

# The Seven Deadly Sins of Distribution Expense Control

An IBS Value Drivers eBook



# Not glamorous but critical

Sales people get all the glory in most companies – after all, they bring in the big deals and feed the business with revenue. In contrast, reducing operating expenses is seen as a dirty job – but someone has to do it.

For most distribution companies, managing operating expenses has a far bigger impact on the business than simply pouring more revenue into the top of the funnel.

In today's tough times, operating expenses have moved to the center of the boardroom table and the top of the agenda.

This short eBook – the second in our series on the five main value drivers in distribution – focuses on operating expenses. More specifically, it covers seven of the most common expense-creating 'sins' in distributors and wholesalers.

Some of these will seem obvious. But our experience working with hundreds of distribution businesses all over the world shows them to be extremely common.

We hope it helps you think differently about your own business and find new ways to drive down the expenses that are sapping profits and inhibiting growth.

If you want to get to grips with your expenses, I may just know someone who can help!

**Clark Green, Jr.**  
Vice President, Marketing - IBS AMERICAS

**79% of distribution & warehouse managers say that reducing operating expenses is a major strategic requirement.**

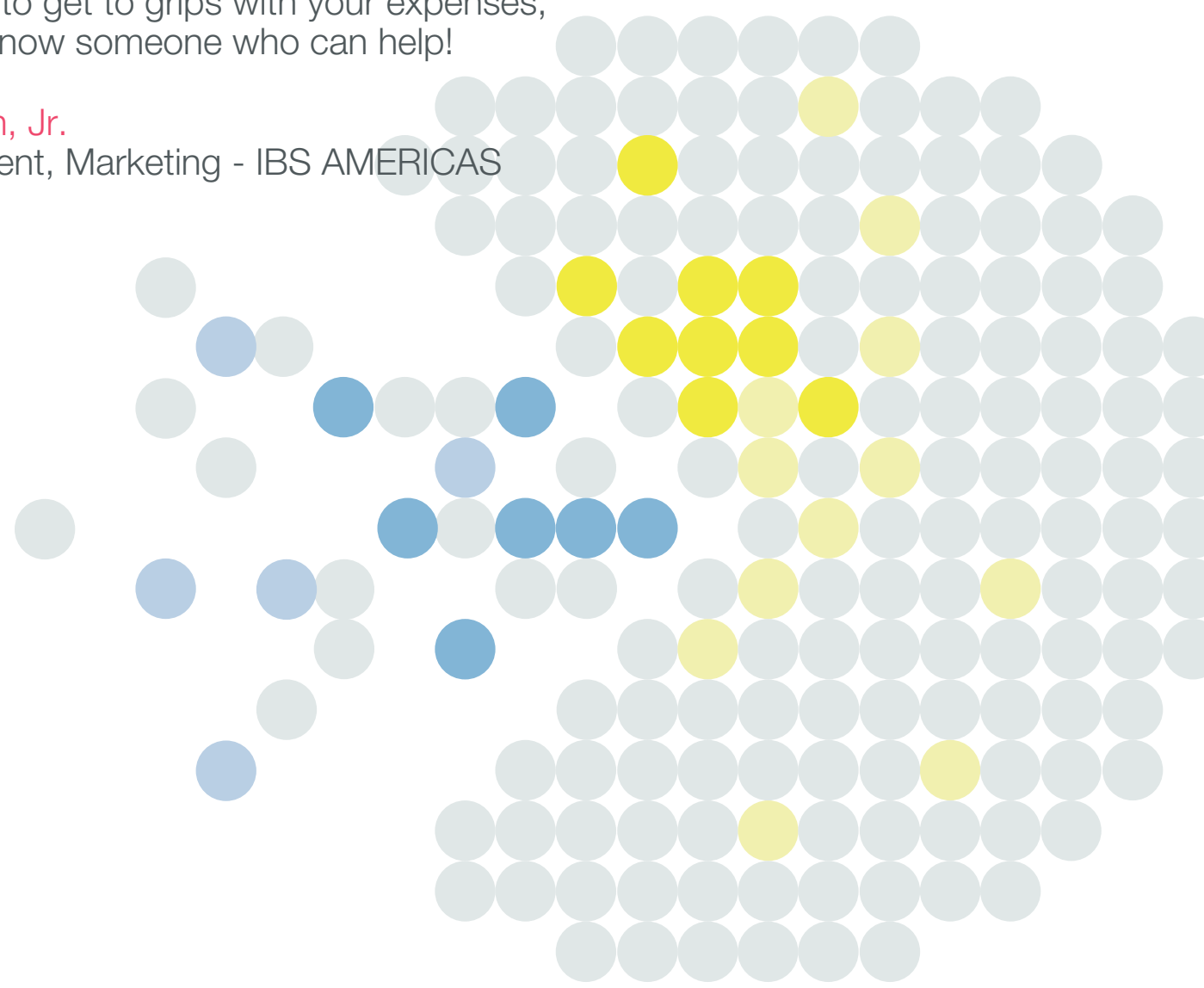
Source: Aberdeen Group: On Time and Under Budget, December 2009

## The state of play

Controlling expenses has never been so important in distribution:

- Margin pressures show no signs of letting up
- Transaction and data volumes keep growing
- Workflows are more complex and fractured
- Globalization and consolidation transform the industry

In short, the triple threat of change, complexity and competition make expense management a matter of survival.



