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**PHASE ONE SPREADSHEET MODEL:**

**BASIC CONCEPTS**

The problems you will work in phase one relate to part one--"Introduction To Retailing" of *Retailing* (2011) by Dunne, Lusch and Carver.

The baseline financial information can be found by clicking on the woman with the dresses

[CLEDR006](baseline%20phase%201.xlsx)

For phase one you need to understand the following concepts:

1. **Net Sales** is the dollar value of annual sales.
2. **Cost of Merchandise Sold** is the monetary amount owed or paid suppliers for the merchandise the retailer sells during the period along with inventory shrinkage. Cost of merchandise sold is estimated as a percentage of net sales. The three components of cost of merchandise sold for *The House* are product cost, freight and inventory shrinkage.
3. **Gross Margin** is the Net Sales minus the Cost of Merchandise Sold. **Gross margin percent** is the Gross Margin as a percent of sales.
4. **Variable Operating Costs** are costs that increase proportionately with the sales volume of the store. For example if variable costs are 30% of sales then for each one-dollar increase in sales the variable costs rise 30 cents. The components of variable operating costs for *The House* are hourly wages, fringe benefits on the hourly wages, a portion of utilities cost, supplies and*ouseHouse*  advertising.
5. **Fixed Operating Costs** are the costs the retailer incurs regardless of the level of sales. The components of fixed operating costs for *The House* are supervisory and other salary and fringe benefits, rent, most utilities, depreciation, maintenance, buying trips, insurance, and interest on debt.
6. **Total Operating Cost** is the sum of fixed operating and variable operating costs.

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1. **Net Profit** is the amount remaining after total operating costs are subtracted from gross margin.
2. **Total Assets** is the value of the things the retailer owns, which it uses to operate its business. The components of assets for *The House* include fixtures, accounts receivable, cash and inventory.

In addition to the preceding, you need to understand some important relationships between the preceding concepts. These relationships are best understood in terms of three basic financial ratios. Repeatedly throughout the simulations you will see that the impact of changes in the retail business have an ultimate effect on these three financial ratios.

1. **Net Profit Margin** is the ratio of net profits divided by net sales. If the net profit margin is 3%, it indicates that on each dollar of sales the retailer has earned 3 cents of net profit.
2. **Asset Turnover** is the ratio of net sales divided by total assets. If this ratio is 3 times, it indicates that the retailer generates $3 in sales for each dollar invested in assets.
3. **Return on Assets** is net profit divided by total assets. If the return on assets is 8%, it indicates that the retailer has earned 12 cents on each dollar invested in assets.

The baseline financial information can be found by clicking on the woman with the dresses

[CLEDR006](baseline%20phase%201.xlsx)

Click to return to exercises:

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[2-A](Exercise%202A.docx) [2-B](Exercise%202B.docx)