Cutting your distribution costs

Before bad things happen to good distribution costs, it's time to take control.

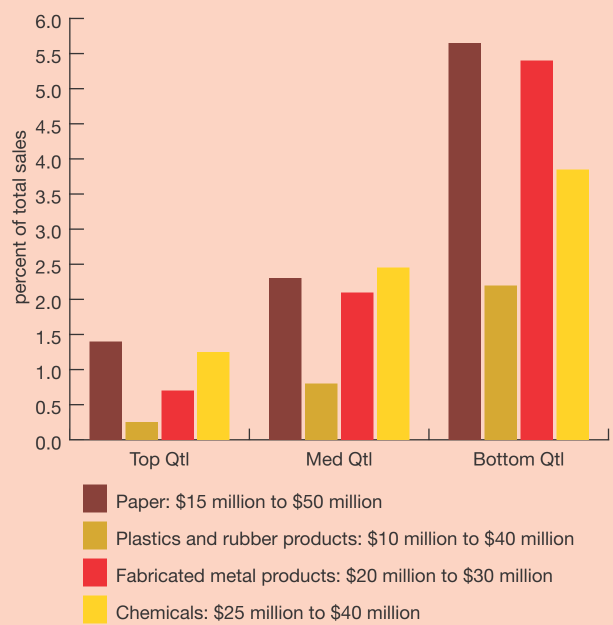
Running on thin margins? Got a new major customer with requirements that are way beyond your distribution capabilities? The efficiency of your distribution network is your front line defense against high costs that can eat away your profitability.

Outside of product costs, distribution expense—including costs related to transporting, storing, and delivering products to customers—is one of the largest cost components for most businesses. "In many cases, distribution costs can exceed ten percent of gross sales," says Tom White ☎, a manager with PricewaterhouseCoopers' Consumer and Industrial Products Advisory Practice in Atlanta. "We find that just by comparing distribution expenses across industries, and paying attention to metrics each month—such as order accuracy, warehouse costs as percentage of sales, or transportation costs as percentage of sales—businesses can zero in on areas for improvement." [See accompanying charts.] Distribution costs that are above industry norms or seem excessive relative to total sales are prime candidates for examination.

Executive summary

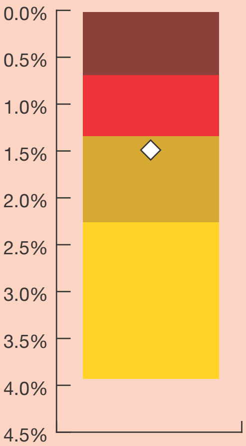
How a business transports, stores and delivers its products to customers is essential to its ability to maintain and increase profitability. A number of opportunities for cutting distribution costs are discussed.

Distribution expenses across four industries



Data source: PricewaterhouseCoopers AMMBIT©, the Advanced Middle Market Business Intelligence Tool

Warehousing and inventory management as a percentage of revenue



Number of respondents: 68

Data source: PricewaterhouseCoopers LLP. Global Best Practices ® — a knowledgebase that contains best practices and benchmarking information. The knowledgebase can be accessed at www.globalbestpractices.com

This ratio measures how much revenue is consumed by the cost of the inventory management function. Total costs include direct labor, contract services, outsourced services, insurance premiums, storage space, operating expenses, and information systems support. This measure reflects how well the department controls its costs for an organization of its size.

For the benchmark group depicted in the illustration, the median percentage is 1.37%. The demonstration company is slightly below the median with a percentage of 1.5%. Additionally, the percentage range for all companies in the benchmark group begins optimally at .02% and gradually increases to 3.94%, which is at the higher end of the spectrum.

Your Company	Benchmark group <<< optimal				
	minimum		median		maximum
1.50%	0.02%	0.71%	1.37%	2.26%	3.94%

Leading companies improve performance on this measure by reducing the costs to operate. Strategies to accomplish this may include redesigning work processes to eliminate the causes of errors and downtime; implementing technology that makes the manufacturing process more efficient; and addressing the causes for excess labor costs. When operations run smoothly, departments are able to contain costs as a result of well-designed manufacturing processes, effective use of technology and capital equipment, and efficient use of staff.

It's usually time to review your distribution costs when:

- A company experiences growth, has a change in its customer or product mix, or decides to expand geographically. Under these circumstances, it is almost always worthwhile to do a comprehensive distribution cost assessment," observes Don Wen ☎, a partner with PricewaterhouseCoopers' Private Company Services group in San Francisco. "For example, a manufacturer or distributor working with a national retailer may be expected to make significant up-front investments to upgrade—and sometimes customize—warehouse and logistic capabilities, to meet specific service requirements."

- Merger or acquisition activity, or haphazard growth causes distribution facilities to overlap. "Good network design specifies where warehouses need to be, and which customers should be served out of them," says White. "Why carry the overhead of six warehouses, when you could serve the same customers with three?"

- High growth strains the current distribution network, or renders it inadequate. Watch for symptoms, which include shipping the wrong product or an inaccurate quantity, frequent late deliveries, and high customer charge-back expenses.

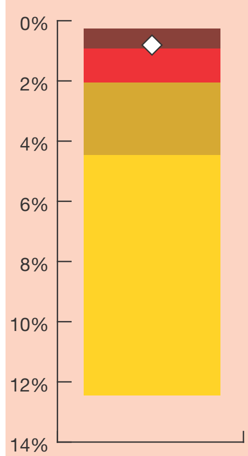
"High levels of charge-backs can hurt a company's cash flows and may result in lower margins," observes Wen. "Too often, a company invests scarce financial resources to investigate and dispute charge-backs, only to end up reshipping to unhappy customers. As a company grows rapidly, limiting charge-backs caused by product fulfillment errors is a key to maintaining or improving profitability and accounts receivable turnover." This may be accomplished with varying levels of investment, from simple process changes to more extensive technology applications—all driven by the desired result, with an eye toward timely return on investment.