# The expenses myth

It's easy to think of distribution as a fixed cost business in which sales can grow without a similar growth in expenses. The reality is that almost all expenses incurred by distributors vary directly with sales (starting with sales commissions themselves).

This single myth is probably responsible for more bad decisions in distribution than any other. A clear-eyed look at your profit and loss accounts show that:

**Even small increases in revenue generate higher expenses.** And huge sales increases generate huge spikes in expenses.

**Expenses often wipe out all profit in any increased revenue.** These 'bad sales' often drag down overall profitability – unnoticed.

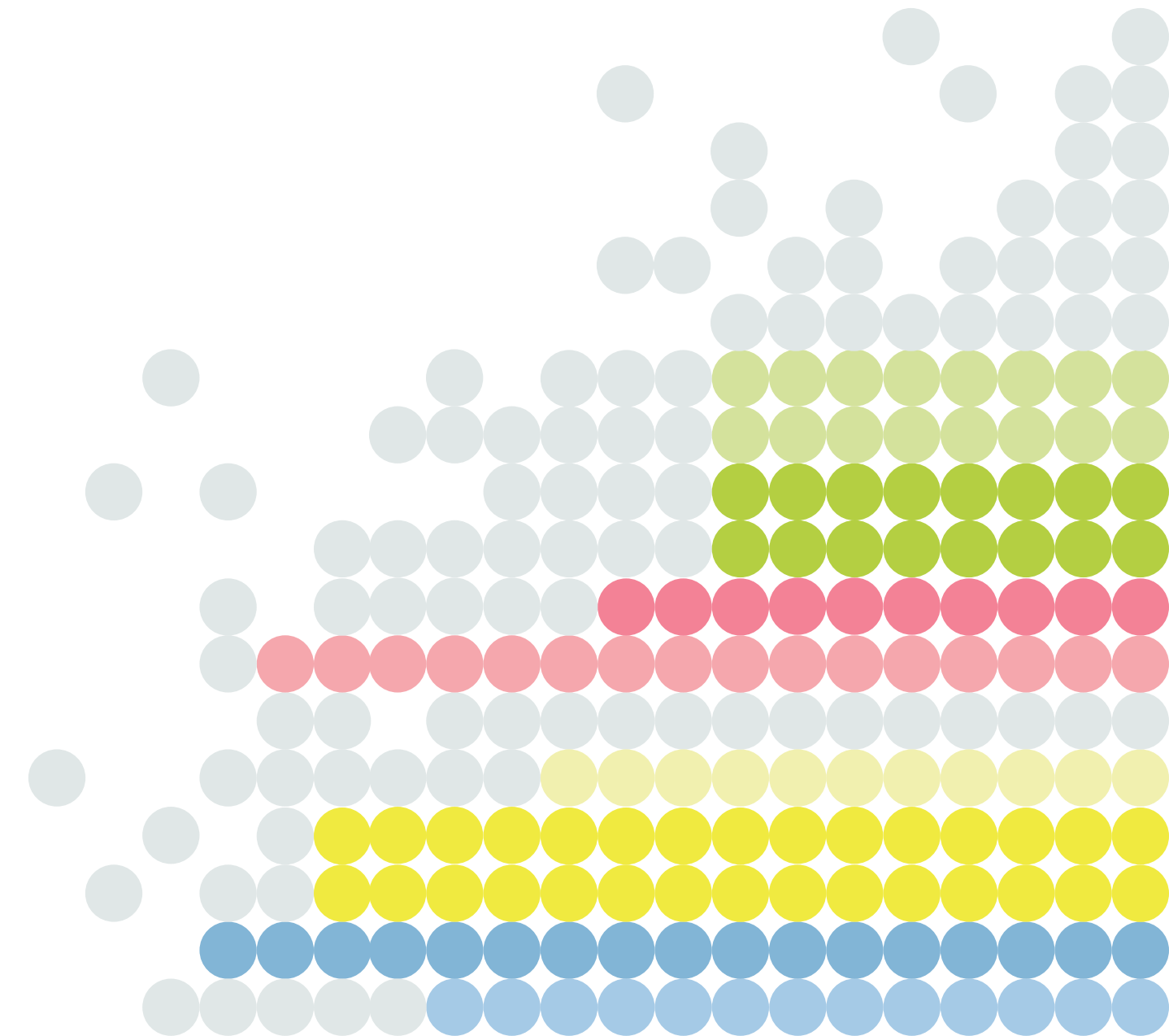
**It's almost impossible to reduce prices and expenses together.** So price cuts always make a bigger than expected impact on profits.

