Aligning the Warehouse, Purchasing & Sales for Your Success and Sanity!

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What does aligning purchasing, distribution, and sales mean?

• The three disciplines work in unison as a supply chain to provide the best possible product and the greatest profit
  – Marketing is also a forgotten, but key player
• Decisions about everything from vendor selection, product stocking decisions, and “go to” market sales strategies are decided as a team
• Financial and performance results are measured as impact to the corporate bottom line, not silo accomplishments
The Three Silos

• Procurement
• Distribution
• Sales/Marketing
Silo 1 – Procurement

- Their Current Core Priorities
  - To source stocking product at the cheapest price
  - To reduce COGS
  - To have enough product in stock for sale
  - To lower the impact of inbound freight on COGS
  - Many procurement teams are awarded (financially) on lowering the COGS metric
Silo 2 – Distribution

• Their Current Core Priorities
  – To validate and receive inbound stock against expected requirements
  – To house and manage inventory
  – To process outbound orders at the lowest possible cost with highest possible accuracy
  – Many procurement teams are awarded (financially) on order OTD, order accuracy, and cost per order/line shipped
Silo 3 – Sales and Marketing

• Their Current Core Priorities
  – To sell product at the highest possible price while increasing sales
  – To provide clients with goods and services that differentiate their products from competitors
  – To ensure that their customers are satisfied with the level of product and services received
  – To introduce new and improved products
  – Usually directly compensated by margin on sales
Why is this a problem?

These 3 elements; Procurement, Distribution, Sales and Marketing typically work as independent entities within a company

• They are rewarded on goals that may negatively affect the other areas
• The true cost burden of decisions made within an area may be shifted to another area
• There is not a true understanding, operationally and financially, of the true impacts of decisions made outside of their own immediate goals
• The 3 areas work as Silos working to independent goals as opposed to a larger corporate vision
3 components of profit

• Revenue
• Margin
• Operating Expense
Example 1

REAL WORLD EXAMPLES
Example 1 – Procurement Changes Inventory Source

• Procurement switches vendors from US based to china based vendor
  – Saved 4% on unit COG (including freight
    • Viewed as 4% margin bump
    • Core inventory line (several items affected)
    • Larger purchases (to account for over extended lead times) made freight costs neutral
Example 1 – Procurement Changes Source

• Distribution Impact
  – Cartons stacked in container, not on pallets. Had to be hand unloaded, sorted, and stacked
  – Carton Labeling was not adequate and cartons has to be relabeled by the distribution center for facility use
  – Damaged product increased from less .25% for domestic OTR to 9% (either repacked or non-saleable)
  – Pallets had to be purchased, shrink wrap added for internal handling
  – Purchasing quantity raised from 1 month supply to 3.5 months to get container loads maxed and overcome lead times; pallet storage requirements more than tripled
  – Packaging was slightly different and the DC had to keep the different products segregated (even returns)
Example 1 – Procurement Changes Source

• True impact
  – The great deal that procurement got
    • 4% reduction in cost of goods
    • 7% increase in the cost of goods when the distribution impact costs were added to the COGS
      – Originally, the DC impact was only considered a cost against the operations, not as a cost of the product (higher sales margin, unrelated increase costs in operations)
  • The Net result was a 3% margin loss
Example 1 results

- The true LANDED cost of the product (ready for distribution) went UP when all costs were factored in.
- The DC had increased labor and supply costs NOT attributed to the product change.
- Inventory turns dropped as physical storage requirements increased.
- Service level and quality dropped.
- The lack of vendor compliance requirements and guidelines means the company ASSUMED the extra responsibilities and costs for the product.
- There is no mechanism for the company to see the true cause and effect as a supply chain metric…only in the silos.
Example 2

REAL WORLD EXAMPLES
Example 2 – Marketing and sales pushes a product line

- Sales/Marketing wants to give a boost to sales numbers
- Key Product line, core items to have special lower price for 2 weeks starting the following sales Monday
- Sale Product is featured on landing page of website
- Email blast announcing limited time special price
- Sales force is given marching orders to push the product
  - Sales given extra incentive rewards for category sales
- Call Center and CSRs given scripts to push the product
- All hold messages changed to reflect sales offer
Example 2 – Marketing and sales pushes a product line

- Impacts to procurement and distribution
  - Were not informed of sale, the scope, or forecasted increases in volume
  - On hand quantities not sufficient to fulfill increased volume
  - Procurement forecasts were not accurate due to the unprecedented temporary bump in volume
  - Procurement ordered product based on short term need with lead times out of range of sale; product was expedited at a higher cost and the supplier had to break up shipments
  - Stocking levels of the primary pick mediums in the DC no longer sufficient / running through stock
  - Average line per order / average revenue per order drop
  - Product out of stock must be backordered
    - Process as separate orders by the DC (doubling costs)
    - Company must pay shipping on back orders
Example 2 results

