Distribution 2010: Capitalizing on Advanced Inventory Management

Table of Contents

Introduction

Distributors of all kinds are now facing challenges to their survival and success as today's difficult economy puts increasing pressure on inventories.

As competition intensifies, costs rise, customer expectations increase, and profit margins continue to shrink, the margin for error around inventory management has continuously narrowed. Now, wholesalers/distributors are forced to confront the dilemma associated with inventory. They must determine how to keep stock levels as low as possible without sacrificing customer service.

Unfortunately, their pain points are increasingly exposed. Whether they are stocking electrical supplies, medical devices, automotive parts, food and beverage products, building materials, or products from other sectors, most distributors are now challenged to rethink their approaches to inventory management.

While some industry leaders are demonstrating winning strategies and practices, industry laggards are now facing such problems as:

- Insufficient controls
- Excessive costs
- Strained customer service levels

Today's laggards, however, have an opportunity to enhance operations—and even position themselves for success in the inevitable economic recovery. As leading distributors have discovered, new strategies and systems associated with advanced inventory management can turn an operationally challenged distribution organization into an operationally excellent one.[1]

What's the payoff?

- Exceptional control over the inventory lifecycle
- Deep visibility across an extended, multi-warehouse enterprise
- Inventory levels that are fully in synch with demand
- Reduced costs associated with inventory in stock
- Enhanced customer service tied to increasingly optimized fulfillment

Distribution executives—whether they are owners, senior managers, or operational leaders—now have an opportunity to embrace advanced inventory management, increase operational performance, and lay the foundations for profitable growth in the coming years. The only question is: Who will seize the moment?

[1] F. Barry Lawrence, Senthil Gunasekaran, Pradip Krishnadevarajan, National Association of Wholesaler-Distributors, *Optimizing Distributor Profitability: Best Practices to a Stronger Bottom Line*, 2008.

Market Trends and Drivers: Difficult Economy Puts New Strains on Distributors

Against the backdrop of a difficult economy, distributors are challenged to meet the high expectations of their customers. However, the distribution environment in most sectors is in a state of dynamic and turbulent change as working capital tightens, customer demand declines, operational costs rise, and competition becomes more intense.

The current downturn has created havoc for wholesale distributors with thin margins. They are especially challenged by the tightening of their available working capital. Such capital quite often is tied up in existing inventory and unavailable for key activities necessary to properly run the business. This cash crunch, exacerbated by the reluctance of banks to lend on terms that are acceptable to distributors, is putting increasing attention on inventory management. With so much of their working capital tied up in their stocks, distributors are seeking ways to reduce inventory costs without undermining customer relationships and diminishing service levels.

Of course, the greatest contributor to these challenges is the reduction in demand from customers. Distributors in such sectors as automotive and construction have been especially hard hit as these sectors have undergone severe contraction. In the current environment, demand is far less predictable than it has been in the past. Demand forecasting, as a result, becomes far more important if distributors are to avoid the fate of carrying unnecessary inventories that further erode profitability. And, given the buyer uncertainty and restricted demand of the present, every potential sale must be pursued with extreme care.

Operational costs, meanwhile, have not relented. The costs of energy and transportation have continuously fluctuated. As other commodity costs have also risen, some distributors have experienced a rise in their cost of goods. Given that they may have little leverage to pass those rising costs on to prospective buyers, distributors are further squeezed and challenged to confront their inventory issues.

Finally, competition is intensifying in the distribution arena. Many distributors willingly accept reduced margins to drive inventory turns, putting further pressure on profit margins across the board. What's more, in some cases, manufacturers are attempting to bypass distributors and go straight to market to protect their own margins.

On the positive side, distributors that increase their productivity and performance to adapt to this new and harsher economic climate may be well positioned to thrive when the economy inevitably recovers. The actions they must take now to survive can be expected to contribute to their success in a stronger economy. To smartly and cost-effectively adapt, distributors will need to take inventory management to new levels of performance.