The new imperative for every distributor is to increase revenues while reducing operating expenses. The relationship between sales and expenses is absolutely critical but often overlooked. In fact, cutting expenses often delivers a greater impact than increasing sales. The answer to the puzzle lies in a close examination of every business process and the technologies that support them.

Inside every distribution business, there are thousands of places for expenses to hide. We've tried to organize the most common ones into seven broad principles and the seven sins that siphon off profits every day in even the best-run distributors...

**“The sad reality is that, far too often, sales volume is viewed improperly and sales-related actions produce negative results.”**

Albert D. Bates, DBA, Profit Myths in Distributors and Wholesalers



Sin #1

## Using your warehouse for storage

Distributors and wholesalers hold the risky hand in the supply chain card game. As you buy in bulk and aggregate product, you're also accumulating inventory and risk expenses running out of control.

Today's warehouse should be used as an efficient way to keep things moving, rather than a home for inventory. The best distributors are the ones that keep goods flowing in and out, or even straight by, with maximum efficiency and minimum time in storage.

### Action Points

**View all inventory as an expense** and excess inventory as excess expense.

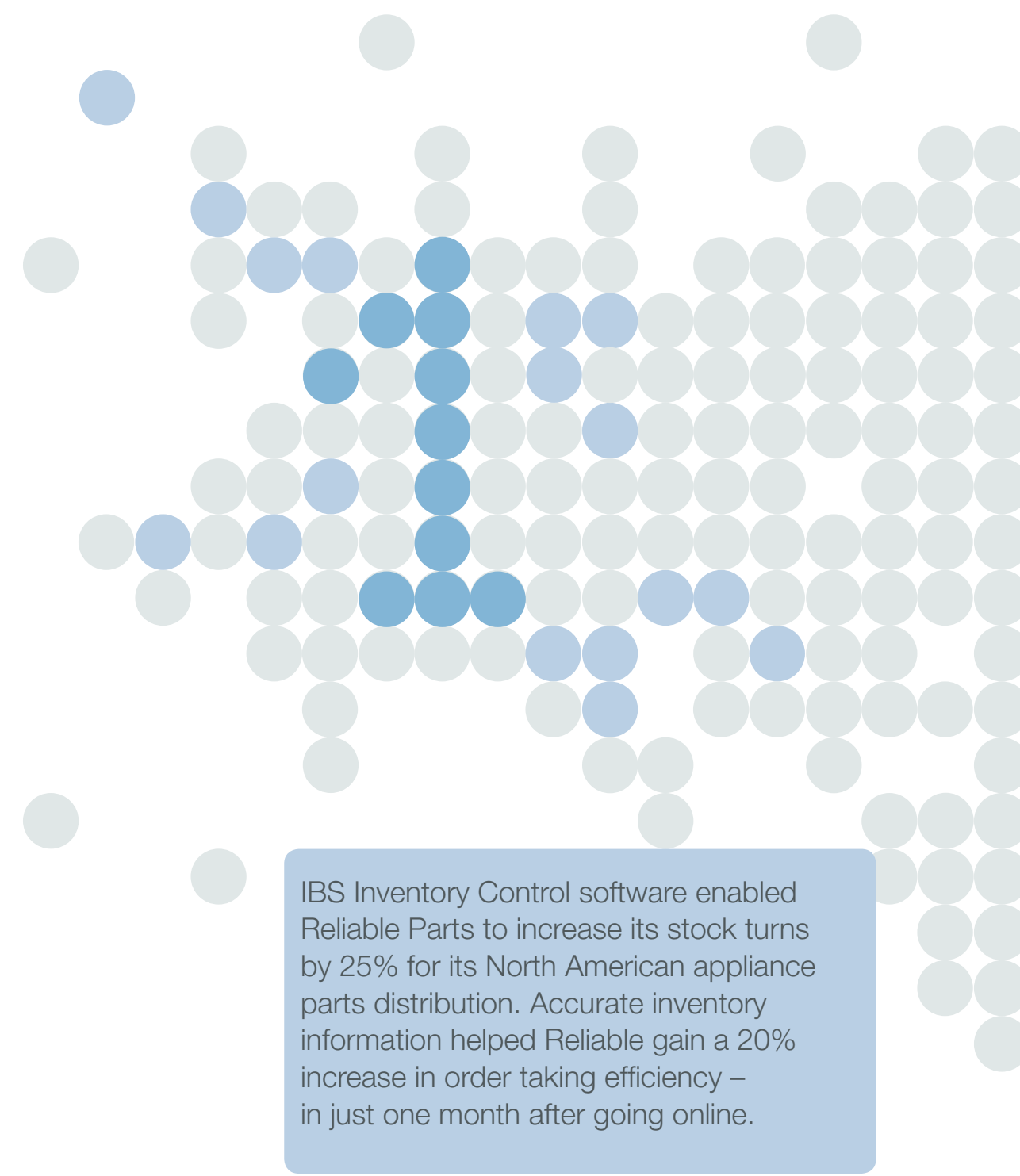
**Slow inventory generates expenses at a higher rate** than high-velocity SKUs – processes and margins should reflect this.

