

# A Distributor's Guide to Taking Cash Out of Customer Inventory

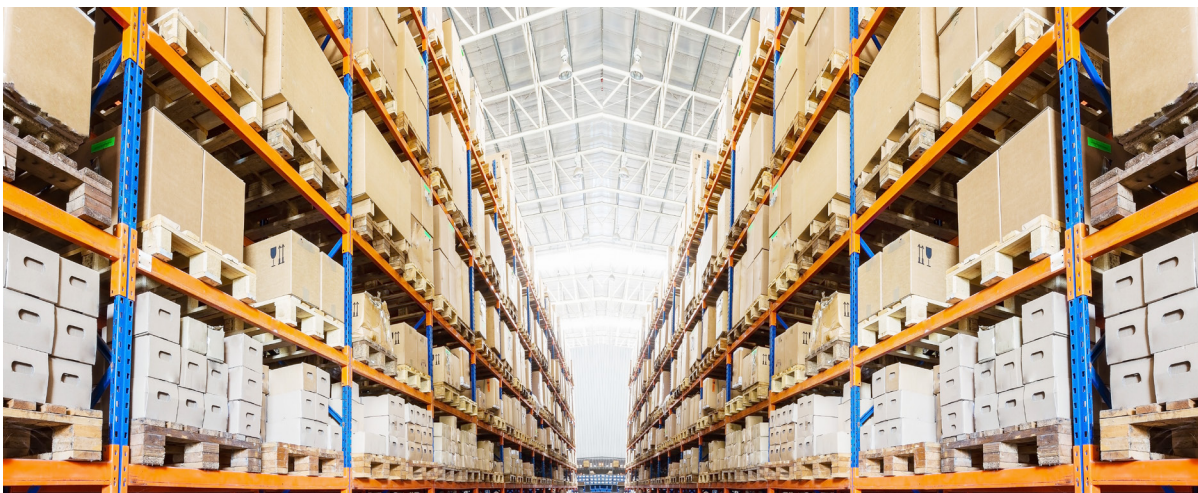
## How to Reduce Forecast Error and Carrying Costs by Optimizing Replenishment

Because distributors tend to base their sales forecasts and inventory purchases on past sales and arbitrary sales goals rather than actual demand, there's a lot of room for error. This can lead to overstocked inventory, increased carrying costs, stockouts and longer lead times for new items.

That's why forecast accuracy matters. It drives decisions on what to buy and when, as well as what to stock and where.

Demand planning and sales forecasting are similar tools, but they are not the same. Demand planning involves closely monitoring internal and external factors that could affect customer demand and product availability, while sales forecasting is the act of trying to predict future sales. To do both right, you've got to involve the right people, use the right technology to gather the right data, and fold demand planning into your overall planning strategy.

This e-book looks at how to reduce forecast error and optimize your distribution centers by feeding your demand planning process with actual customer usage from the point-of-use.



# WHY FORECAST ERROR MATTERS

**TO FORECAST DEMAND** and plan inventory needs in their own distribution centers and at customer locations, distribution companies tend to depend on historical sales data, as well as a usually arbitrary sales goal for the year.

For example, if they want to grow 5% in 2020, they increase stock of the items sold over the past 12 months by the same amount based on their aggregated sales history. They may add in seasonality, but in general, most distributors' forecasts follow this formula. They may also add in salespeople's forecasts for their own territories based on expected purchases. Distributors typically assume that the same demand for individual items will occur at the same time in the same quantity each year.

Most know there are flaws in this method. But everyone is working to get as close as possible to the stock levels required to best serve their customers. Not surprisingly, distributors are always looking for more ways to increase accuracy and reduce forecast error.

## What is forecast error?

At its most basic, forecast error is the difference between the forecast demand and the actual demand. A lot of calculations go into forecast error, but the bottom line is that the greater the difference between actual demand and forecast demand, the greater the impact on a distributor's bottom line.