Savvy warehouse/distribution managers are benchmarking key metrics and adopting best practices to make sure they stay one step ahead of the competition.

Much is riding on such moves—for both distributors and the economy at large. According to John Brandt, CEO of The MPI Group, "Warehouse/distribution facilities are crucial leverage points for the supply chain in our global economy; any mistake during the distribution process spells loss of profits and friction with customers. Savvy warehouse/distribution managers are benchmarking key metrics and adopting best practices to make sure they stay one step ahead of the competition."[2]

[2] John R. Brandt, The MPI Group, *Distribution 2008: Executive Summary*, 2007.

Key Inventory Management Challenges: Controls, Costs, and Customer Service

At present, most distributors are struggling with a set of difficult inventory management challenges that threaten to undermine their performance and further diminish narrow operating margins. Their central challenges revolve around limited controls, excessive cost, and strained customer service levels. Let's consider these issues one by one:

Limited Controls—Distributors often lack full inventory visibility. They are unaware of the inventory they possess, whether it is at a particular site or spread out among multiple locations. This problem may be especially acute when they have acquired other distributors and now have multiple, disparate inventory management systems. As a result, they may have overstocked inventories and be prone to ordering items they already own. They may even find themselves re-ordering items that are in transit or are sitting on the dock. They have limited control over their inventory.

To have complete control over their inventories, they must have information about existing stock items and available inventories right at their fingertips. They must know what quantities are available—and identify the sites where goods are located. They must know the cost of available items to make bids. They need to know what is selling and what is not, particularly when demand is prone to seasonal patterns, sudden spikes, or severe declines. They must, in essence, have deep visibility into all their warehouses.

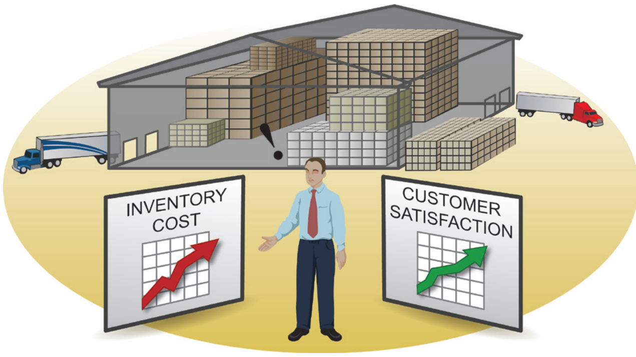
Excessive Costs—In today's difficult economic environment, distributors cannot bear the added costs of needless inventory. They are challenged to manage their limited working capital as effectively as possible. However, inventory is the most significant factor on their balance sheets. If they are unable to manage this factor with greater precision, they are unlikely to succeed in increasingly challenging markets.

Unfortunately, this is the case with too many distributors today. Their capital is tied up in inventories that do not reflect customer demand—or they are carrying duplicate and excessive stocks in their various warehouse locations that drive up costs. They also bear the handling costs associated with that inventory. They even suffer the opportunity costs associated with lost sales when they don't have the right inventories on hand.

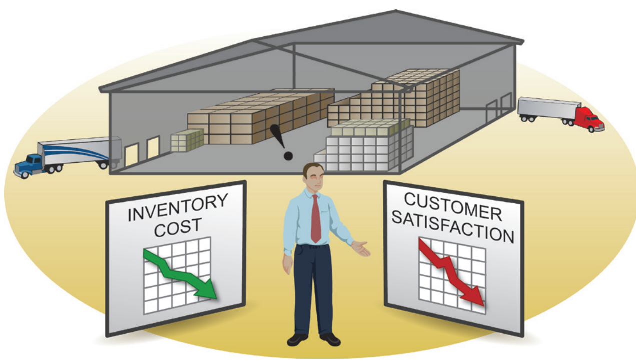
But it doesn't end there. In the absence of inventory control and visibility, they also are unable to bargain with suppliers for better deals and terms for the goods they must stock. They tend to pay for too much warehouse space and equipment to operate their facilities. Moreover, they overpay for labor—both fixed and variable—because they are unable to effectively deploy their human capital. Labor productivity, says Pembroke Consulting Founder Adam Fein, is "crucial to profitability in wholesale distribution because employee compensation costs—salaries, commissions and benefits—represent 60 to 70% of total operating expenses."[3]

[3] Adam Fein, Pembroke Consulting, IBM Website, "Where Productivity Is Growing in Wholesale Distribution," August 2006.