- Increased gross sales
- Lower gross margin (due to special pricing)
- Lower revenue per order / lower profit per order
- Increased landed cost of product (higher COGS)
- Increased warehouse cost per line (receiving, replenishment, picking, packing, consumables)
- Increased outbound shipping cost burden
- Increased sales at a lower net operating profit
LET’S FIX IT
Teamwork

• The disciplines CANNOT work and make decisions in the vacuum of their department
• Weekly planning meeting that have all of the disciplines involved
• The silos should be aligned on concepts and programs
• The true impact of a program or concept on the supply chain should be clear and understood by the entire team
• Never have performance goals or incentives tied to things that will negatively affect another discipline, rather positively affect the corporate bottom line
Fixing it! Think like a 3PL when it comes to operations

• Every function has a cost
  – Product storage and space required / cost per location
  – Product handling (receiving, picking, counting) / cost per touch
  – Product prepping (re-boxing, labeling, documents, etc)
  – Value added costs (inbound and outbound)
  – Product attribute impact – products of unusual size or handling requirements
  – A good 3pl will NEVER take on product or services where they cannot clearly define the cost impact to the COMPANY
Procurement’s NEW Priorities

• Vendor Compliance Program
  – Spell out all inbound requirements
    • Cartons, labeling, pallets, UOM’s
    • Volumetric data (key for Ecom)
  – Police Vendors in terms of communicating results
• COGS calculated on TRUE landed cost (ready for put-away in the DC)
• Product Return program, especially on new products/ product lines
• Increase inventory turns by focusing on both volume items and excess / obsolete
• Calculate the FULL financial impact and physical requirements of special buys
Distribution’s NEW Priorities

- Define cost of storage and services to communicate to the other disciplines
- Document vendor compliance performance results
- Streamline and automate value added services
- Use volume-metrics to determine space and system requirements (no guess work)
- Use cost per order/line processed to measure financial performance and gauge improvements
- Define and communicate order service levels to sales (what is the time horizon to process orders)
Sales & Marketing’s NEW Priorities

• Include the other disciplines on sales and marketing initiatives
• Align sales quantity breaks with stocking UOMs whenever possible (i.e. price break on 5 when box is 6)
• Understand the prep time to ramp up procurement and operations for a major sale or product launch – BE PREPARED TO FORECAST
• Understand what the value added service you offer or your customers request REALLY cost
• Provide realistic sales forecasts for proper planning
Joint Operations

• Active excess and obsolete program resolution
  – Inventory carrying costs valued typically at 20-25% of it’s value year over year
  – Invoke a REAL program – set up a structure
    1. Put the items on sale
    2. Put the items on sale AND spiff the sales/CSR’s
    3. Fire sale the items below cost
    4. Sell the items to a jobber for whatever you can
    5. Throw the items out or donate them
## Carrying Cost Financial Impact - Item

<table>
<thead>
<tr>
<th>Example</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Light bulbs - D item class</td>
<td></td>
</tr>
<tr>
<td>Cost Ea</td>
<td>$ 10.95</td>
</tr>
<tr>
<td>Quanitiy on Hand</td>
<td>50</td>
</tr>
<tr>
<td>COGs on hand</td>
<td>$ 547.50</td>
</tr>
<tr>
<td>Last Year sales</td>
<td>2</td>
</tr>
<tr>
<td>Carrying cost factor</td>
<td>20%</td>
</tr>
<tr>
<td>Year 1 Carrying cost</td>
<td>$ 109.50</td>
</tr>
<tr>
<td>Year 2 Carrying cost</td>
<td>$ 109.50</td>
</tr>
<tr>
<td>Gross Margin on Product</td>
<td>25%</td>
</tr>
<tr>
<td>Margin on my 2 units</td>
<td>$ 27.38</td>
</tr>
<tr>
<td>After 2 years, COG</td>
<td>$ 766.50</td>
</tr>
</tbody>
</table>
## Carrying Cost Financial Impact – overall

<table>
<thead>
<tr>
<th>Actual Client</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Inventory Items</td>
<td>52852</td>
</tr>
<tr>
<td>Items without sale in one year - E Items</td>
<td>12581</td>
</tr>
<tr>
<td>Total Inventory COG</td>
<td>$3,800,000</td>
</tr>
<tr>
<td>E Items COG</td>
<td>$855,000</td>
</tr>
<tr>
<td>Carrying cost factor</td>
<td>20%</td>
</tr>
<tr>
<td>1 year carrying cost</td>
<td>$171,000</td>
</tr>
<tr>
<td>3 year carrying cost</td>
<td>$513,000</td>
</tr>
</tbody>
</table>
Summary

• Think like a 3pl – every function has a cost
• Sales, Procurement, and Distribution should be a working team for ALL facets of planning
• Understand the real impacts of inventory carrying costs and give yourself options to return inventory before it gets old
• Implement a vendor compliance program, even if you can’t get 100% compliance
• Don’t be penny wise and pound foolish – understand overall true cost impact to the company, not just on metric
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