As forecast error goes up, the risks go up:

- Overstocking inventory in a distribution center or a customer's location, significantly increasing carrying costs
- Stockouts of critical items, increasing the risk a customer will go elsewhere to fill those needs
- Increased lead times for new items with shorter sales histories

## Why is forecast accuracy important?

Forecast accuracy matters. It drives decisions on what to buy and when, as well as what to stock and where. It could also drive decisions around hiring personnel and where you allocate your most expensive resource. It can mean the difference between meeting your customers' needs, or service breaking down when customers need it most.

## What causes forecast error to go up? Here are a few factors:

### Distributor-customer inventory-level agreements.

Many distributors have agreements with customers that require them to have a certain level of inventory – no matter what. It may be two to even 15 times more than what they need, but because they agreed to do it, they must stock it contractually. That will skew forecasts. And if distributors aren't compensated in some way for holding that inventory, it will cost 25% to 55% of the inventory cost annually to carry it.

### Safety stock for rarely used items.

Some customers need certain items in stock, even though they only use them once or twice a year. But if they don't have them in stock when they need them, it could cause a production line to go down or

a project to stall temporarily. The problem is that these items could go obsolete before the customer even uses them. And if they are purchased for the sake of putting on a shelf, that sales history will be reflected in any forecast. We're not saying you shouldn't stock these for customers; but the data needs to be considered when making purchasing decisions based on sales history.

### **Relevance of the data.**

More than the quality of the data, the relevance of the data in a distributor's inventory system has a big impact on forecast error. When a distributor lists all the items a customer purchased in the past 12 months and bases future inventory purchases on that data, they miss any shifts in the customers' businesses. For example, an electrical contractor may be doing more lighting in a new year instead of just general construction projects. So the items that the customer is going to order will change. And that means the relevance of that customer's sales history for forecasting loses a lot of value.

Customers are notoriously overstocked. Distributors can reduce inventory when they base purchasing on usage.

### **Sales reps keeping market or customer shifts to themselves.**

Distributors tend to have siloes when it comes to data within the organization. For example, sales reps working day-in and day-out with customers probably have the intelligence that inventory managers need to reduce forecast errors. But that front-line data does not usually make it to the people that need it. Sales reps also frequently default to overstocking a customer's location because they are afraid the customer will go elsewhere if they don't have what they need. (They are usually compensated based on volume, as well, so there is little incentive to pare down customer inventory.) The just-in-case mentality rules. Very few reps in any industry will make the effort to tell management what the customer is actually using vs. what's just collecting dust on the shelf.

### **How to reduce forecast error**

The simplest way to reduce forecast error is to base demand planning on actual usage data vs. historical sales. The difference: Usage reflects actual consumption of an item. In other words, just because a product was sold to a customer doesn't mean that product was used. Customers are notoriously overstocked. Distributors can reduce inventory significantly when they base purchasing off usage, and not just past sales. When you parse the data, some distributors have found they have up to 80% more inventory than they need.



# REDUCE FORECAST ERROR WITH DEMAND PLANNING: Improve Service and Cut Carrying Costs

**IT CAN BE A CHALLENGE** to know exactly what customers need and stock accordingly. One element of successful supply chain management is demand planning.

## What is demand planning?

Demand planning involves closely monitoring internal and external factors that could affect customer demand and product availability. According to TechTarget, demand planning is considered a critical part of supply chain management. For example, customer demand might slow in the face of natural disasters, and labor force issues may affect customer spending. The coronavirus epidemic has driven demand for masks to stock-out levels. On a smaller, more predictable scale, seasonal shifts affect customer demand; demand for snow shovels will spike in the winter, and go away in the summer.

Demand planning in 2020 and beyond requires not only conscious observation of the market, the supply chain and customer behavior, but intelligent use of apps that can incorporate data on usage into decision making. Modern demand planners must take a proactive look at real-time data and actual usage rather than relying on historical sales numbers. This involves a renewed emphasis on the customer's needs and usage, rather than the drive to simply stock products on shelves, just in case they need them. It's about anticipating true demand instead of blindly fulfilling inventory.