**Profit calculations need to look at actual cost** which includes all expenses. It's much more than the cost of goods; it encompasses the warehouse, the office, the logistics, and the people. It's often ignored when people make top-level calculations.

**Consolidate warehouses to reduce the cost** of your most expensive asset; and poor space utilization leads to search, retrieval and wastage costs. If you centralize and automate, perhaps into larger distribution centers, you will control your biggest expense: labor.

**Speed up your processes to cope with product life-cycles** because now it's not just fast moving consumer goods (FMCG) that have a short time to obsolescence. The longer goods stay in your warehouse the more it will cost you. You're heading for trouble if you don't understand the pace of today's product life-cycles.

It's time to start thinking about the warehouse as a high-speed node in the supply chain, not the place where goods (and profits) go to die.



IBS Inventory Control software enabled Reliable Parts to increase its stock turns by 25% for its North American appliance parts distribution. Accurate inventory information helped Reliable gain a 20% increase in order taking efficiency – in just one month after going online.

Sin #2

## Relying on manual and localized data gathering

The efficient operation of any distribution business depends on total visibility of the entire distribution chain. That means managing data, in a way that makes it easy to gather, store, check and share.

You can't do this with a distributed, local approach to data; or by letting each member of staff determine their own tasks. Efficient management of labor costs depends on centralized data management.

### Action Points

**Automate all data processes** from order to returns; manual processes (like stock takes) are slow and error-prone, and provide less visibility.

**Track your inventory in real time** with cycle counting, ideally controlled by an integrated Warehouse Management System and calibrated for product velocity.

**Manage multiple warehouses and both suppliers and partners** with more central visibility. If you can view and source products automatically across different warehouses and companies you can service customers faster and more accurately. Why say 'no' to orders you can actually service?

**Use rule-based storage management** to respond to urgent and important tasks. Say goodbye to inflexible, unwieldy processes, and embrace demand-driven processes. Real-time information on the shop floor empowers your people to make expense-cutting decisions that go straight to the bottom line.

Information is the lifeblood of the modern distribution business. The most competitive wholesalers treat it like an asset and deploy it to improve processes.

**“Companies conducting physical inventories have a greater than 8% discrepancy between what they believe they have on hand and what is actually in their warehouse.”**

Aberdeen Group, 2009

US-based TimBar, which designs, produces and distributes shipping containers, packaging and point-of-purchase displays, saved three man-hours per day by eliminating manual errors and improving integration processes.

**“We have saved in labor costs and production costs many times what we paid for IBS Integrator.”**



Sin #3

## Getting stuck with inflexible processes that are hard to change.

Many distributors are only set up to handle standard requests. But customers are often prepared to pay a premium for flexibility and added-value services.

The inflexible distributor unknowingly turns high margin business away – or (even worse) provides the service complete with profit-destroying expenses.

### Action Points

**Avoid rigid work stacks and schedules** with agile thinking and actions. Make sure employees know what's both urgent and important so the right things get done at the right time. If you can't change your processes easily whenever the situation requires it, you're inviting expenses.

**Find new ways to respond to profitable RFPs** – these are the real dividends of distribution agility.

**Actively build value adding processes with cost control** including re-labeling, customization, packaging and kitting.

**Set up custom process tracks for flexible orders**, don't just mirror your standard processes, but be careful (see next point).

**Carefully monitor hidden expenses closely** – custom, flexible projects are notorious for generating expenses that you're not set up to track.

**Empower your people** with dynamic work flow that instantly approves incoming invoices or delivers alerts on urgent purchasing. Quick, automated and accurate decision-making eliminates expenses.

The best run distributors streamline their processes to ensure they identify and create opportunities for high-margin, added-value business. Wholesalers too inflexible to seize these opportunities are cutting off their own air supply.

Macfarlane Packaging offers added-value packaging and labeling for its European and North American customers.

**“With IBS software we have improved customer service by delivering the right product at the right time and at the right price.”**



Sin #4

## Tolerating human error

One of the most dependable metrics that separates the best-performing distributors from the rest of the pack is accuracy – especially in the big three warehouse processes: picking, inventory and forecasting.