To improve its efficiency and timeliness, one distributor set up a warehouse information system to manage shipping and receiving activities. Wen explains: "When a new order is received, it is automatically mapped to the product locations in the warehouse, and the system generates a pick list to determine the most efficient way to pick all of the orders for that day. When all the orders are picked, warehouse personnel scan the various product barcodes, giving a sorting instruction that matches product to customer. If a product is picked that doesn't fit a customer's order, the system raises an alert. Or, if the customer's order is shorted, the system will also raise a flag." With the appearance of more midlevel warehousing and transportation management systems in the past several years, there are more affordable options for a midsize company.

- Transportation planning is not managed strategically across all facilities. Companies with multiple manufacturing and distribution facilities have found significant savings opportunities by looking at where they put their inventory, and how they manage transportation.

Building a database helped one business to better understand and forecast product demand by retailers and distributors across the country. "As a result, the company was able to use a transportation management system to figure out where it has the most traffic and, correspondingly, where to

Transportation cost as a percentage of revenue



Number of respondents: 70

Data source: Global Best Practices® PricewaterhouseCoopers LLP

Total costs include direct labor costs; carrier fees; depreciation and rental fees; insurance premiums; fuel, tires, and maintenance costs; and information systems support. This measure reflects how well the transportation department controls its costs for an organization of its size.

For the benchmark group depicted in the illustration, the median percentage is 2.15%. The demonstration company is in the optimal range with a percentage of .75%. Additionally, the percentage range for all companies in the benchmark group begins optimally at .027% and gradually increases to 12.57%, which is at the higher end of the spectrum.

Your Company	Benchmark group <<< optimal				
	minimum		median		maximum
0.75%	0.27%	0.98%	2.15%	4.44%	12.57%

Leading companies improve performance by (among others) reducing transportation department operating costs; improving transportation efficiency; consolidating transportation providers to negotiate more favorable rates; and outsourcing the transportation function.

put its inventory," says Wen. "Also, taking aggregate shipment information to third party transportation companies such as FedEx or UPS, is often effective for negotiating better rates for the entire company, rather than relying upon rates negotiated through each local office." [See preceding chart.]

- Inefficiencies exist within the order management, warehouse, or transportation processes.

"Within warehouse operations there are often opportunities for companies to improve shipment accuracy and reduce costs," says White. "In some cases, this can be as simple as laying out a warehouse to reduce travel time and labor time required to find and pick items and put them away. For manufacturing and distribution businesses, the average transportation expense tends to be four percent, but can be upward of nine percent," he notes. "That's a big chunk of costs that might be addressed with organizational or transportation initiatives. A $550 million consumer products company was spending $12 million on transportation. A major issue was the higher cost of shipping less-than-truckload shipments. Now the company uses technology to optimize shipping planning and processes. The optimization engine looks at the orders that must be shipped in a given window, and may suggest when it is feasible to hire one truck for all the orders, having it make multiple stops to customer destinations. As a result, the company saves in the 15-20 percent range."

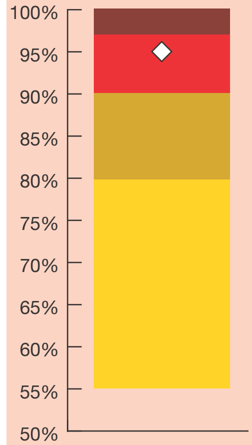
- Inventory levels are excessive for certain items, and stock-outs are frequent for others.

"Forecast Accuracy, the percentage of accuracy of a given month's forecast versus actual orders, is a key metric," says White. "Companies that forecast demand well typically see an aggregate accuracy of 85 percent, while those that are best in class can achieve up to 95 percent accuracy. Increasing forecast accuracy by improving processes and discipline in key functions tends to foster improvements in customer service as well as operating cost reductions." [See accompanying chart.]

In the quest to cut distribution costs, businesses may discover additional benefits of their new efficiencies—from the ability to increase revenues and differentiate themselves from competitors, to the joy of delighting customers. ●

By Janice K. Mandel

Perfect order rate



This measure indicates the percentage of orders filled completely and on time in the past 12 months. The order should be considered on time when the delivery date is the customer-requested date. A perfect order rate above the benchmark group's median may indicate that the company is highly committed to meeting customer needs. Rates below the median may indicate that the company has not effectively planned for customer demand or does not carry adequate inventory to fill customer orders.

Your Company	Benchmark group <<< optimal				
	minimum		median		maximum
95%	55%	80%	90%	97%	100%

For the benchmark group depicted in the illustration, the median percentage is 90%. The demonstration company is near the optimal range with a percentage of 95%. Additionally, the percentage range for all companies in the benchmark group begins at 55% and increases to the optimal level of 100%.

Number of respondents: 70

Data source:
Global Best Practices®
PricewaterhouseCoopers LLP

Directory

To find out more about how to cut distribution costs, please contact:

☎ Thomas White
678-419-3101
thomas.h.white@us.pwc.com

☎ Don Wen
415-498-8265
don.wen@us.pwc.com

To find out more about AMMBIT, PricewaterhouseCoopers' benchmarking database designed exclusively for private companies with sales up to $500 million, please contact:

☎ Brad Allen
267-330-2170
bradley.j.allen@us.pwc.com

To find out more about PricewaterhouseCoopers' Global Best Practices® knowledgebase and benchmarking, please contact:

☎ Michelle Porter
312-298-2255
michelle.l.porter@us.pwc.com

Or call the PricewaterhouseCoopers office nearest you, listed on the back cover.