## Why is demand planning important?

Demand planning helps you better manage your business and improve the way you serve your customers, while conserving cash. A strategic approach to demand planning fuels decision-making with actual data. Demand planning helps distributors:

- **Get more in-sync with customers.** Effective demand planning means your inventory aligns more closely with customer usage, and therefore reflects customer needs. Demand planning may help identify places where your customers may be able to save cash or may be experiencing challenges, giving distributors an opportunity to help.
- **Produce more accurate business metrics.** Over time, an effective demand planning process helps businesses better understand what affects customer needs.
- **Improve inventory management.** With the right data, companies can fine-tune minimum and maximum inventory levels to optimize service levels for their customers and save both the customer and the distributor money.

## What is the difference between demand planning and supply planning?

Similarly, demand planning is often compared with supply planning. Demand goes hand in hand with supply, and the best strategies are complementary. Generally speaking, supply planning gives a company a strategy for creating supply to align with expected product demand. This usually involves collaboration across teams in logistics, operations and manufacturing.

Here's a look at how sales forecasting, supply planning and demand planning are different:

- **Sales forecasting.** Sales forecasting is the act of predicting future sales – which distributors usually base on past sales. Taken alone, this can be an inaccurate way of stockpiling inventory based on a “just-in-case” mindset.
- **Supply planning.** Supply planning involves interpreting an organization's demand forecast, and then creating a plan to match that expected demand.
- **Demand planning.** Demand planning takes a holistic view of the market and what influences customer demand – ideally incorporating consumption data at the point of use – to better anticipate and fulfill customer needs.

## Demand planning challenges

Demand planners face several challenges when it comes to anticipating customer needs, especially in a time of market volatility.

### Inaccurate tracking

Perhaps the biggest challenge is accurately tracking stock usage. Particularly in distribution, tracking stock may involve tracking products in multiple warehouses, trucks and customer stockrooms in different regions. When there's no visibility into stock levels — not to mention what's actually being used— it's much more difficult.

Many companies rely on historical sales data to predict demand, but that doesn't account for real-time changes.

### Lack of data

The biggest challenges in demand planning are rooted in lack of data. Many companies rely on historical sales data to predict demand, but that doesn't account for real-time changes, customer insights or shifting customer business strategies.

### Forecast error

When the forecasted demand is different from actual demand, the risks of overstocking or running out of stock at a customer location go up. Some reasons for forecast error might include outdated agreements on customer inventory levels, irrelevant data and lack of communication between inventory planners and field sales reps as to changes in customer behavior. Reducing forecast error can improve overall demand planning.

## Demand planning tools and techniques

To be successful with demand planning, use the tools and talent available to you to gather information, monitor market shifts and make changes as needed.

### Involve the right people.

Gather intelligence from experts across your sales, marketing, operations and finance departments, and collaborate. Get a sense of how customers are buying, and what each department sees in terms of behavior. You'll also see more internal investment in demand planning success, and the technology that will drive it.

### Put the right tools to work.

Effective demand planning relies on the right tools and data for the job. Your typical enterprise re-

source planning (ERP) system and spreadsheets won't be flexible enough to react quickly to changes in customer usage at the point-of-use. Instead, opt for tools designed for the job, including eTurns TrackStock Precise Demand Planning Solution and eTurns TrackStockMMT, which collect real-time data on inventory consumption at the point-of-use.

**Look for patterns.**

According to Supply & Demand Chain Executive, "Best-in-class firms rely on a combination of statistical forecasting and collaborative market intelligence to create sales forecasts." That does include historical sales data, which can show trends and patterns that might be useful in demand planning. In addition, look at items in aggregate to see which product "families" may be trending.

Demand planning needs to be folded into your overall business strategy to have a lasting impact.

**Make it part of the process.**

Demand planning isn't a "set it and forget it" kind of tactic. Supply & Demand Chain Executive says that demand planning isn't a part-time job — it's something companies need to be committed to from both a resource and technology perspective. The right software tools can help. Demand planning needs to be folded into your overall business strategy to have a lasting impact. Integrate the demand planning strategy with different parts of your supply chain, such as supply planning and delivery. Look at the demand planning strategy at the beginning of each month, then look back to measure performance as the month plays out.



# GUIDE TO INVENTORY CARRYING COSTS

**HOLDING INVENTORY IN YOUR WAREHOUSE OR STOCKROOM** is great for ensuring customers have access to what they need, when they need it. But there are costs to storing and holding these items, and they're known as carrying costs.

