The Distribution Team
We wrote THE BOOK on Distribution Inventory Management

Getting Into an Inventory State of Mind (Part 1)
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You've heard the saying "location, location, location" when it comes to real estate. When talking about hard goods distribution, it is "inventory, inventory, inventory!" Every distributor in the world deals with some inventory issues. Some have more issues than they can handle. However, if inventory issues run your company and take up all your resources, you really need to get into a full time inventory state of mind.

Inventory issues start on the buy side. What you do or do not do when buying inventory will have a huge impact on your inventory success. Don't kid yourself, most inventory strategies flow from the top down. What the President or Owners want is what is reflected in the inventory challenges you face. A few simple changes can help get some inventory issues under control.

Don't take the trip

Owners are the worst at buying new items and "trip" inventory. This is the time of year when "trip" inventory becomes more prevalent. "Trip" inventory is a result of the vendor offering you a great opportunity in the future for buying product today. For example, the vendor may offer you something like this: "if you buy $100,000 worth of our product by the end of the year, you are eligible to take a luxurious trip to the Carribean next February." Hey that sounds like a great deal and the call is made to the purchasing manager to see how much product we have bought so far this year. Let's say we are at about $80,000 and thus another $20,000 is needed for the "trip". Don't fall into this trap anymore. Hey if you paid for a trip to the Carribeam yourself it would not cost you $20,000. But more importantly, the additional inventory bought to reach the "trip" goal really costs you $20,000 plus the inventory carrying cost. That is one very expensive trip that benefits few people in the organization. Besides the pictures you take on the trip, you will have constant reminders of the "trip" for many months as the inventory sits in your warehouse. Fully investigate and analyze all vendor inventory offers this time of year as they are also trying to meet some of their annual sales goals. They will try many things to get you to add inventory under the auspices of "year-end specials".

Don't let New become Ugly

Go to work on making it hard to add new items to your inventory in the future. New items are great because they get everyone fired up and hopefully increase sales. They are also the largest source of dead stock because they need to be managed closely in the first year of their life cycle. Owners are also the worst at buying new items. If you talk to any owner in distribution, they all have at least one story (you hope it is only one) about the great new item deal they agreed to purchase but years later they are still looking at those much older new items on the shelves.

Create a new item purchases committee of three people who will help determine if beyond the initial excitement of the product, the product survive in your marketplace. Step one is to let each of the three people have an equal vote before the decision is made. Usually someone from sales, purchasing and finance comprise the committee. They need to look at how the product can be bought to yield the highest return beyond the initial great purchase. They need to figure out how to finance the additional investment (often reallocating cash resources). They need to realistically determine the market activity once introduced.

Secondly, this group needs to determine three written exit plans with measurable timeframes for the product before it arrives. The first should be to sell the initial purchase quantity within a pre-determined timeframe. Second should be to return to the vendor within a time frame with full understanding of the potential cost of that action. Third should be to give it your dead stock manager within a timeframe so you can re-coop some of the costs while the product still has some value. The most critical piece of this plan is determining the timeframes you are going to use to help monitor your action plan. Taking new items into inventory without a timeframe oriented plan is only asking for additional inventory challenges down the road.

Is bigger better for you?

Another challenge distributors face is the desire to expand the marketing territory or going after new customers by taking on new product lines. This is often done by adding products that you might already carry by another vendor, but a new vendor might provide similar products and some greater variety. This is commonly a result of a customer or potential customer request for you to carry certain products or lines to keep or get their business. Now we must decide if the additional inventory investment in product and duplicate product offerings will yield a high enough sales return to warrant the decision. Sales personnel will often suggest we do it because we will gain a new customer. The decision is not whether to get another customer, it is a cash flow decision that has a long term impact.

We all want to add new customers, and unfortunately we will do about anything to make that happen. Adding duplicate products from different vendors to make this happen will cost you money in the long run. There is the issue of managing these products to ensure that we are not over buying one and letting the other suffer. There is the issue of the initial buy on the new line, and what else we need to buy to get the products desired. There is the issue of the length of the contract we need to agree to just to begin carrying these products. There is the issue of how you can return the products if they don’t sell. There is the issue of having purchasing manage the most cost effective quantities of duplicate products so we can buy them right. Finally, there is the issue of making sure your sales personnel push the duplicate item if a customer requests the other one but you are out of it.

Knowledge is Power

Getting new customers forces us to make some decisions that cost us more money than the customer could ever generate. Transferring product between locations just to make a sale often creates a huge expense and deteriorates gross margins. Getting into an inventory state of mind requires us to know the profitability potential of our customers. Before we transfer any product from one location to another just to make the sale, we should know how much profit we actually realize on the customer requesting the product. This is even more critical when we need to transfer items from one location to another to complete the sale.

Every distributor should complete a detailed profit realization analysis on their customers on an annual basis. This simple calculation helps everyone in the organization determine whether investing additional freight costs to make the sale is worth it in the long run. A profit realization analysis looks at every customer sales, cost of goods sold, gross margin, cost of order processing and contribution to net profit. It is usually done annually to help us make inventory decisions. It is more critical when it comes to transferring product. If you were asked the question, “should we transfer product to another location to make a sale on a non-profitable customer where we pay the freight costs?” we would all profoundly answer NO! But in reality, we do this all the time because we don’t know which customers we should and should not transfer product for. This is critical to your thought process and has a profound impact on your inventory. Stealing inventory from one location to make a sale on a non-profitable customer in another location creates negative cash flow. It also impacts future cash spending decisions on inventory because of the lack of cash. Finally, the branch sending the product will often get more than they need the next time they order because they never want to run out of stock due to non-profitable transfers we actually encourage in the excitement of sales.