Human error used to be simply an accepted cost of doing business. Today, the entire business needs to be focused on preventing errors and identifying the ones that slip through before they generate avoidable expenses.

### Action Points

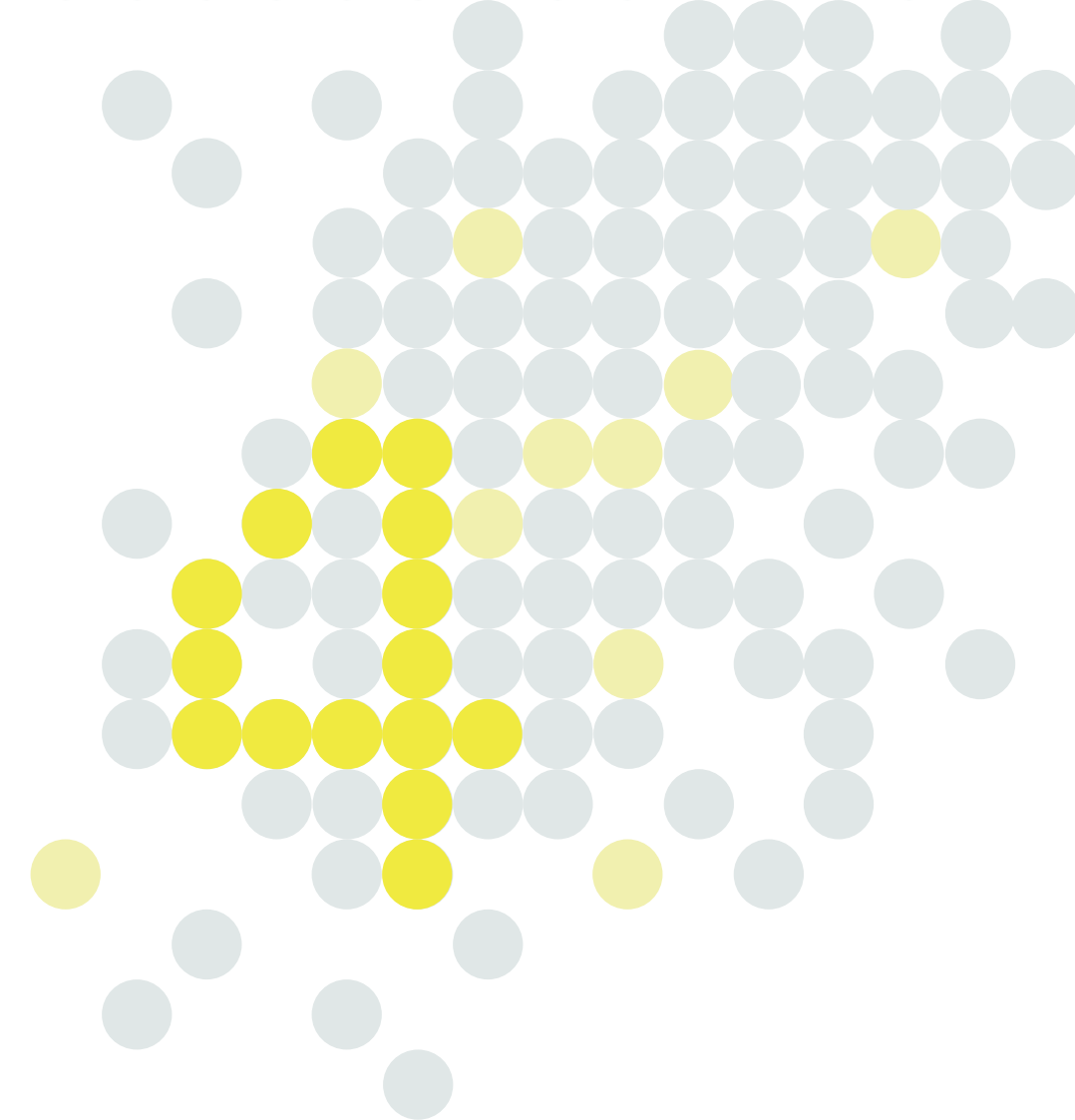
**Again, beware of manual processes** – automating wherever possible and building in checks where not.

**Catch picking errors before they become shipping errors** which incur 3-5 times the expenses of picking rates and irritate your valued customers.

**Use Returns as a KPI** – managing it tightly with automated reverse logistics and daily visibility rather than simply accepting its expense building impact.

**Build intelligence into the workflow**, including communications, order processing, invoice approval and validation. Simple sales order mistakes have turned mini-dramas into major crises in the past so make sure you've got a built-in alerts system. It costs you not to expect the unexpected.

Adding a single percentage point to your pick accuracy and inventory accuracy can dramatically reduce your expenses and increase your profitability.