Finally, they are prone to selling off inventories at a loss to reduce their stocks. All such costs represent a drag on the performance of distributors and, in today's hyper-competitive environment, a threat to their ongoing profitability. Even when customer satisfaction ratings are kept high through heroic effort, their business suffers.



Strained Customer Service Levels—When customer orders are delayed or mishandled, distributors are clearly vulnerable to dissatisfaction, financial penalties, and even lost business. Customer expectations, after all, have risen significantly in recent years. Industry analysts now discuss the necessity of delivering on "the perfect order"—the right product at the right time at the right price.[4] Unfortunately, many distributors now struggle mightily to meet these expectations, particularly as stock levels drop in relation to diminishing working capital.



To fulfill orders swiftly and accurately without loading up on inventory, distributors must have intimate knowledge of both customer demand and available stocks. They must directly confront the dilemma of reducing stocks without undermining customer relationships. Distributors that do overcome this hurdle have the opportunity to stand apart in the marketplace, enhancing customer service levels even as they increase their own profitability.

[4] David Blanchard, "The Perfect Order," Industry Week, January 1, 2007.

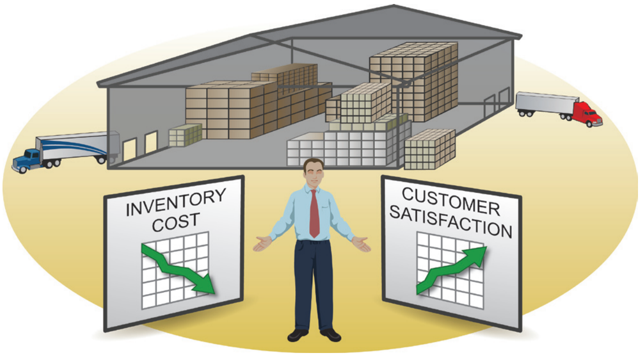
Business Solution: Advanced Inventory Management

To remain profitable, competitive, and operationally effective in the coming years, best-in-class distributors have adopted advanced inventory management solutions. Such approaches, which revolve around a mix of new strategies and systems, are designed to optimize inventories while maintaining excellent customer service.

Strategically speaking, distributors are unlikely to be successful in the coming years unless they have an expansive view of their inventory assets covering all sites and locations. They need to go beyond the conventional view of inventory that relies on rigid, rule-bound processes for ordering (and reordering) stock to both optimize inventories and meet the dynamic, often unpredictable, needs of today's demanding customers.

Strategic imperatives, however, cannot be addressed without considering the systems that enable strategies to be executed. Some distributors now rely on spreadsheets and other labor-intensive methods to operate their warehouses, while most others rely on constrained "min/max" reordering formulas that limit one's inventory management capabilities. It's now critical to make purchasing decisions based on factors such as lead times, safety stock days, and sales histories.

Instead of simply reordering when a stock falls to its minimum level (or holding steady when a maximum stock threshold is reached), distributors need to be able to analyze demand trends and patterns, identify inventories in multiple locations (including in-transit shipments), and make stocking decisions based on an optimal mapping of supply to demand.



This is the promise and the reality of advanced inventory management. Such systems are capable of providing distribution managers with a big picture over operations while managing the full inventory lifecycle from sourcing to stocking to shipping.

Advanced inventory management systems possess several core capabilities:

- **Stock Level Calculation**—This capability enables distributors to determine stock levels based on usage, ensuring they have the right product level on the shelf to match demand. Unlike the min/max approach, it enables one to factor in seasonal considerations, location, speed of delivery, and demand trends.

