



The Distribution Team

We wrote THE BOOK on Distribution Inventory Management

Compensation Packages Require Creative Thinking

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We are in a strange working environment today, as the motivation for employees to stay on board, work hard and become team players requires a diversified compensation package. It used to be a good salary or hourly wage was attractive enough to keep people; however, with the dynamics of the workforce changing, people are motivated by more than just money. They are looking for stock options, flexible hours, extended vacations, floating days off, insurance options and future earnings potential. As business owners, we are challenged to find ways to make the most mundane jobs attractive enough for good people to stay with us. Compensation is often the method we use, as many of us cannot offer stock option plans.

The trick to develop good compensation packages is to find key measurements in every role, so that compensation can then be based on performance. There might well be two or three people with the same title and role earning different compensation due to performance. Historically, we have been very creative with sales personnel compensation plans, as they usually require more variables to be attractive. Most of them are performance based, using sales, gross margin, net profit and cost as factors. Often there are various tiers or levels – each one having a different net result for the employee.

Now, take the same premise and try to design similar multi-tiered compensation plans for everyone else in the organization. The trick is always to have measurements. For example, if you look at accounts receivable personnel, what measurements are available to pay for performance – what statistics can we monitor and report back in a comfortable manner? Without some statistical measurements, compensation plans tend to be more subjective. Purely subjective plans cause unrest and sometimes dissention among employees. Measurable tasks need to be identified and reviewed. In the accounts receivable area, there are things like: days outstanding, amounts collected in a certain period of time, number of times customers are contacted, follow-up calls made, and bad debt write-offs collected. These are all statistics that can be measured in a rather simple format. Being even more creative, look to accounts payable and determine how many times they take discounts offered, discounts forfeited, vendor deals, payment schedules negotiated, etc.

In the warehouse (vault), many of us have difficulty keeping people motivated and challenged to give superior performance on a regular basis. Vault personnel are, in fact, cash managers in terms of working with our largest assets (inventory). They need to fully understand the impact of tracking and managing the inventory (cash). Since most of

what is heard from customers relates to the receipt and shipment of product, inherently there are a number of measurements. We could use: the number of shipments received and put away within a specified time period; the number of shipments to customers per day; the number of orders picked per day; or, cycle counting accuracy (require a high rate of around 95% and above). The vault needs to be cleaned nightly before going home. Transfers to other branches need to become a priority, and we can easily measure how often those branch transfers are sent on the day scheduled.

Purchasing personnel also have various measurements that can be used in performance-based compensation programs. For those doing budgets, keeping on target or within a certain range of the purchasing budget is a measurement. Annual purchasing dollars managed, the number of new items managed in a certain timeframe, the number of rebates negotiated, payment plans negotiated, and favorable return options negotiated are also measurable. New items create a series of measurements for purchasing personnel. What initial costs can be negotiated with the vendor? How often can unsold products be returned? Can you get restocking charges negotiated before taking on the new item? New items need to be managed closely, because they are the number one source of dead stock. **Therefore, managing the dollars invested in new items becomes extremely critical.**

In addition to managing new items, purchasing personnel have the best handle on replacement items, slow movers, dead stock items and superceded items. Each of these categories of stock has cash impacts on the bottom line. Working in conjunction with the Sales Manager, purchasing personnel can highlight replacement items and superceded items, so they are

not stuck with them in the future. Slow movers and dead stock items also can be moved in conjunction with creative sales programs. The trick is to identify them early, and develop a program that sales can implement. If early identification happens (before the item is totally dead and not moving), be creative in incentive programs. Develop teams of sales personnel and purchasing personnel to attack these items. Bonuses or some incentives for the team can be helpful in reducing average inventory value – and, more importantly, our dying and dead stock.

Branch managers need compensation programs that are both tough and flexible. Tough from the standpoint they should include plenty of “wins and losses.” If branch managers are in complete control of what they carry in inventory, there needs to be some incentive (or disincentive) from keeping excess inventory on hand. Branch managers will keep an abundance of stock on hand if they can get away with it, because they never want to be out of anything. Most of them have a sales background, and therefore have never been trained in good inventory practices. They want to service customers at the highest level, even if it means keeping lots of slow movers and some dead stock on hand.

Good branch compensation programs have similar foundations. Inventory is “pushed” out to the branch, based on current on-hand quantities and sales activities. A minimum and maximum inventory level is used to direct the replenishment process. This keeps the inventory moving at a fairly rapid pace, and prevents overstocked items from sitting out at the branches. If you do not use the “push” method, monitor the inventory using other methods. A couple of ways to help manage cash (inventory) in branches is to have: disincentives (“take-aways” from bonus) for excess inventory; on-hand dead stock, slow movers on-hand; and, special orders till sitting on the shelf. These disincentives are designed to keep the manager’s eyes on the total picture and cash pot. If you only pay on salary and a yearly bonus, you are allowing them to figure out methods to beat the system. Design your branch compensation plans so that you give them numerous ways to increase personal compensation, as well as helping improve the overall net profits. Increases in sales dollars, increases in sales percentages, increases in realized gross margin, reduction in bad debts, management of special orders, collection of outstanding balances, maintaining average inventory values, and increases in net profit are all possibilities for branch managers. Another one to track is the number of branch transfers. Branch transfers are usually used to get stock for a customer when the requesting branch is out of stock. However, branch transfers in many cases are not prudent net profit decisions, as we usually end up paying for freight costs of the transfer. If transfers are used often, track the number of times the branch manager has been able to get customers to pay for freight, rather than having him just eat the cost.

Compensation plans are a challenge for every distributor. How to keep good people is a main concern for many. Compensation plans alone will not provide the answer, however they are a great help. In today’s work environment, employees are looking for more than just money. Days off, extended weekends, flex time, insurance plans, 401(k) plans, profit sharing and stock options are all part of the mix. Since everyone in your organization is somehow involved in cash management, being creative in compensation programs usually helps keep their eyes on the cash pot. Many distributors have changed the way they pay over the years, because they realize just an hourly rate or an annual salary wasn’t working anymore. Cost of living increases become too subjective in many cases – and, people end up leaving for what appears to be the smallest of increases. Your goal is to design programs that create excitement, create a “win-win” environment, and allow personnel to be part of the game 365 days a year. If they have to wait for a potential “holiday or year-end” bonus, they will not focus as hard on the tasks at hand in June or July. They are just working for a set amount, and the potential bonus seems to far off to mean anything in the heat of the summer.

Try very hard to be as creative as possible when designing your next compensation programs – even breaking “old school” rules. Give everyone in the organization the possibility of getting paid for performance. The trick is to use measurements that can be tracked and compared. Get employee “buy-in” by having them sign their next compensation program. Allow them to ask questions to fully understand the “wins and losses,” or the incentives/disincentives they are agreeing to for the next year. Remember, everyone in your organization is managing your cash (net profit); therefore, design your plans to keep them enthused about their cash management roles everyday of the year.

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