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THE ECONOMIC CONSEQUENCES OF THE RETAIL INVENTORY METHOD

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ABSTRACT

Since the 1920s, the use of the retail inventory method for valuing inventory and determining costs of sales by merchandisers is generally accepted. This convention approximates inventory cost by using current retail prices. While some retailers have moved away from this technique given advances in inventory management, technology, and the supply chain, many merchandisers continue to use the retail inventory method. Yet, little attention has been given to this valuation method in the literature since the 1950s. Moreover, determinants for its continued use in modern-day retail is uncertain, especially in the economic context of profits, cash conversion, and market returns. In response, this study investigates the current economic consequences of the voluntary use of the retail inventory method of accounting.

Results using a random sample of publicly traded retail firms for the period 2006 - 2016 suggest that retail firms using the retail inventory method are significantly different in profitability and asset management metrics. Preliminary analysis of these metrics, using ANOVA indicate that firms who continue to use the Retail Method will underperform their industry rivals.