- **Non-Stock Inventory Visibility**—This lets the distributor track items that are not part of "normal" inventory—ones typically ordered to "complete" a customer order. Whether the items are moved, shipped, released back to the supplier, or made available for selling to someone else, they need to be tracked—by quantity and location—like normal inventory.

- **Multi-Location Visibility**—This enables the distributor to identify available inventories within its own network of warehouses, providing insight into its full inventory, and enabling it to ship from multiple locations to meet customer needs.

- **Usage Reporting**—This capability gives the distributor a thorough understanding of the history of product sales and demand patterns—what is selling and what is not. This helps the firm intelligently plan and optimize its stocks.

- **Vendor-Managed Inventory**—Because some customers prefer to have their own inventories automatically replenished, this capability enables a distributor to track inventories necessary to ensure customer service levels and performance agreements are appropriately managed.[5]

Such capabilities address the wider mission of optimizing inventories while meeting rising customer expectations. Indeed, there are several key benefits associated with advanced inventory management. Among them:

- Exceptional control over the inventory lifecycle
- Deep visibility across an extended, multi-warehouse enterprise
- Inventory levels that are fully in synch with demand
- Reduced costs associated with inventory in stock
- Enhanced customer service tied to increasingly optimized fulfillment

Consider some of the distributors that have capitalized on advanced inventory management to operate effectively in today's challenging environment.

[5] Adam Fein, Pembroke Consulting, IBM Website, "Demand-Driven Customer Relationships," 2007.

Case in Point: Kipp Brothers

From its headquarters and 100,000-square-foot warehouse just outside Indianapolis, Indiana, Kipp Brothers sells a wide variety of novelty gift items including small toys, party favors, mugs, key chains, costume jewelry, decorations, and seasonal items such as Easter baskets and Christmas ornaments.

Founded in 1880, Kipp Brothers is a privately held importer and wholesaler, importing much of its diverse inventory from Taiwan and China. Kipp Brothers maintains more than 3,500 different items. Currently, the company serves more than 78,000 customers, ranging from large supermarkets and retail stores to schools, gift shops, and home users across North America, the Caribbean, Russia, Spain, and parts of South America.

Setting the Strategy—Although the ownership of Kipp Brothers has changed over the years, the distributor continues to grow and flourish in a business environment that is increasingly challenging and competitive. With a large and diverse customer base, ordering patterns can be both unpredictable and complex. Combine that with the many challenges of purchasing stock from Southeast Asia, where it takes 60 to 120 days to receive inventory, and it is amazing that Kipp Brothers successfully keeps its fill rates at above 90% and ships all orders within 24 hours of receipt.

So how does Kipp Brothers efficiently manage the complex and unpredictable intricacies of its import and wholesale business while successfully servicing such a large and far-reaching customer base? The answer is Infor™ ERP FACTS Warehouse Management.

Getting Business Specific—When Bob Glenn, president of Kipp Brothers, began searching for software to help his company fill orders more quickly and accurately, he knew he needed one that was easy to use and could grow with the business. He selected Infor ERP FACTS Warehouse Management because he believed the application met those criteria without question. After the application was implemented and up and running in a short time, Glenn was immediately impressed with the distribution functionality and the flexibility to customize the application to more precisely fit the company's unique import business processes.

Seeing Results—With Infor ERP FACTS, Kipp Brothers has completely automated its inventory, sales order, invoicing, and accounting processes. According to Glenn, "Employees continue to reach higher levels of productivity, accuracy, and efficiency, dramatically improving our customer service and overall customer satisfaction."

Using Infor ERP FACTS, company managers also can quickly view reports on sales history, gaining access to key business information on customers, product trends, order history, and ways to improve inventory forecasting. Says Glenn, “Previously, when a customer wanted to know about past orders, someone would have to literally dig through paper files to locate the right information. Now with Infor ERP FACTS, comprehensive customer records are just a point and click away.”

