



# The Distribution Team

We wrote THE BOOK on Distribution Inventory Management

## **We Don't Have That in Stock – Now What? (Part 2)**

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In Part I of this article we talked about asking the right questions of the customer before making some drastic decision when we are out of stock. I want to re-emphasize that being out of stock of certain items over time is not a life and death situation. Look at every out of stock situation and determine if this is a rare occasion or something we need to fix on a long term basis. We very likely will run into those special orders that drive our in stock quantity to run to zero. This happens from time to time when we have a customer order that no one anticipates and soon we are out of stock. What we do then can make a big difference in your overall inventory status.

Let's look at some out of stock situations and determine what we should do. If we have items where the out of stock situations occur more than once a month, on an item we have committed to having in stock, you need to fix the replenishment plan. You can either order it more often from the vendor, increase your safety stock or shorten the review cycle such that it gets looked at by purchasing more often. Stock outs that are happening multiple times in a month indicate to us that we have items that are moving but we have not purchased to meet the anticipated demand. This situation is very "fixable" by adjusting our ordering controls.

If we have items where stock outs occur two to three times a year, the problem is not as easy to fix. First we must look at the items to see when they occur. We might very likely have seasonal items and the stock out issues happen before the season and we are waiting for the seasonal buy to arrive. We might experience stock outs at the end of the season where our seasonal buy quantity did not match the customer demand for that season. We might have a new customer that has a big project and drives our item level to zero. In these situations you need to carefully analyze your reactionary step. Seasonal items often cause stock outs to happen because we are relying on "mother nature" or some natural occurrence to define the "season". Building materials distributors often suffer stock outs when winter does not start until two months later than it did the last 3 years. We plan and purchase for seasonal items based on some seasonal history. We look to indicators to help us determine when we "think" the season will start and end. We will make pre-season buys to hopefully cover us through a season. When nature changes our "best guess" we will suffer stock outs. Taking a drastic step and putting in a large buy quantity to a vendor at end of season pricing often causes you to have "non-moving" inventory for the long "off season". Having a six month supply of water coolers on the shelf during the winter months is not a good thing. However, since we ran out towards the end of the

“hot season” and needed some to get us by, we placed a large vendor order to get a great per unit price. Then the “hot season” cooled off quickly and we are stuck with the water coolers until things warm up.

Seasonal items are often one of the biggest hassles distributors face. There is no magic formula for when a season starts and ends. We might look to the Farmers Almanac to help, but even then we are “best guessing”. Looking back in years to other seasonal patterns is a great help, but that too is a best guess. When we are suffering stock outs of a seasonal item towards the end of a season, I would suggest you look to your competitors for help. Buying a smaller amount from them to get you by is a much better deal than placing a larger purchase order to the vendor. If nothing else, you won’t have a seasonal item hanging around all during the “non-season”. If you recall from our previous articles, this rule of inventory is very true- “more bad things than good things can happen to anything you bring in and stock”! One of the bad things is the fact that we end up moving around those seasonal items during the non-season. We lose them, we break them, we misplace them and we often spread them around the place because we need the room for other items.

One more simple rule for seasonal items is that only your most experienced personnel should be involved with buying them. New purchasing personnel should not even know you have seasonal items. Without some experience – and you know that in purchasing experience equates to having made plenty of mistakes – new buyers will often over buy seasonal items. Experience, mistakes, wisdom and age are all beneficial skills for the seasonal product purchasing agent.

## **Backorders**

Backorders caused by stock outs are a constant nightmare. Some distributors swear they are in the backorder processing business. They never seem to have the right stuff in the right quantity in stock. Backorders are the nature of the distribution business. If you never had any backorders, you probably have too much inventory. Backorders are an indicator that you are selling what you have in stock. Backorder processing is a key component of customer service. But backorders can be a royal pain. Why they happen is hopefully not a mystery. Most software written in the last quarter century put in a routine called backorder processing. When a customer asks for a product and you are out, you create the backorder in order entry. It is usually pretty clean since you have a customer name, customer number and a product number. You either find the product needed immediately or you wait until the incoming vendor order arrives. Once the product arrives from the vendor; another part of backorder processing kicks in called backorder fill. This takes the received product and assigns it to the backorders waiting to be filled. The most common method of filling backorders is called “oldest first”. This looks at the date the backorder was created and compares it to the date the product was received in. Those with the longest time of being open or un-filled get product allocated to them, then those with the next longest time and so on. In other words, you are allocating product to old orders based on age. While this is easy for the software companies to program in the system, it may not be the most prudent method for filling backorders.

A few simple rules should apply when you are doing backorder fill. First look at all orders older than two weeks or 14 days. These orders would receive the allocated product first based on the system's method. But think about it for a second, you are going to allocate product to a backorder that is two weeks older or more. Some distributors will simply fill the backorders and send them out to the customer. This can be even more painful since any order that is two weeks old or older should be scrutinized before sending out the product. Unless we are the only game in town, there is a good chance that your customer found what they needed sometime in the past two weeks. If you just fill the backorder and send them the product, you very likely might be getting it back soon because they no longer need it. A good rule of thumb is to run all backorders that are two weeks old or older and make a few phone calls first. Ask if they still need the product and in what quantity they need it now. Two weeks ago it might have been a different need. Today it might not be a need. Simply filling the backorder based on age could mean you get to process a credit memo pretty soon. And we all know that credit memo processing is an expensive venture since we have sunk costs from shipping, from returned goods, possible some damage and we wasted our time. Pick up the phone for all orders two weeks old or older before shipping, you will be amazed at how often you can sell the product you would have allocated and sent to the backorder customer to a new customer and eliminate another backorder. My preferred method of backorder fill is allocating product to my best customers first (premier status) and then allocating to the "low life" customers, if there is any left for them. Whatever you do, do not allocate the entire shipment to backorders, because you will just create new backorders for the same product on the next order entry request.

## **Substitutes**

One of the best ways to reduce your out of stock and backorder issues is to set up a good "substitute" item file for as many products as you can. Substitutes are items that can perform the same function as the product originally requested by the customer, but might be from a different vendor. Some customers are vendor specific and oriented, and they ask you for the product by the vendor name. If you are out of stock but have the same item from a different vendor, then have the order entry program pop that substitute up on the screen for you. This can be done easily by building the substitute item file as part of your inventory master file. Try it and see how many "duplicate" items you have in your inventory today. These are items where you have one from let's say an OEM vendor, and you have the same product from a "knock off" vendor. They do exactly the same thing but they have different labels on them. If the customer asks for the OEM part and you are out of stock, then your order entry routine should populate your screen with the knock off vendor part.

If you really look at your inventory, there are hundreds of substitutes you can build to help make the sale, help reduce your backorders and help move your overall inventory. I am often reminded of the distributor that had over 300 different gloves in their stocking inventory. Many did the same thing but were from different vendors. It drove the President crazy. They would only sell the gloves when a customer asked for them by

vendor. The glove inventory never shrunk but grew to include more gloves from more vendors as they added more customers. He finally drew a line in the sand and said, “we will carry “x” number of gloves from “y” number of vendors, everything else will be special order! If a customer asks for one vendor’s glove and we don’t have sell them the substitute item.” This little action caused the glove inventory to shrink substantially and move much better. The President was able to sleep at night because he could not understand why a plumbing distributor should be carrying so many gloves in the first place. For him, stock outs on gloves was music to his ears.

Remember that stock outs can be a good thing sometimes. However, every stock out needs to be looked at carefully before making some knee jerk reaction. Some times waiting is a good thing. While patience might be a virtue, I know that ignorance when solving stock outs will never be blissful!

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