BRANCH INVENTORY MANAGEMENT BEGINS WITH BRANCH MANAGEMENT COMPENSATION

THE DISTRIBUTION TEAM

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Most distributors have faced the question of expansion sometime in their career. Should I remain a single location and concentrate my efforts regionally, or do I make the plunge into expansion and head down the branch path? Some distributors opt for the acquisition route, others prefer the homegrown method of opening new locations in another geographic region. From a marketing perspective, branching can be a great way to pick up the additional sales afforded to local stocking facilities. Your organization may have a substantial base of existing sales in a particular region. It is currently being served by a local sales representative, and a long range delivery route or common carrier. This isn't necessarily a bad formula from an operational perspective. The local sales person may have another opinion on this matter.

In most distributorships, sales has a very loud voice. Arguments to pick an incremental percentage of sales growth in a region steamroll the voices of operational reason and net profitability. Let's face it, some of us add locations to look and feel bigger than we really are. I have been told that in some cultures, the number of branches one possesses is a sign of virility. Ok, I made that one up. I have witnessed, and been party to, a certain chest puffing at national conventions. "We are having a really great year, we opened 3 new locations." This also tends to excite our vendor partners. More outlets means more sales opportunities. Who cares if they are profitable? We do.

Owners care about profitable locations. I would not suggest that they are immune to the excitement surrounding the prospect of a new location; but, the financial performance becomes a real factor in measuring the success of a branch location. Branch locations need to be highly profitable in order to offset the management headaches that they provide. It is a well known fact that the further away you get from the mother ship, the branch becomes more difficult to manage. The physical visits to the sites, the data equipment necessary to communicate and the logistics of transferring product all play into the hassle factor associated with branch locations. For those of you considering opening your first branch, become really familiar with the term "transfer". This word, more than any other, will dominate more future operational meetings in your organization.

In order to make managing a branch more practical, we look to employ an individual who will manage the daily functions of the branch so that we don't have to. Hiring the right branch manager has more to do with the eventual success of the location than you think. While their first responsibility is to increase sales, they must also be charged with managing the financial assets located in their four walls. This is the most overlooked area in branch management. In many cases, our branch inventory asset is very poorly managed. Branches become havens for dead inventory, surplus inventory, items way outside of your core competency and general inventory inaccuracy. Unfortunately, we tend to pick our branch management from one particular job title – sales.

Branch inventory management begins with branch management compensation. I recently worked with a company that was having trouble with too much overall inventory. They are a multi branch organization that enjoys a strong revenue stream in most of their locations. Over the years, inventory had crept up due to a lack of attention paid to the increase. Strong sales revenue tends to mask a lot of operational neglect. The management found itself in a position where the board of directors was demanding that the inventory levels be reduced company wide. In order to make this happen, each location was going to have to contribute to the overall reduction. Here is where we found the problem. Branch managers were given bonuses based on the sales performance of their location. There was no consideration for the management of assets, particularly inventory levels. If your compensation was based on sales, wouldn't you want as much inventory as possible to meet any potential customer demand?

In the situation, we decided to introduce the concept of inventory control to the branch managers in a subtle way. As I mentioned earlier, this company was enjoying a good stream of revenue. As a result of their prosperity, they were able to give out an annual bonus based on the profitability of the organization. We decided to use the bonus as a motivator to reduce overall inventory levels. Our first step was to establish a companywide goal to reduce the level of inventory by 1 million dollars in 12 months. Each location was given a goal based upon their relative size. The plan was very simple, if you reduced your inventory by the goal, all of the members of your team received 100% of their bonus. If you only made 80% of goal, your team would receive 80%

of their bonus. In addition, we modified the payout of the bonus. In order for incentives to be meaningful, they need to be based on shorter increments. Rather than paying an annual bonus, we modified the payout to quarterly. This brings constant attention to the initiative. If you want people to be serious about goals, they need to be tied to compensation. The days of people doing things “for the good of the company” are gone.

In this organization, we were able to utilize an existing bonus structure to create a program for meeting the company’s inventory reduction goals. This approach works really well for meeting a short term initiative. Our goal here was to reduce overall inventory by a million dollars. So what happens in year two? This is where we need to look at a more comprehensive plan designed to maintain inventory asset responsibility for the long haul. I am not advocating that we do away with the sales component of our branch management compensation. We sell things for a living. I am simply suggesting that we add some inventory management components to the overall compensation picture. Here are some suggestions:

Inventory Turns – At a base level, you want the branch to do as well as the company average. Since branches often have the ability to pull from a central warehouse, they should be able to carry less inventory. Push branches to have at least 2 more turns than the company average.

Dead Stock – Set a company goal for branch locations. 3-5% is a good starting place. Allow locations to move dead inventory back to hub locations a couple of times annually.

Inventory Accuracy – This is where cycle counting is critical. Inventory accuracy is critical if you are using a central purchasing scheme. All purchasing decisions are based on what the system says we have on the floor.

Service Levels – This is commonly known as fill rate. Service level is measured by how many times you were able to fill a line item 100%. For example, if you had an order with 10 line items, and you were able to fill 8 lines complete with the other 2 as partials, your service level percentage on that order would be 80%. Either you satisfied the request or you did not. Shoot for a 90-95% service level. A 98% service level would indicate that you are carrying too much inventory.

Surplus Stock – This is not dead stock. It is good turning inventory that you happen to have too much of. Be a stickler here. This is where sales people feel that carrying more is justified. Keep it below 1% of total inventory.

This list should get you started. I should note that all of these measurement components, with the exception of inventory accuracy, should be reserved for locations with at least 2 years of history. It will take you a solid 2 years to figure out what you should be stocking in order to satisfy the local market. There are several other asset management components that you can get your branch managers involved in; but I have a word of caution – make compensation plans easy to understand. It may take a couple of years to get all your components into a plan. This is the time to be patient. Educating your branch managers on the importance of inventory management will go a long way toward achieving your net profitability goals.