**Thirty pick errors a day at \$10 per error adds up to over \$100,000 a year.**

When German machinery and equipment distributor Industriehof switched from manual processes to an automated IBS system, data administration shifted into high gear. Error rates were reduced by about 95%.

Sin #5

## Failing to understand true demand

In distribution today, success or failure often comes down to the ability to accurately forecast demand and monitor it in real time.

A good understanding of demand is a front-line expense hunter. Let's look at purchasing: great forecasting means fewer people making fewer bad decisions to reduce your expenses across the supply chain.

With today's distribution resource management technologies, the 'finger in the air' method is no longer sustainable.

### Action Points

**Integrate to increase visibility** – standalone point solutions, departmental silos and process islands are the biggest causes of demand forecasting failures. The information is inside your business – your job is to harness it.

**Collaborate outside for expense insight** – only part of the demand story lies within your own operation. Open up your systems to downstream suppliers and upstream customers and your demand forecasting gets a lot more accurate.

**Collaborate inside for expense insight** as what's going on inside your company can impact demand.

A sales promotion can mean welcome product spikes and unwelcome product slumps. Know what you need and what you need to avoid.

**Liquidate bad inventory** to clarify your real position, expose demand issues and turn stock into cash before expenses claim its life.

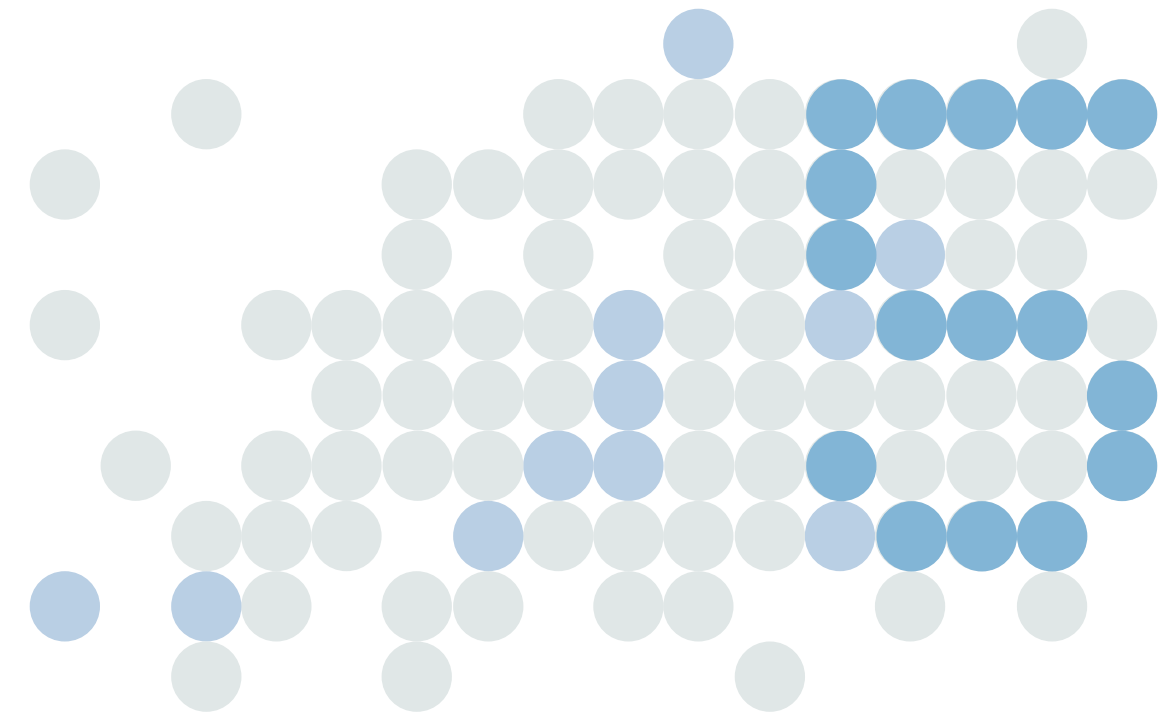
**Support cross docking** when you receive goods from your supplier. Your system should tell you if the same goods are required on a pick list. It's the most efficient way.

**Don't forget EDI** – it's still far too overlooked and the price is a lack of visibility. If you receive data directly from your customers then it reduces the manual workload, and errors, to free up your internal resources.

Demand planning does not start and end with the sales team's projections. The entire business needs to be oriented around sensitivity to demand-related indicators.

Orrefors Kosta Boda creates renowned glasswork for the world from its Swedish headquarters. The company has a clear view of demand with IBS planning applications.

**“With IBS software in place, information is delivered in a more cohesive manner and forward planning is much easier.”**





Sin #6

## Failing to actively optimize stock

Excess inventory is like a bad virus – it tends to spread across the supply chain and fester in dark corners. Managers can become expert at moving stock around to conceal inaccuracies and inefficiencies.

