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Gross Margin Return on Inventory Investment (GMROII) analysis illustrates how inventory turn can trump gross margin percentages. This is especially true when it comes to the profitability of similar products carried at your business. GMROII reveals whether a business is earning an adequate gross margin compared to the investment in inventory required to generate gross margin. The real question is whether the required investment in inventory you are carrying is contributing to the same level of profitability your gross margin suggests.

The formula for calculating GMROII is simple. However, it requires some basic information. To complete the formula the follow information is needed:

- Business' revenue
- Vendor purchases
- Beginning inventory
- Ending inventory and/or the average inventory for each of the brands carried for a given period

For businesses using accounting software, they are more than likely already capturing this information. The GMROII formula is:

$$\text{GMROII} = \left[\frac{\text{Gross margin}}{(1 - \text{gross margin})} \right] \text{X} \; \text{Inventory Turn}$$

Inventory Turn = (360/Days Inventory Outstanding) If additional information is needed to calculate a business' inventory turn, please visit the Wells Fargo CDF Learning Center.

While calculating the GMROII, the product sold at a higher gross margin may garner less overall profit when the inventory turn is incorporated into the calculation. For example, a product line generating a 33 percent gross margin, which turns two times per year, generates the same GMROII as a product line with a gross margin of 25 percent turning three times a year.

Manufacturers' minimum order quantity, back-up stock requirements, frequency of vendor delivery, proper product mix, and consumer brand preference are all important factors when it comes to inventory turn. However, when measuring overall profitability and determining which brands to stock, inventory turn and GMROII are beneficial metrics to monitor in order to help businesses attain their goals.

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Jim Morphey is the vice president of corporate development for Wells Fargo Commercial Distribution Finance (CDF). Morphey has more than 40 years of management experience in consumer finance, trade credit, and most recently with domestic and international inventory financing, as well as factoring. Morphey's career has been devoted almost entirely to the domestic consumer electronic, appliance, and outdoor power industries. His background includes executive assignments in operations, credit, and relationship management at the national level with Whirlpool, Whirlpool Financial Corporation, Transamerica Distribution Finance, and senior relationship assignments at GE Capital.

Morphey received a Bachelor of Science in Management from Northern Illinois University. He was a member of the Association for Finance Professionals (AFP). He earned professional certifications from The National Association of Credit Management/Credit Research Foundation (NACM/CRF) Graduate School of Credit & Financial Management held at Dartmouth College, and also from The Finance, Credit, and International Business Association (FCIB). Morphey has published many articles on the topics of inventory management as well as cashflow. He also helped produce a six part video series on a variety of cashflow topics which may be found at www.cdf.wf.com/learningcenter. Morphey and his family reside in southwestern Michigan.

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