



# The Distribution Team

We wrote THE BOOK on Distribution Inventory Management

## **Don't Rob From Branch Inventory**

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There are many Do's and Don'ts when it comes to inventory management. You can spend a career trying to implement them all and still not get the job done. It seems that every new vendor line, every special customer contract, every new trend brings about another challenge for inventory control managers. These professionals often have to use every ounce of knowledge and trickery to keep pace with the army of combatants that make their jobs so challenging. In addition to managing hundreds of thousands, even millions of dollars of inventory, they often need to handle a myriad of rush orders, backorders and special deals. Their jobs are not easy, and I believe they need some help to have a chance at being successful.

One area that causes them and business owners fits is the careless and sometimes needless transferring of stock items between branches. Because all distributors want to provide the highest customer service possible, they will go to great lengths to get products into customer's hands. In multi-branch operations, this might be accomplished by transferring product from one branch to another branch because a customer has asked for it. Sounds like a simple solution doesn't it? We can make another sale and make another customer happy with a simple transfer of product. However, there are some potential problems distributors need to manage.

Often, branch operations get re-supplied from a large branch or central distribution location. They can also be re-supplied from the vendor directly. The branch manager will order what they feel they need to handle their customer's requests. Based on actual usage rates by product, they can use a variety of methods to help them determine what to stock, and how many to purchase. Since they are a branch location, they cannot stock one of everything the distributor offers, as that would be too costly. Rather they should have only those items that sell and turn rather frequently. They also should not have much safety stock at the branch, as often they can get re-supplied fairly quickly from the central distribution center. They should keep smaller quantities on hand and try to keep their inventory investments to a minimum.

Everything sounds good so far doesn't it? But here is what often happens! Slowly and silently, cash begins to leak out of the business. Let's say a branch in El Paso gets a request from one of their customers for a stocked item. The branch manager looks it up in the system and sees they are out of stock, but notices that Phoenix has a couple on hand. Because customer service at all cost is a company policy, the El Paso manager requests that the product be transferred and shipped out of the Phoenix location to El Paso for this customer. So far no real damage has been done, except that I always am

curious as to who pays for the cost of that transfer? Some distributors charge the customer, but many more don't charge them anything extra for shipping it over from Phoenix. Some distributors have trained their personnel to say something like this, I am sorry but we are out of that product right now, but for a reasonable freight charge I can get it here for you tomorrow. Good training for those distributors, as they at least have a fighting chance to help cover the transfer freight costs. Others have trained their people to say something like this, I am sorry that we do not have any of those in stock at this location, but I see there are some in Phoenix, and I will get one transferred over right away for you. The customer applauds the customer service level, and the product is requested from Phoenix.

However, as this practice continues throughout your multi-branch operation, one thing becomes apparent. Someone (most often the distributor) is bearing countless freight charges. Often, there is little regard given by the branch manager in El Paso as to the gross margin dollars made on the item, but rather just trying to do anything to make the customer happy.

Now that the product has been requested by the El Paso manager, and is picked, packed and shipped by the Phoenix location, what do you think the Phoenix manager will do to get his inventory back to a comfortable level? You guessed it, they will order more than they need! Why will they do this? It is simple, they too want to make their customers happy, and they don't want to be out of stock. But really happened is we caused the Phoenix branch manager to no longer know who their customers really are!

The Phoenix branch requested stock quantities to meet their customer's demands. But each time another branch steals their inventory, they start to lose control of whom their customers really are. Are they the customers normally served by the Phoenix branch? Or, are they the customers and all the other branches that can call and take their inventory whenever they need it? More often, the latter is true. To compensate for this not knowing who their customers really are dilemma, most branch managers will order extra stock to cover themselves..also known as CYA (Cover their Assets) inventory. Allowing any branch to steal any other branch's inventory will lead to reckless inventory creep in all branches. They WILL find a way to beat the poor practices in place, and they WILL stock more than they need to service the customers in their areas. To help solve this problem, some rules need to be in place, and followed by everyone in the organization.

You will recall from previous articles that one of the silent killers in distribution is the carrying cost of inventory. Expressed as a percentage of the total inventory dollars on an annual basis, it runs at about 30%. It is a huge number, but one that happens everyday of the year inside of your company. When we allow random stealing of stock between branches, and the branch managers respond by stocking a little more of each item than they need, we are allowing thousands of dollars to leak out of our business each and everyday by paying additional carrying cost of the creeping inventory in all branches. Depending on the number of branches, this number can grow rapidly. Not only are you paying the vendor more for just in case inventory, you are losing cash by having to

store it, move it, keep it safe and pay taxes on it each year.

Instead of allowing the El Paso branch to simply transfer inventory from any branch to make their customer happy, try implementing some guidelines for stock transfers. One guideline would be to never transfer items where the gross margin dollars do not meet your established goals. Another might be, never transfer items without having the customer pay for the freight costs. Another might be to only transfer items for your Platinum Class of customers ( defined by those customers that contribute the largest dollars to you bottom line profits). This requires some sort of customer profitability analysis on your part. Dr. Stephen Pearce of Value Associates in Bryant, Texas can help you with the analysis through his customer profitability software offerings. (Note: please contact The Distribution Team for Dr. Pearce s software offerings). Finally, you might want to consider never transferring stock items from one branch to another unless the products your are transferring are surplus items for the transferring branch. Let me explain what I mean.

Instead of having your branch manager in El Paso pull up the product and see everyone s on hand quantities, consider allowing them to see only surplus stock in other locations. By seeing which branches have excess or surplus inventory, it will help you reduce that excess by transferring it and selling it. If any excess quantity exists, it only makes sense to sell it and transfer it when you have a customer order in hand. However, if you let any branch take anything from any other branch, you are creating an internal nightmare that can cost thousands of dollars. You will have all of your branch managers stocking more than they need because they can be robbed of their inventory at any given time. Use a calculation of a surplus point to help you manage this problem. A surplus point compares the replenishment stock level quantity for an item to a healthy stock level point, such that any quantity above that surplus point could and should be transferred at will to satisfy another branch s customer order. Using a surplus point to identify excess inventory is a better option. It basically says that if one branch has a quantity above the surplus point, that inventory is fair game for any other branch to transfer at will. Transferring surplus inventory will not effect the transferring branch s ability to service their customers, or cause them to experience stock outs. Surplus inventory is often inventory with levels that have plenty of safety stock already on hand. It makes sense to reduce your surplus inventory wherever possible. Do not steal from another branch s normal stock, as it will create a negative cash flow reaction by the transferring branch s manager they will buy more to cover themselves from future robberies. Thus you are spending cash to buy extra inventory and spending more cash to carry it. It s only money, and you can use these simple rules to save more of it if you don t steal from Phoenix to pay El Paso!

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