2009: Cash reserve hit near bottom, reports continued to show orders were down and CEO Fran Rodgers got a letter from the bank stating that it was reducing their credit line by half.

It was always a point of pride that Fran Distribution *(not the real name)* was a regional leader in their medical and electronics parts business. Their well-stocked warehouse had separated them from the competition, and their strong cash position and flexible line of credit supported that business model for 15 years. Now the dynamic had changed. What options were there for an inventory-intensive parts distribution company?

Inventory was sacred

Their broad inventory selection had always been the differentiator, and Fran was not willing to change that or their rapid delivery service. Her questions:

– Could they reduce their cash needs without impacting service?

– Could they change any processes to reduce the financial burden of their large inventory?

– Could some inventory carrying or fulfillment expenses be cut?

– How much could their current system help?

They started with a physical inventory to identify any discrepancies between what their system showed and what they actually had in inventory. Many were surprised at the difference in the two numbers. As they began to "peel the onion" to find the reasons, they uncovered their inefficiencies. Among them was the old accounting system. It was good for producing financial reports that kept the accountant happy, but where was the operational detail about customers and inventory? There was more information Fran Distributing needed. They came up with a list of five areas to

customers, but it was a shocker to see nearly 20 percent of their customer orders required a rush shipment from their supplier due to being "out of stock." Fran Distribution incurred extra shipping expense ($$$$) and an additional loss because volume price breaks were often eliminated ($$$$) when purchasing smaller quantities for these rush orders. This was another case of burning money, where the goal to keep customers happy with fast delivery was reducing margins dramatically.

3. Alternative Parts: As they counted inventory, they noticed some anomalies, one of which was that battery orders stood out. Fran stocked brand names like Duracell, Eveready and Rayovac. The reports showed plenty of Eveready batteries in stock and several rush shipments of Duracell and Rayovac orders to customers over the last six months, all of which incurred extra ($$$$) shipping charges. Could they not substitute with customer approval? Sure, but there was no prompt to alert their customer service team to suggest selling an "alternative part" when the original requested part was out of stock.

4. Know Thy Customer: Their physical inventory revealed that they had fallen into a regular habit when it was time to replenish: Reorder the same quantity as last time, instead of regularly reevaluating demand. The result was overstock of an item a customer used to order, but had stopped ordering ($$$$) after a change in manufacturing specs. They now required a different item, with a longer lead time. Fran would probably have to fire sale the old product unless they lucked into finding a new buyer for it. Worse, their relationship with this long-standing customer was at risk since they were ($$$$) out of stock the last three times the customer ordered the new product.

5. Seasonal Fluctuations: Several of their large customers had seasonal fluctuations in purchasing, but Fran's analysis of inventory showed they were not adjusting for this. The effect was to tie up their capital ($$$$), keeping stock levels high on these items year-around when they only needed those higher quantities for about five

– The ability to assign lots to their inventory items with expiration dates that were easily visible. Employees know immediately which lots are oldest and to sell those first. The change brought Fran's expired inventory costs down from 15 percent to less than 5 percent ($$$$).

– On demand reporting that shows purchases and sales by month and by customer. Now they know who is buying what and when are they buying it. This knowledge gave Fran the confidence to modify their purchasing, reducing some items and stocking up more on others at the right time. Within a matter of months, they had reduced the percent of orders requiring rush shipping from 20 percent to 10 percent ($$$$) and were on their way toward lowering it to 5 percent. Those not-so-little rush charges add up, and every penny saved in this initiative fell to the bottom line.

– An easy set up of "alternative items" for each of their parts. This meant that the next time they were out of Duracell AAA batteries, an alert popped up offering the option to substitute Eveready or Rayovac AAA. It's no surprise that customers were just as happy with the alternative or substitute item nearly 80 percent of the time. Carrying costs of inventory went down ($$$$) because they could reduce quantities on hand.

– Other items they had not considered: In addition to the historical information they now have, they added bin locations, delivery time information from their vendors, and order quantity discounts ($$$$) from vendors into the new system. This lets them better manage replenishment and keeps down carrying costs.

In the end, Fran and the team actually considered themselves thankful that the economic downturn had forced them to do a detailed examination of their inventory processes. They discovered that tying up so much cash in inventory was costly, and more surprisingly that it did not always translate to happy customers. The win for everyone was multiple ways to add to the Fran Distribution bottom line and improve

Sponsors.