The company’s processes are streamlined, efficiencies are achieved, information is quickly accessible, and most importantly, customer service is improved. As part of the company’s shift to electronic commerce, Kipp Brothers recently launched a new website that integrates with Infor ERP FACTS and enables customers to view, order, and purchase products online. Notes Glenn, “We now see about 40% of our orders conducted online, and our customer numbers are over 78,000.”

“Infor ERP FACTS Warehouse Management has enabled us to process orders more quickly, provide better customer service, and improve our cash flow, positioning us to more than double our business without additional investments in equipment or personnel.”
BOB GLENN, PRESIDENT, KIPP BROTHERS

One of the most dramatic benefits of Infor ERP FACTS is how it has improved the company’s cash flow. “At Kipp Brothers, we turn our inventory three or four times a year, which is a lot for the import business,” says Glenn. “FACTS helps forecast how much inventory I need for a specified period, which is about all you can ask for in this business. It’s hard to predict how much our customers will order or if a typhoon or strike at the docks will delay receipt of our shipments. Sometimes we need a crystal ball.”

Since implementing the Infor ERP FACTS Warehouse Management module, Glenn has seen impressive improvements in productivity throughout all processes in the warehouse. “With Infor ERP FACTS Warehouse Management, we have reduced our inventory overhead from $2.2 million to $1.3 million, significantly improving our overall cash flow and inventory investment,” says Glenn.

“The entire materials handling process is automated with Warehouse Management. Employees have access to real-time data on every aspect of warehouse operations,” he adds. “Both customers and employees have access to real-time inventory. The application is so easy to use that employees can be trained on it in as little as an hour. Previously, it took at least a week to get workers trained in the warehouse.”

Infor ERP FACTS Warehouse Management has redefined the way Kipp Brothers manages its inventory. Gone is the company’s tedious year-end inventory process that involved the entire warehouse staff manually counting items. Now, Kipp Brothers uses just two people for inventory cycle-counting. “Since cycle-counting is now so fast and easy, it’s done continuously rather than just at year’s end,” Glenn explains. “Now we know exactly how much inventory is on hand at all times.”

Glenn further mentions the true bottom-line benefit of the application, which can best be summed up by the company’s successful expansion without increasing overhead. “Infor ERP FACTS Warehouse Management has enabled us to process orders more quickly, provide better customer service, and improve our cash flow, positioning us to more than double our business without additional investments in equipment or personnel. The application has also allowed us to expand our fulfillment business by offering our order-filling services to other companies.

Case in Point: Endries International

Endries International is a worldwide distributor of Class E materials, mainly consisting of fasteners and products for the maintenance and repair organization (MRO) and original equipment manufacturer (OEM) markets. Its 120 locations span the globe, with the corporate office located in Brillion, Wisconsin.

The mission of Endries International is to develop long-term partnerships with customers by helping them meet their cost reduction, vendor consolidation, and productivity improvement goals. The company offers its customers engineering support services, documented performance measurements, and cost-saving opportunities as part of its drive for continuous improvement.

Setting the Strategy—In the early to mid-1990s, Endries International took a close look at its homegrown software and decided that it needed a major upgrade. With an aggressive growth plan, the company knew that it needed to adopt robust and flexible applications as a solid foundation to support long-term growth and manage all the business changes along the way. Its objective was to be able to continually upgrade its technology with minimal disruption to its business processes while seeking new ways to streamline those processes.

According to Todd Fischer, vice president and corporate information officer at Endries International, "At that time, our revenues were only about $15 million, and we were focusing on growing the business significantly. Our goal was to be over $100 million by 2000, and we knew the existing software just couldn't get us there."

Getting Business Specific—Endries began the search for a vendor and application that met every requirement along its path of continual growth. "We conducted an extensive review of five different software suppliers," says Fischer, "and Infor came to the forefront on several important points. For one, the company had a solid base of employees and showed every indication it would be with us throughout the years. We wanted to make sure that our software backer was going to support us for the long haul because we were making a major strategic decision. We chose Infor ERP SX.enterprise because it proved to be a strong package that met all of our requirements."