The goal must be to throw light into every corner of the supply chain, from one end to the other, so that excess inventory can't hide.

### Action Points

**Introduce consignment stock** because it turns warehouses into efficient stock management operations. You have the right supplier goods to hand with flexible payment and no overstocking risks. You can quickly make sales without onerous, up-front planning, purchasing and billing costs.

**Implement systems to align stock with demand** and processes to regularly track your performance.

**Utilize back to back order** because the most profitable middle-man doesn't even touch the stock as it whizzes from supplier to customer.

**Vendor managed inventory** to remove purchasing and time-consuming (so expense creating) order taking.

**Assign a stock champion** responsible for day to day stock optimization.

**Consolidate your warehouse** because consolidating and centralizing warehouses reduces the stock levels in the supply chain, which reduces expense. It's not about "what am I buying into the warehouse" anymore, it's about "how can I get rid of my warehouse."

Huge amounts of expenses are tied up in stock. But for many distributors, the responsibility for removing excess inventory is spread across the entire team – so no one really owns it.

**"Distributors can end up with costs completely out of control in relationship to either sales or margin."**

Albert D. Bates, DBA, Profit Myths in Distributors and Wholesalers

IBS software gives Univern dynamic demand forecasting and inventory analysis to make reliable decisions on product replenishment. For this Norwegian wholesaler and importer of work clothing and protective gear, IBS is a great fit for optimizing stock.



Sin #7

## Failing to measure your successes

Cutting expenses can be a thankless task. To keep the performance up, you need to prove your case and actively market it to the business as a whole.

Only when people can see the results of your expense management and its impact can you start to instill the low-expenses mindset throughout the company.

### Action Points

**Establish clear KPIs** – specifically related to expense reduction; then track them and share the results.

**If it moves, measure it** – no process, department or discipline is exempt from the expense-reduction machine; but you can't manage it if you don't measure it.

**Provide regular reports** to management and the entire business on pick accuracy, expenses, returns, inventory levels...

**Create an expenses dashboard** with live feeds of the key expense-related metrics. Use distribution-focused business intelligence to identify expenses, follow them, measure them and destroy them.

**Find out your true profitability** by measuring everything. If you measure the expenses incurred throughout the whole process from purchase to sale – for example order taking, picking, dispatch - you can calculate your internal expenses and see the real cost of your enterprise.

Managing expenses is always a journey, not a destination. Build processes that treat it this way, measure your progress and share your results to make the improvement non-stop.

IBS helps Rexel subsidiary SELGA maintain the company's position as a leading Swedish distributor of electrical supplies. SELGA gains a complete, accurate picture of inventory as well as all operational business operations.