Here, we'll dive into what carrying costs are, why they can be problematic and how to reduce them by putting the right technology to work.

## What are carrying costs?

Carrying costs are the costs of holding inventory. This generally includes the costs of storing inventory in a warehouse and includes things like rent, utilities and warehouse employee salaries. It can also refer to costs such as insurance, perishability, or shrinkage. Essentially, carrying costs involve the costs you pay to keep inventory on hand for customers to purchase. Inventory carrying costs usually add up to about 25% to 55% of inventory value.

## Types of carrying costs

Inventory carrying costs are typically broken down into variable costs, fixed costs and other costs: Variable costs. These include the cost of money (that is, the money tied up in the inventory itself, also called cost of capital), taxes and insurance. These costs can fluctuate over time.

### Fixed costs

Fixed costs include warehouse expenses, such as rent and utilities for storing goods in the warehouse space. These costs also include salaries for permanent warehouse staff.

### Other costs

Additional costs that contribute to inventory carrying costs might include inventory control, obsolescence, pilferage and clerical costs. Many of these are unpredictable, such as when items are stolen or when demand suddenly drops or spikes — such as during a global pandemic.

Because inventory has value, and it's not free to store those items, there will always be some sort of carrying cost associated with your inventory. However, sometimes those costs are tying up more cash than they need to be.

## How would a business incur excess carrying costs?

Distributors incur carrying costs by:

- **Building an inventory buffer.** Distributors tend to keep extra inventory in case consumer demand spikes above expected amounts.
- **Catering to seasonal demands.** A company that sells snow shovels would want to ramp up inventory right before winter hits, or right before a pending snowstorm.
- **Saving on transportation costs.** Some companies order inventory in bulk, especially from overseas suppliers, to save on costly shipment fees or take advantage of scale. This can help save money, but may leave them with more inventory than required.

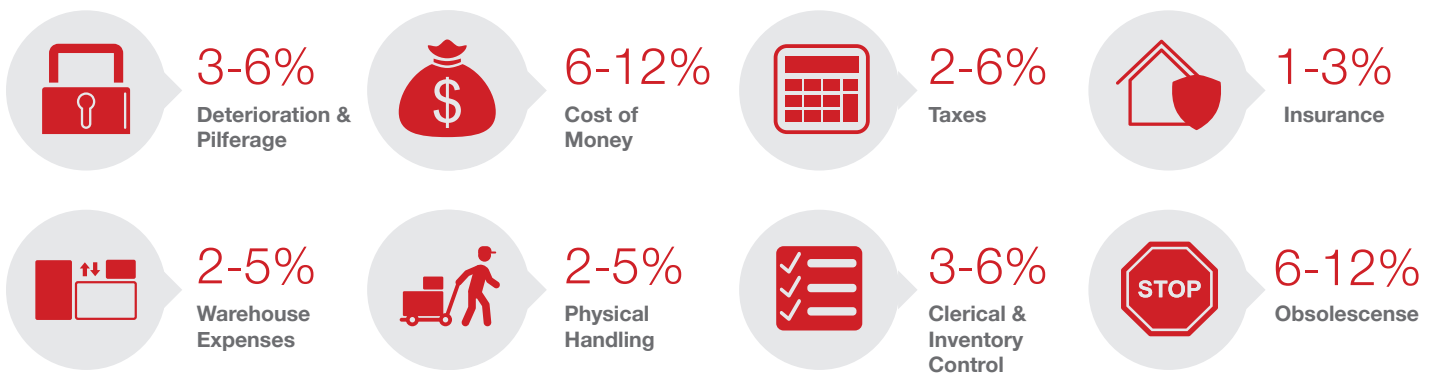
- **Outdated or unwanted inventory.** It's not uncommon for businesses to eventually notice that certain items just aren't flying off the shelves. This "dead" inventory can tie up cash. Discounts or price reductions can help get them moving.

Some of these costs may feel essential, and depending on the product and the demand, many of them might be. However, there's a good chance that many businesses are determining how much inventory to carry not by a mathematic equation but through a gut feeling. Instead, distributors can use technology to reduce carrying costs: 1) to a smaller percentage of inventory value and/or 2) by reducing the inventory required to maximize service levels automatically reducing annual inventory carrying costs.

