

# **Creating Process Excellence To Build Brand Equity and Increase ROI**

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Kevin Fox, President, The TOC Center, Inc.

## **Reduce Inventory Stocks While Increasing Sales**

Inventory stocks are held to insure the availability of an assortment of products to meet customer demand. At the same time, it is very difficult to predict the required stock level per product (SKU) per location. The resulting mismatches between supply and demand result in an increased likelihood of both lost sales and surplus stocks, creating a drain on both elements of the company's return on investment (ROI).

For brand-building companies such stock outs frequently result in customers purchasing competitive products, negating their considerable investments in brand awareness and customer intimacy. Additionally, the holding of surplus stocks occupies additional cash—lowering ROI—that could be used for brand building activities.

TOCC offers a unique solution to this problem, enabling retailers and brand builders to achieve a much closer match between supply and demand, greatly boosting ROI. The solution creates a more agile and responsive distribution supply chain that can achieve full availability with much lower inventories. Companies such as Nike and Procter & Gamble have already driven their inventories down by 40% or more while achieving greatly improved stock availability levels.

## **Identifying the Constraint in your Distribution System**

It is important to note that no matter where your company stands in the supply chain you will suffer if the retailer (or wholesaler in a wholesale supply chain) experiences either surplus stocks or stock outs of any SKU at a selling location. Excess stocks will lengthen order cycles, potentially drive markdowns, and delay or reduce your revenues. Stock outs on a SKU represent lost revenues for everyone in the supply chain.

Companies experiencing either stock-outs (lost sales), or too much inventory (or both as is often the case) have their constraint internal to the supply chain—they are not able to put the right inventory in the right place, at the right time to match demand. For such businesses there is immediate potential to increase sales, and free cash tied up in inventory, by creating agile, responsive distribution supply chains. While quantifying the magnitude of lost sales due to stock-outs is difficult at best (it is hard to know what someone would have purchased had a product been available), the change in sales realized by the adopters of this model show a jump ranging from 5%-20%, simply by providing a more full-availability of product to the customer. For most companies this quickly translates into a gain of 50%-100% in net income.

## **Maximizing Cash Generation**

Process excellence in distribution means responding effectively to the actual fluctuations in supply and demand to create full availability of all products with much lower inventories. What makes this so difficult are three internal policies that reduce the system's ability to respond to fluctuations:

- ? Forecasting
- ? Minimum Order Quantities (MOQ)/ Economic Order Quantities (EOQ)
- ? Cost Allocations to transactions and products



Although vitally important to do so, it is very difficult to determine the precise demands of every product (SKU) at any given point in time at each selling location. Efforts to forecast these demands tend to be pretty successful at the product type level, e.g. how many blue crayons Crayola will sell this year. But they are far less accurate at the final configuration (SKU) level, e.g. how many boxes of the 16-pack crayons will be sold at the Wal-Mart in South Holland, MI. But since such local fluctuations are nearly impossible to predict, the result of pushing inventory to locations based on forecasts is almost always the combination of surplus stocks in one place, and stock outs in another. The only way to reduce dependence on SKU-level forecasts is to become much more responsive to *actual* fluctuations in demand and supply.

The MOQ/ EOQ policies employed in most companies stem from the need to drive down the costs of producing and distributing goods. While in the local sense it serves to help control costs, it has a detrimental effect on the system's cash generation. Minimum order quantities lengthen order lead times (the time between orders for a given SKU) and increase inventories in a given location because more must be ordered at once. The result is that inventory is placed in a location further ahead of when it will be consumed (higher inventories) and is not available to be sent to another location with immediate demand. EOQ policies by the same token drive manufacturing batches up—in an effort to save on change-over costs—lengthening the time it takes to cycle through the range of products in supply.

The sum outcome of MOQ/ EOQ policies is that we are pushed further from the market, are less able to respond quickly to fluctuations in the market, and become more dependent on forecasts.

The third driver of lost sales and high inventories in many companies is the reliance on cost allocations to both transactions and products as the mechanism for managing distribution. Efforts to reduce cost per unit and per transaction can only result in increases in transaction size, which will postpone future orders. By lengthening the time between orders, we increase inventory levels in one outlet, creating the likelihood of obsolescence and/or markdowns which lower margins and return on capital. At the same time this increases the risk of supply shortages in other outlets, reducing our turnover and further lowering ROI.

The basis of efforts to control costs in this way is the assumption that the measurement of a local unit of the supply chain reflects the total effect on the supply chain. Unfortunately, by increasing inventories and obsolescence, and reducing sales, these drivers serve to reduce cash generation and ROI. Leading companies who have already addressed these critical measures have found that costs drop and revenues increase when focus is shifted to driving total supply chain performance rather than local cost objectives. By focusing on increasing responsiveness they have been able to adjust readily to fluctuations in supply and demand and eliminate lost sales with much lower inventory levels.

### **Creating Process Excellence**

Creating process excellence in distribution is not as difficult as it may seem. While many of the changes represent a significant shift in operating practices and thinking, the new management processes and supporting tools are already well-developed. They have been validated with dramatic results in many leading companies. TOCC's solution involves a combination of management support, education, analysis, and process management software that is adapted to your business environment and needs.

Using this approach companies are seeing significant reductions in inventory and lost sales within just a few months. The financial benefit is achieved from a 20-30% reduction in working capital employed, increased cash generation from previously out-of-stock items. For many companies this added working capital and increased revenue stream has enabled them to grow at rates far greater than their competitors, even in down markets.



### More Information?

If you would like more information, please contact TOCC at (847) 625-8775, [info@tocc.com](mailto:info@tocc.com).

About TOCC- TOCC is a leader in providing practical, sustainable solutions for complex business systems. Our team consists exclusively of senior consultants with a minimum of 10 years experience in designing and leading lasting organizational transformations. We collaborate with management to develop custom solutions for your business to enable you to cope with the demanding conditions of lean organizations, and high uncertainty.

About Dynamic Flow Management™ (DFM)- Perhaps the only constants in business are change and uncertainty. Since no one has yet invented a crystal ball for seeing reliably into the future, and with the velocity of change increasing each year, the only solution is to build agile organizations able to respond on a dime to change where and when it occurs. Dynamic Flow Management™ is the only business system that deals with uncertainty and change at the business level, where profits are made or lost. It's about creating the nimble, fluid organization you have always dreamed of, able to deliver faster, more reliably, at ever-lower costs, and without the constant crisis that saps motivation. Nearly 20 years of development have produced extraordinary results across nearly an array of industries, in companies from the largest to the smallest. Household names such as Intel, HP, Bosch, Pharmacia, Kroger, P&G, and ITT have realized improvements in profits, inventory reduction, lead-time reduction, and on-time delivery performance of 50% or more.