

HOW TO TRAIN
EMPLOYEES
TO SEE LOST
INVENTORY AS
LOST WAGES

PREVENTING INVENTORY EVAPORATION

Most distributors realize the importance of an accurate perpetual inventory — that is, having the available quantity of an item in your computer agree with what is actually on the shelf in your warehouse. Management realizes the bad things that happen when inventory accuracy doesn't exist:

Wasted Time: If your inside salespeople constantly have to go out to the warehouse to check stock, they're wasting time. They can't walk out to the warehouse and answer phone calls at the same time. And, your customers' time is also wasted as they sit on hold while you dash out to check stock. Do they really enjoy listening to Muzak or a 10-minute advertisement describing your commitment to customer service?

Wasted Money: If inventory is lost in your warehouse, whether through misplacement, theft or breakage, it must be replaced. Buying replacement material is an expense. And, like payroll, rent or any other expense, the replacement material must be paid for with part of the

Your inventory represents the money in your business's pocket. Getting your employees to treat inventory as money in their pockets takes some doing but pays off in reduced shrinkage, higher accuracy and greater profits.

distributor's net profits. For example, if \$250 of material is lost per week (\$13,000 per year), this \$13,000 comes off of your bottom line. If your gross margin is 20 percent, it takes \$65,000 in additional sales each year to make up for this loss!



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Disappointed Customers: If you promise material to a customer based on what your computer says is in stock, but the material isn't actually available in your warehouse, the result is often a disappointed customer. You'll lose your reputation as a reliable supplier. And not being a reliable supplier is the best way to increase your competitor's sales.

There's little doubt that management realizes the importance of inventory accuracy. But, how do you convince your employees that inventory accuracy is important?

EVERYONE MUST UNDERSTAND THE COST OF BAD INVENTORY MANAGEMENT

Many distribution employees behave as though their employers get the funds necessary to run the business from some magical source. These workers believe their paycheck is not dependent on how well they perform

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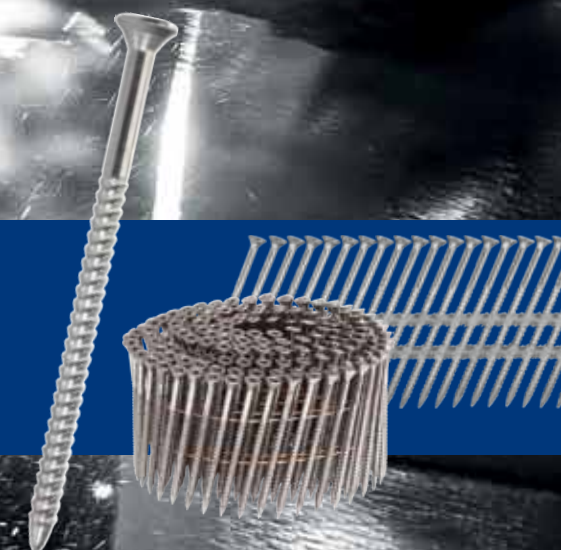


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their job. Further, they are convinced that the company's profits are two, three or four times what is actually on the bottom line!

It is imperative that all of your employees, from the guy who sweeps the floor on up, realize that your company makes money by buying material at one price, and selling it to other companies or individuals at a higher price. Gross profits are the primary source of funds the company has to pay expenses. And your company is probably pressured by customers and competition to keep prices low, resulting in small gross profits. One category of expenses is wages, benefits and salaries.

If you buy material, but it's lost before it can be sold, it doesn't contribute to gross profits; that pile of money available to pay employees and other expenses. In fact, when material is broken or lost, money must be taken out of the pile to pay for replacement material. If too much material is lost, there won't be enough money in the pile of available cash to meet the payroll. Management does not have the option of printing more cash in the back room (without risking a long, all-expense paid vacation at a government-run facility)!

At the end of every week, let everyone know what the material lost that week cost the company. How much money was wasted instead of being available to pay salaries, benefits and other worthwhile expenses?