### How to reduce carrying costs

Many distributors are keen to overstock "just in case," or carry an excess of inventory that doesn't

## Annual Carrying Costs Equal 25-55% of Inventory Value



actually meet customer usage demand. Many distributors rely on generic forecasts based on historical sales data to stock their distribution centers. The problem here is that those numbers don't reflect actual customer usage.

Rather, you must use data that gives you a more realistic view of actual customer usage. The best data is gathered in real-time at the point-of-use. When you have that kind of insight, you can take a much more proactive approach with inventory replenishment.

To achieve this, you may have to look outside your traditional ERP. That's where the eTurns Track-Stock app can help. It can shift inventory planning from being based on a generic forecast to a precise, known quantity.

Here are a few ways to reduce inventory carrying costs:

- **Base forecasts on usage.** Rather than basing your sales forecasts on historical sales data, base them on actual usage. Find out what customers are actually using, and stock accordingly.
- **Sell off old/excess inventory in online marketplaces.** If you have excess inventory on your shelves that isn't moving, consider ways to sell it off. Bonus: You'll improve your cash flow. Consider discounting the inventory to attract buyers, or sell them in online marketplaces where the products are more likely to reach a wider audience.
- **Invest in the right technology.** Putting the right technology to use makes a big difference when it comes to making better decisions regarding inventory. ERP technology does not have the ability to drill down into actual customer usage data. Instead, optimize your distribution centers with actual customer demand and usage information rather than historical data and forecasts.



# HOW eTURNS CAN HELP

With the eTurns [TrackStock Automated Replenishment Apps](#), distributors track and replenish inventory for customers at the point-of-use. Distributors can leverage this usage data to [optimize their distribution centers](#) and [to consign inventory at customer sites](#), reduce carrying cost and improve customer service.

The eTurns TrackStock Apps provide you with:

- Which items your customers are going to order
- The quantity they will order of those items
- The precise date those items will be ordered because it can calculate these valuable data points from the point-of-use:
  - Quantity on Hand (QOH)
  - Minimum Stock Levels (Min)
  - Maximum Stock Levels (Max)
  - Average Daily Usage

It's simple, but powerful. The old way of using a full year of generic aggregated data presents too many opportunities for error. eTurns TrackStock Precise Demand Planning Solution looks at 30-45 days of usage data — continually updated, in real-time — so that you can fine-tune your demand planning based on actual usage. It knows to exclude data from items that aren't used regularly but can't stock out, and it incorporates item data that comes into the system that is new — such as a new product line that a customer suddenly wants but could not be forecast based on historical sales.

The result: optimized distribution centers. And distributors can wring cash out of their consigned stockroom inventory at customer sites with eTurns TrackStock, as well. Automated replenishment through the eTurns TrackStock Replenish and TrackStock Manage Apps includes a powerful Min/Max Tuning Dashboard that uses a customer's actual usage data to optimize inventory and save cash, not only in the first year, but on an ongoing basis through reduced carrying costs. If the inventory is customer-owned, the customer also saves money from optimized stockrooms with the Min/Max Tuning.

## ROI of eTurns

Distributors recoup the investment in eTurns TrackStock in four ways:

- Most distributors stock up to 90% more inventory in consigned customer stockrooms than they need; that is an immediate source of one-time savings.
- The cost of carrying inventory is 25-55% of inventory value so by decreasing inventory levels, distributors can save significant money annually.
- Distributors frequently see same-customer revenues increase up to 30% by providing TrackStock.
- Staff productivity for Vendor Managed Inventory services increases by 4 to 10 times. On top of that, TrackStock helps distributors transition from Vendor Managed Inventory to Customer Managed Inventory with our barcode scanning app for even bigger productivity improvements.

The TrackStock benefits for a Distributor's customers are all similar. Customers who use TrackStock have removed cash of up to 73% of inventory value (one-time) and 25-55% of inventory value annually from carrying costs. They also see increased productivity by 4 to 10 times vs. manual inventory management methods. **Contact us today to evaluate your potential ROI with eTurns.** 