**“IBS Business Intelligence software gives us a key business advantage in a hugely competitive market.”**

Case in point

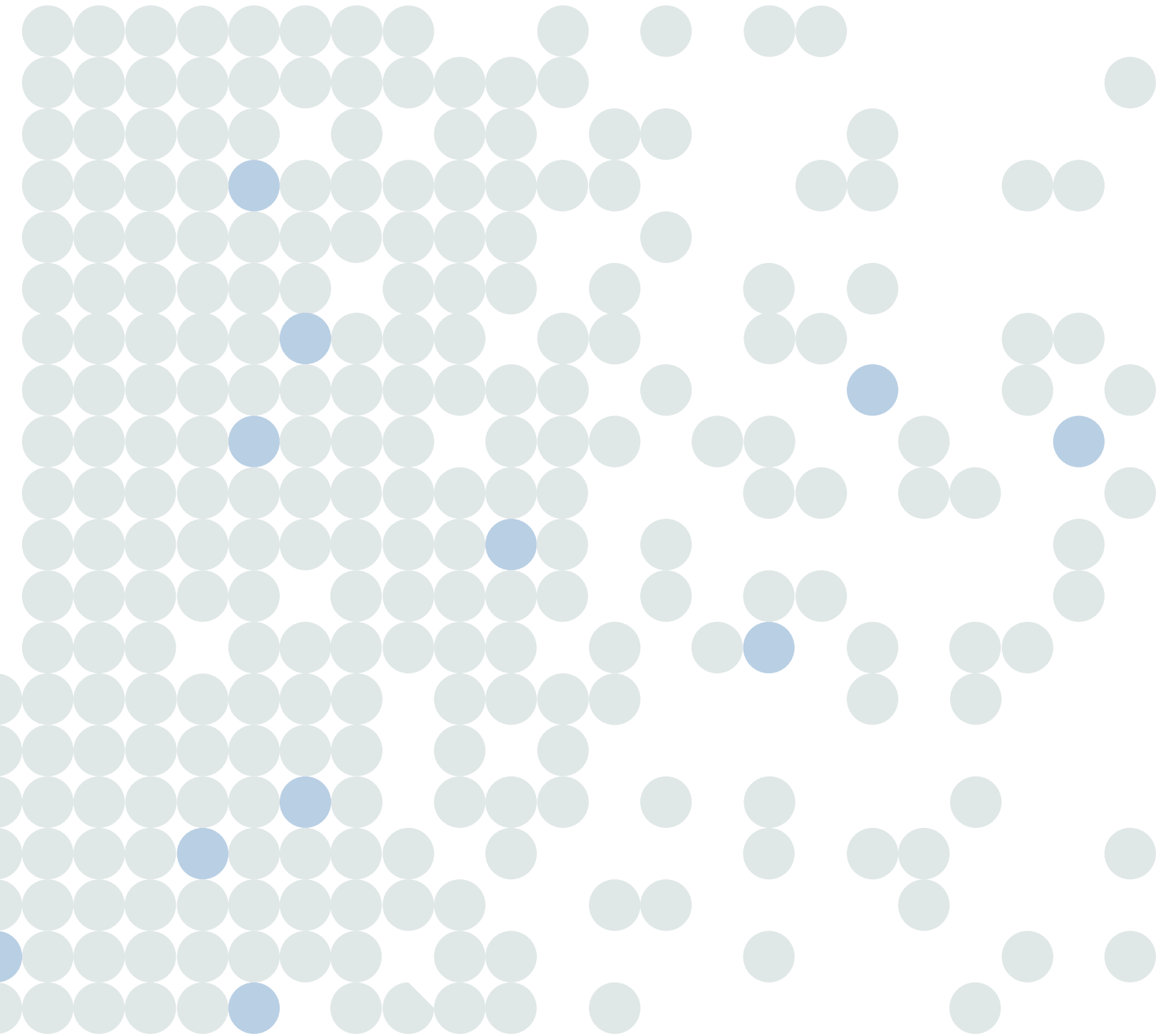
## DSV lives by accuracy

DSV supplies Volvo's production lines with 3,330 SKUs from 25,000 locations. Stock in its 50,000 square foot warehouse rotates every three days with 185,000 picks per day (at 2.2 seconds).

With over 70 inbound trucks and over a million transactions per day, it's a high-pressure, just-in-time operation.

DSV maintains some of the best accuracy in the industry with a comprehensive approach to data gathering and sharing.

With integrated quality control, location management and voice and RF picks, DSV delivers every part to the line in the precise order that it's needed. It's all about information flow, automated processes and management discipline to drive expenses and inefficiencies out of the operation.



## About IBS Enterprise.

IBS is the world leader in distribution resource management software – business applications for the wholesale, distribution and manufacturer/distributor markets.

We have over 30 years' experience of helping wholesale and distribution companies streamline, automate and accelerate the processes needed to run distribution businesses.

Through our software and services expertise, we deliver significant value to our customers by helping them improve their inventory planning, purchasing and supplier management, warehouse processes, demand management and returns processing.

Our comprehensive IBS Enterprise suite is used by thousands of wholesalers, distributors and manufacturer/distributors of all sizes, including Electrolux, Everfresh, Heinz, Honeywell, Lexis Nexis, Hitachi Maxell, McGraw-Hill, Miele, Mitsubishi, Pearson, PaperlinX, Rexel, Univar and Volvo.

IBS Enterprise lets distributors control their entire operation from order to cash and unlocks every penny of margin from every process.

# Contact IBS.

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IBS has subsidiaries in 21 countries.  
To view our global offices details, please visit:  
[www.ibs.net/global-offices/](http://www.ibs.net/global-offices/)

# Resources.

## **Aberdeen Group** **On Time and Under Budget:** **Maximizing Profits with Efficient** **Warehouse Management**

Scott Pezza, Nari Viswanathan,  
December 2009

## **The National Association** **of Wholesaler-Distributors**

Publications, services, events and advice.  
[Visit www.naw.org](http://www.naw.org)

## **SCOR®**

The Supply Chain Operations Reference model from the Supply Chain Council. The cross-industry de facto standard diagnostic tool for the supply chain industry.  
[Visit www.supply-chain.org](http://www.supply-chain.org)

## **DuPont Analysis**

A method of understanding the source of superior (or inferior) returns in comparison with companies in similar industries (or between industries).  
[See the Wikipedia entry](#)

## **Industrial Distribution Magazine**

From Reed Business Information, the leading publication for distributors of industrial products.  
[Visit www.inddist.com](http://www.inddist.com)

## **Profit Myths in Distributors and wholesalers**

By Albert D. Bates, DBA  
[Purchase at www.naw.org/publications](http://www.naw.org/publications)

## **Facing the Forces of Change: Lead the Way in the Supply Chain**

By Adam J. Fein, Ph.D.  
[Purchase at www.naw.org/publications](http://www.naw.org/publications)