Improving Service & Cash Flow Through Inventory Management

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Agenda

- Repeated Experience Identifies <u>Three</u> Main Areas yields Dramatic Positive Results

  - Shared Responsibility
  - Planning vs. Forecasting
  - Inventory Spending Budget (requires dedicated effort)

Shared Responsibility

- Inventory is one of the largest assets (or liabilities)

- Inventory Control usually treated as second class citizen
  - Yet, Inventory control touches EVERY department

- Responsibility – usually left to one department

Inventory Impact

Properly controlled inventory can move substantial profit $$ to (or from) bottom line

Examples:

- $25m business - every 1% increase in final fill increases $250k to bottom line
  (which also reduces potential overstock; Since most other costs except variable have already been spent.)

- Assuming a 5% EBITDA --- a 1% increase in final fill could increase profit by 10%

TIP # 1

- Recognize Inventory Control as Critical Component of the Organization

- Share Responsibility

  - e.g. – Make buyers and Inventory **jointly** responsible for fill rates AND overstock
  - Physically situate inventory control to facilitate communication with buyers, marketing & creative departments

Planning

- How many PLAN their catalogs over a "horizon" (season) of time?

- Most identify forecasting as biggest Bang for Buck

DISAGREE !

Tip #2

Q: Would you build a house without plans?

■ Detailed <u>Horizon</u> Assortment Planning makes decision making easier

■ Plans are the foundation – allows change, yet recognizing that the further along you go – costs rise

■ Allows identification and removal of potential item "losers"

■ Conscientious planning makes forecasting and timing of buys more accurate*

30-40% of backorders are caused by bad (delivery) timing not bad forecasts

Inventory Spending Budget

- How many "Budget" cost of merchandise for a season or horizon?

- In the same way we budget and track?
    - Catalog costs
    - Cost per order
    - Advertising Expense
    - Payroll
    - Etc

Tip # 3
Graduate Degree (requires effort)

- Create an actual "line of credit" for merchandise costs

- Inventory Control becomes the "banker"

- Key Factors include: (at cost using initial margin targets)
  - Demand
  - Achievable Fill Rate/Cancel
  - Returns
  - Overstock Generated
  - Carryover

Inventory Spending Budget

- Line of credit will fluctuate (up or down) with demand
  - This will raise "overbuy flags" if demand is lowered as "available credit" is reduced
  - Ensures not spending same $$$ twice

- By-Product: an overstock budget is created (which can also be tracked)

Summary

- Responsibility – Everyone shares the same goals

- Planning vs. Forecasting – Improves fill rates and customer service, allows decisions in advance

- Inventory Spending Budget – results in **dramatic** positive impact to cash flow and inventory turns

Guarantee

All three "TIPS" working together
will have <u>overwhelming</u>
positive results

Sample Assortment Plan (partial)

Description	This Year Items	%	This Year Demand	%	TY Avg. Item	LY Avg. Item	TY Perf. Factor	LY Perf. Factor	This Year Space (# of pages)	%	TY Perf. Factor Space	LY Perf. Factor Space	TY Space Costs	LY Space Costs	TY Sell Ratio	LY Sell Ratio
Spring 06-d1			5500.0													
TOTAL DROP:	218	100.0%	5500.0	100.0%	25,229	21,999	1.00	1.00	56.00	100.0%	1.00	1.00	1485.0	1420.0	27.0%	29.7%
GIFTS	43	19.7%	1204.5	21.9%	28,012	27,670	1.11	1.26	11.50	20.5%	1.07	1.09	285.0	290.0	23.7%	28.3%
ART	12	5.5%	390.5	7.1%	32,542	27,225	1.29	1.24	3.00	5.4%	1.33	1.28	93.0	89.0	23.8%	27.2%
COLLECTIBLES	17	7.8%	440.0	8.0%	25,882	25,321	1.03	1.15	4.50	8.0%	1.00	0.83	109.0	103.0	24.8%	29.1%
CERAMIC	14	6.4%	374.0	6.8%	26,714	31,145	1.06	1.42	4.00	7.1%	0.95	1.34	83.0	98.0	22.2%	28.6%
HOME	54	24.8%	1353.0	24.6%	25,056	19,157	0.99	0.87	13.00	23.2%	1.06	1.01	389.0	351.0	28.8%	29.1%
STORAGE	25	11.5%	220.0	4.0%	8,800	5,776	0.35	0.26	6.00	10.7%	0.37	0.37	59.0	58.0	26.8%	30.4%
DOMESTICS	5	2.3%	440.0	8.0%	88,000	99,775	3.49	4.54	1.00	1.8%	4.48	4.68	123.0	117.0	28.0%	29.3%
KITCHEN/DINNERWARE	11	5.0%	192.5	3.5%	17,500	17,030	0.69	0.77	2.00	3.6%	0.98	0.67	56.0	48.0	29.1%	28.2%
GENERAL ACCESSORIES	3	1.4%	264.0	4.8%	88,000	56,750	3.49	2.58	1.00	1.8%	2.69	2.66	77.0	66.0	29.2%	29.1%
GLASSWARE	2	0.9%	110.0	2.0%	55,000	19,720	2.18	0.90	1.00	1.8%	1.12	1.16	35.0	29.0	31.8%	29.4%
STATIONARY	8	3.7%	126.5	2.3%	15,813	17,329	0.63	0.79	2.00	3.6%	0.64	0.71	39.0	33.0	30.8%	27.2%

A number of columns, including LY data, have been hidden to fit this visual

Sample Performance Factors

- **<u>Performance Index</u>** = (% of demand / % of items)

- **<u>Category Space Index</u>** = (% of demand / % of space)

- **<u>Sell Ratio</u>** = (Item percent of page * cost per page) **/** Projected item $$ demand in Offer

- **<u>All</u>** = (Projected Item $$ Demand in Campaign/ Number of items) / Average Item Demand

Inventory Metrics - Benchmarks

- Final Fill Rate (item)
  - Apparel – low/mid 90's
  - hard goods – mid/upper 90's

- Initial Fill Rate (item)
  - Approx 10 points lower than final target

- Average Inventory for $25m business with a 3.5 turn s/b approx $2.9 to $3.2m*

Margin, import vs. domestic, seasonal peaks, etc. would impact average inventory