> "Even with 60,000 to 80,000 products in the warehouse, the picks per hour increased significantly....(from) about two-and-a-half...to about five-and-a-half lines per hour."
>
> TODD FISCHER, VP AND CIO, ENDRIES

Seeing Results—How successful was the company? Fischer declares, "After Bob Endries set revenue goals of $100 million and we implemented the Infor software, it performed so well for us that our business grew quickly. Our processes improved hand over fist. With SX.enterprise, we added inventory, customers, and personnel, and within five years we reached our $100 million revenue mark."

Endries International continued to look for ways to streamline its operations and improve inventory accuracy and productivity. The next step was to employ an integrated module of SX.enterprise. "We looked at other products on the market, but we didn't see any major advantage over Infor SX.enterprise Total Warehouse Logistics (TWL). We got it up and running within a reasonable time and avoided the huge expense of interfaces with other systems."

> "Our savings on just one warehouse was half a million dollars with Infor SCM Demand Planning—an ROI within one year."
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> TODD FISCHER, VP AND CIO, ENDRIES

Fischer explains the specific reason for using Infor's warehouse management system. "We deployed it to minimize loss of product and increase our picking lines per hour. After TWL, everyone could locate products—whether they were in picking, shipping, or receiving." Even with 60,000 to 80,000 products in the warehouse, the picks per hour increased significantly. Fischer says, "Before implementing TWL, our pick rate was about two-and-a-half to three lines per hour. After TWL, we started running at about five-and-a-half lines per hour. We didn't reduce staff, but we avoided hiring new staff—a huge gain for us."

Inventory accuracy at Endries improved so much after the application was implemented that the company no longer needed to do year-end inventory counts. "Having 100,000 products in the warehouse makes it difficult to do a full cycle count," Fischer adds. "TWL allows us to do cycle counts as we are running the business. Our accounting firms now do just samplings, and our accuracies are up around 99.7%. We've eliminated the annual four-day shutdown by doing continuous counting throughout the year."

The next level in Endries' growth evolution was inventory management. After implementing Infor SCM Demand Planning, the company tested it in several warehouses and found that it helped save dollars in safety stock. "Our savings on just one warehouse was half a million dollars with Infor SCM Demand Planning—an ROI within one year." The company is rolling it out to additional warehouses and expects the same return.

"We've increased our picking and delivery accuracy as well as shipping efficiency," says Fischer. "We're able to continue to grow, make upgrades, and keep our business on the leading edge of technology with Infor products. We've had big paybacks."

In summary, Infor ERP SX.enterprise with Total Warehouse Logistics and SCM Demand Planning have helped Endries International to:

- Increase revenue from $15 million to $100 million over a five-year period
- Increase pick rate from two-and-a-half lines per hour to five-and-a-half lines
- Improve inventory accuracy to 99.7%
- Eliminate yearly inventory counts by being able to do continuous counting
- Save half a million dollars in warehouse safety stock in one warehouse alone in just one year
- Increase delivery accuracy and shipping efficiency

The company's mission is to drive toward continuous improvement for its customers, and it looks for the same in its suppliers. "Infor has helped us continually improve and grow our business until we are now at $700 million, including other divisions. We love the software," says Fischer.

Conclusion: Strategically Managing Inventory for Future Growth

Many distributors may be merely struggling to survive in today's harsh economic climate. But the actions they take today to sharpen their operational performance and streamline their processes will lay the groundwork for profitable growth as the economy recovers.

Given the weight of inventories on today's balance sheets and their tendency to absorb limited working capital, taking action now is critical to optimize stocks in a way that is consistent with the demands of one's customers. This is a difficult dilemma to confront, but is inevitable and unavoidable.

Distributors now have an opportunity to differentiate themselves and drive performance to new levels by investing in advanced inventory management. As the experiences of some of the best-in-class firms mentioned in this paper suggest, they can expect to increase inventory visibility while driving down inventory costs. Unsurprisingly, this has enabled these firms to further strengthen customer relationships, bargain for better terms with their suppliers, and generate more profitable growth.

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