Consider using this formula to calculate the additional sales you must generate to make up for the lost material:

$$\frac{\text{Value of Lost/Broken Material}}{\text{Average Gross Margin \%}} = \text{Additional Sales Needed to Make Up For Lost/Broken Material}$$

For example, if you lose \$100 worth of material and your gross margin is 25 percent, you must generate \$400 in additional sales to make up for the loss (\$100 ÷ 25% = \$400)!

A great way to communicate this information is to post a billboard showing how much material was lost or damaged each week as well as the sales necessary to make up for the loss:

| Sales Needed to Make Up for Lost Material | | | | |
|---|----------------|----------------|----------------|----------------|
| Week > | August 2 | August 9 | August 16 | August 23 |
| Missing | \$310 | \$250 | \$264 | \$219 |
| Damaged | \$224 | \$184 | \$172 | \$158 |
| TOTAL | \$534 | \$434 | \$436 | \$377 |
| Needed Sales | \$2,670 | \$2,170 | \$2,180 | \$1,885 |

When a warehouse person kicks a box out of the way, he or she must understand that they're kicking the source of funds for their paycheck!

REWARD GOOD PERFORMANCE

You want to encourage your employees to always work in the best interest of your company. Why not compensate them, in part, on how well they protect your inventory asset? That is, maintaining an accurate perpetual inventory. Many companies have seen a marked increase in inventory accuracy when they pay everyone who has access to inventory a small bonus if a predetermined level of cycle count accuracy is achieved. There are two key elements that make these programs work:

The bonus applies to everyone who has access to inventory — Everyone sinks or swims together.

As a result, if someone sees a fellow worker stealing or abusing inventory, they no longer see it as that employee stealing or harming the company. They view it as taking money out of their own personal pocket! The result is that every pair of eyes in the warehouse views inventory as management views it: something to be protected!

The bonus affects the next possible paycheck

— It is not tied to some end-of-year bonus that no one really understands. We also don't want employees to feel that mistakes can be "made up for in the long run." The reward or penalty must be as immediate as possible.

The bonus doesn't have to be big for the program to be successful; just enough to "hurt" if it isn't earned. After employees miss one or two bonuses, peer pressure will ensure that the guilty parties are more conscientious.

PROTECT YOURSELF AGAINST THEFT

Regrettably, theft is a common reason behind perpetual inventory discrepancies. Many companies find it hard to believe that their employees or customers would steal. But unfortunately, stealing, especially petty theft, is a very common reason for "inventory shrinkage." And a company that doesn't admit that theft is a problem, or potential problem, is just burying its head in the sand.

Some companies install security cameras and other theft deterrent devices. While these "hi-tech" solutions often work well in retail environments, their effectiveness in a distribution warehouse is questionable. True thieves usually put considerable thought, time and effort into getting around these systems (i.e., "casing the joint") and continue to steal.

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At the same time, honest employees often feel intimidated and resentful as “big brother” continually watches their every move. These feelings often discourage good and loyal employees from giving their all for the company.

A better way to discourage theft is for management to create an atmosphere that encourages effective inventory management. Ensure that all material movement

is properly recorded. Prevent any excuse for not recording material disbursements by placing a clipboard near every warehouse exit:

| Date | Quantity | Item # | Reason | Taken By |
|---------|----------|--------|---|--------------|
| Feb. 10 | 1 | A-1234 | Sample for Acme Construction | Jeff Miller |
| Feb. 10 | 12 | M 2356 | Emergency for Jensen Controls Will bring back P.O. | Karen Becker |

Every day, a clerical employee updates your computer with each transaction listed on the clipboard. Management reviews these material withdrawals on a regular basis. Be sure to keep this system simple. Don't give your salespeople any reason for not recording every piece of every item they remove from stock. In fact, if you let them design the procedures then they won't have any excuses not to follow them.

Your company can have the most advanced state-of-the-art computer software and warehouse equipment. But if you haven't implemented “best practice” policies and procedures to ensure that your on-hand quantities remain accurate, some of your inventory (and profits) are destined to evaporate into thin air! **CS**

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