales if location has excellent salespeople and service for the customer."

Disadvantages

- ▶ "New and intense competition from big box retailers and Internet sites. Rising costs for wages, insurance, energy (utilities) and legal representation."

Take a gift store that has been in business for 10 or more years. Many of these businesses reinvest much of their profits in adding more inventory. We have seen gift stores bulging with inventory—every nook and cranny filled. Or, take the local toy store a month before Christmas—its inventory may be two to three times the normal levels.

Another concern we have is that trying to calculate the inventory necessary to adequately operate the business is about the same as trying to place a dollar value on the used equipment necessary to operate the business. In many small businesses, the value of the fixtures and equipment necessary to operate the business, which is currently in place in the business, is minimal. Fixtures and equipment normally do not influence the price as the inventory would. In larger, manufacturing-type businesses, the investment in fixtures and equipment can be substantial.

Where Does the Inventory Go?

Bizcomps, in its regional editions of *Recent Small Business Studies*, does not include inventory, but rather assumes that it is or has been added to the prices submitted for inclusion. Here is what is said in the Introduction to the *Studies*:

"The exclusion of inventory from the financial averages requires further discussion. In business sale transactions, inventory transfers at the date of closing are based on the wholesale cost of 'good' inventory existing at that date. Since the amount of inventory can vary so significantly from business to business, Bizcomps believes that the financial ratios of the selling price of a business should exclude this relatively volatile asset. Also, there may be external reasons to manipulate the amount of inventory at the time of closing that, if included, would distort the selling price of the business. If it could be assumed that the optimal level of inventory was included in every business sale transaction or that the aggregate statistics would produce the optimal level of inventory, then inventory could be meaningfully included. The author does not believe this is a safe assumption, and therefore inventory is excluded from the statistical averages."

When writing about this issue in *The Business Broker* newsletter, we received a lot of letters. Again, there was a division among those who responded. Those who work in the General Business Brokerage area feel that the inventory should be added to the price derived from the SDE calculations. Some of the opinions are very practical. By building in the inventory, the price can be greatly increased (in many cases inventory can be reduced, returned or sold off) creating a difficult situation in talking to potential buyers. One writer used the example that if \$100,000 in liquid cash on hand was required to operate the business, would the business sell for \$300,000 or \$400,000 including the requisite cash. Obviously not, says the writer. "The buyer is expected to have the cash required to replace the \$100,000 as a working capital injection. Why should the expectation be any different for inventory?" The writer also says that by including the inventory, the buyer begins business with, for example, 60 days of free inventory. He further states, "... The seller not only pays for every bit of inventory he's sold but pays for the inventory the buyer will be selling, giving the buyer a 100 percent profit margin on that inventory."

It should also be noted that the rules of thumb contained in the *Business Reference Guide* provide that inventory be added. For example, in the case of a gift shop, the rule of thumb is 35 percent of annual sales + inventory.

There is one caveat in all this. Ed Telling, in his article referenced earlier, says: "[Inventory] is probably the largest asset for most retail operations ... A business that has inventory probably has in inventory merchandise it would rather not own. A prudent analysis should determine how much and how troublesome the 'how much' will be to dispose of. Does disposal mean a trip to the dump, or a discount in price (how deep a discount, as compared to cost and/or normal), which will result in an immediate or rapid sale? We should determine with some reasonable accuracy that total amount of inventory that represents 'good clean saleable merchandise.' Inventory that is other than that should be discounted—even in an extreme case 'carried to the dump' (the ultimate discount for lack of marketability, as in today's world there are probably costs attached to disposal)." Adding the inventory allows the process outlined in Ed's article to take place without actually influencing the negotiated price of the business.