DON'T FORGET TO MANAGE THE SURPLUS

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THE DISTRIBUTION TEAM

Unproductive inventory is just a nice way to say that you have captive dollars sitting on your shelves instead of being used to make customer centric investments. As I have mentioned in previous articles, my practice tends to run in themes. The theme of the past six weeks has been about dead and slow inventory management. While I enjoy working on these challenges, I think that we sometimes forget about the third leg of the stool. Dead stock and slow movers may get all the press, but we can't forget that dollars tied up in surplus can be just as damaging to cash flow as the other two.

I know that there will be some in the audience that will argue that their slower and surplus inventory levels aren't all bad because of the rate of inflation we have seen in the past 18 months. News flash, inflation rates are cooling off in 2024. At the current rate of borrowing, which may be getting some relief in 2024, using your warehouse (or vault for the enlightened ones) as a savings account is a really terrible practice. My logic is simple on this. More bad things than good things happen to anything we bring into stock. Selling the item is the only good thing. On the flip side, the negative aspects may be damage, theft, obsolescence, and even misplacement. The longer an item sits on the shelf, the more the potential for these negative consequences. Conversion of unproductive inventory to cash has been a long-standing best practice in inventory management.

Many distributors are seeing record surplus inventory levels at the time of this writing. So how did we get here? It doesn't take a rocket scientist but let me connect the dots. The pandemic caused a very fragile supply chain to temporarily break. In many eyes, reliance on long distance supply was a house of cards just waiting for a stiff wind. The wind blew and our reliance on ocean freight bit us in the posterior. In a panic, distributors cranked out purchase orders in record fashion. The assumption was that they would only get a percentage of what they asked for, so the quantities were inflated. The prevailing thought was that the larger purchase order quantities would entice manufacturers to allocate inventory to these customers first. I can't argue with the strategy, but we forgot to check our brakes if for some reason the supply chain began to mend. Guess what? The suppliers found a way to eventually ship and in came this rolling tide of inflated purchases. Most of these orders are still gracing the shelves of our distributors.

Part of the challenge comes down to a lack of communication between partners in the supply chain. It's like the old therapist joke, "If it's not one thing, it's your mother". Pretty much every challenge in business can be attributed to some failure in communication. In this case, distributors and suppliers had not established solid lines of communication especially when we were seeing pandemic related absenteeism on both sides. As we are able to look back with a critical eye, we need to shore up these lines of communication. How much information are we willing to share with our supplier partners? Are we willing to share usage data with our supplier so that they can be more adequately prepared to fulfill our needs. Again, I think most distributors fall very short on this ideal. I had a great conversation about this with a manufacturer in the plumbing space. We were discussing the benefits of VMI (vendor managed inventory) to both the supplier and distributor. She admitted that they had explored this in the past but couldn't get anyone to bite. If supplied with usage data, her company could better plan their production runs to meet anticipated demand. Some of you might share data with your top two or three suppliers; but what if you were to provide anticipated usage to your top 20 suppliers? This data isn't a promise to buy. It just helps your supplier better prepare for the need.

Looking down the supply chain, how well are we studying economic market data? I have to roll my eyes when distributors create a sales budget by going out and asking their customers what their next year will look like. Generally, it's the field salespeople that are tasked with this endeavor. Do we give them any guidelines on what to ask? Come on, these folks are not trained researchers. One could argue that information gathering is one of the core tenants of a successful salesperson; but this might be outside the scope of their experience.

What are the key economic indicators that will affect your market? With the US GDP looking to grow at an anemic .9% in 2024, will that affect your customers' spending habits? Will a reduction in interest rates, perhaps by more than 100 basis points drive confidence in capital-intensive projects. Is the Government planning to continue spending money on infrastructure? I don't know. If I was a distributor today, I would make it my business to know. The study of economics is way cooler than you thought it was in school. It might just give you the edge over your competitors.

Using this data, you need to get your replenishment and inventory levels locked into your software solution. Don't wait for it to adjust based on historical data. You need to tinker a bit. Every system worth its salt has the option to tweak usage based on current conditions. I remember the inventory guru of the company I grew up in would use the multiplier features to make adjustments up or down depending on current market conditions. Become a student of these powerful tools. Get the system dialed in so that you can be very realistic about the amount of excess inventory you are holding. Make sure that future replenishment decisions are made using an adjusted usage rate versus the historically calculated one. No need to compound the problem.

Now that we know the scope of the problem, we can get down to working on the solution. Good software systems will identify and report your surplus stock. Remember, it is based on the current replenishment parameters, so do your manual repair work first. If your system isn't giving you many options for identification, I tend to look at a "months on hand" calculation. This comes from looking at your inventory on hand divided by the usage rate per month. I have a simple rule of thumb, anything above 9 months of inventory on hand is something I will question. There may be a valid reason for having it, but I am going to give it a critical eye. Obviously, this is my rule of thumb. Let your conscience, and your market, be your guide.

A lot of these same tactics you would use for dead and slow stock liquidations apply, but there might be a few new ones to try. When it comes to vendor returns, most distributors stick to their dead and slow. Successful inventory reduction specialists will add their surplus load to an RGA. Be reasonable here. You made the decision to buy it in the first place. Most reasonable suppliers will let you offload some of the problem if you are a customer in good standing. A little humble pie goes a long way here.

I like some strategic promotions when trying to right-size the inventory. In many cases, the offending item is not a bad seller. You are just a little overstocked. Figure out what your ideal level looks like and blow out the rest. Yes, I mean drop the price and move it for a short period of time. Be careful that this new sales usage is backed out of the replenishment calculation, in your software, or you will be right back in the same boat. I know that many of you hate the thought of doing a yard sale, but don't overlook the opportunity for a cash grab event. The biggest mistake I see is on the marketing side of the sale. Don't call it an "inventory clearance" or "inventory reduction" event. This brings in the garage sale kind of customer. Make sure the message is positive. "Customer Appreciation Sale", "Spring Sale", or my favorite "Octoberfest" can all be used to drive in the right crowd. Invite your suppliers to participate as well. You probably won't be wildly successful the first go around, but don't give up. The home run is when customers start to ask when the next event is.

The reduction of unproductive inventory is just part of being a distributor. It will always be a part of your operating process. Make a plan and execute. The worst thing you can do is expect to sell your way out of the problem through the normal course of business. Many a failed distributor could have this philosophy written on their tombstone. Good luck and know that I am always here to help.

About the Author:
Jason Bader is the principal of The Distribution Team. He is a holistic distribution advisor who is passionate about helping business owners solve challenges, generate wealth and achieve personal goals. He can be found speaking at several industry events throughout the year, providing executive coaching services to private clients and letting his thoughts be known in an industry publication or two. Last year, he launched his first podcast, Distribution Talk. Episodes can be found at ***www.distributiontalk.com*** *and most podcast applications. He can be reached at* **(503) 282-2333** *or via email at* ***jason@distributionteam.com****. You can find additional resources on his website:* ***www.thedistributionteam.com***