Distribution Center
MANAGEMENT

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Managing people, materials and costs in the warehouse and DC

From the Golden Zone

Three common practices at leading distribution centers

By Marc Wulfraat

A good logistics manager knows the names of the people on the floor and is quick to receive respect when walking the floor. He can answer questions about key operating statistics such as pick rates, throughput per hour, order fill rates, and order accuracy.

On the other hand, managers who don't have a feel for the numbers do not spend enough time on the floor getting to know the operation. They usually manage from the air conditioned office situated farthest from the entrance to the warehouse.

Once you're out walking around, here are some other best practices you'll find at successful companies:

Best Practice: Emphasize Return on Assets. Successful logistics companies keep a close eye on working capital invested in infrastructure and inventory. Sometimes this philosophy can be taken to an extreme that can be detrimental to net operating profits, so common sense needs to prevail. For example, many companies incur much higher operating expenses for the sole purpose of keeping assets off the books. I can understand why companies lease warehouse facilities, but I see no logic in leasing racking or other fixed storage equipment. This is simply paying more for an asset that would otherwise cost nothing once it is fully depreciated.

Further, many companies hire third party logistics operators to manage their distribution operations for a long list of reasons. I fail to understand why companies have the 3PL manage the lease of the distribution facility because the 3PL applies their management fee to everything they touch. Why not lease directly from the landlord and save the expense for this non-value added expenditure?

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Successful companies pay attention to return on assets but they also measure their decisions with other financial metrics to balance ROA against return on investment and net present value. One of the most demanding financial metrics is economic value add (EVA). This measure is particularly effective because it treats long-term leases as assets; therefore companies cannot play the game where they make ROA look good but incur substantially higher operating expenses.

Best Practice: Minimize Working Capital Invested in Inventory. In the long term (with emphasis on the word long), companies that thrive are those that have the fastest cash-to-cash cycle, which depends on fast inventory turns. Inventory accuracy is a basic requirement to improving inventory turns. If inventory information is out of date or inaccurate, the purchasing department tends to compensate by overbuying and subsequently overstocking.

Many companies have attempted to increase inventory turns through trading partner collaboration programs, such as vendor-managed inventory (VMI) or consignment inventory. Vendor-managed inventory is designed to pass the responsibility of inventory management back to the supplier. The customer informs the vendor how much stock it sells each day, and the supplier tracks and replenishes inventory as needed. This approach is based on the premise that vendors will do a better job at reducing inventory assets than the customer can do itself because each vendor needs only to monitor its specific items.

One issue with VMI is that people forget to look at whether the total supply chain cost is higher or lower when using a vendor-managed inventory strategy. Instead of ordering an efficient quantity, the company might end up receiving more frequent inbound shipments within a VMI program and there is a cost associated with this higher level of service. In the end, vendor managed inventory is not necessarily about increasing operational efficiency; rather, it is a technique to enable suppliers to have greater control over supplying their products to their customers.

The ultimate goal of VMI is to reduce stock-outs so that both the customer and the supplier enjoy an increase in sales. This goal needs to be balanced against any increases in operating expenses. VMI is an obvious fit in some industries and a drop-dead dog in others.

Best Practice: Scrutinize Technology Investments. Technology is often viewed as a panacea to inefficiencies and poor performance in the warehouse, but companies seem to forget that technology is just a tool. It does not make economic sense to throw expensive tools at simple problems. Successful companies do not invest large sums of money to deal with problems that can be solved with simple methods.

However, there are telltale signs that technology can be beneficial. For instance, if the only way you manage is by putting out fires, then you know you have a problem. Another sure sign of trouble: Finding inventory is a never-ending adventure.

To build a solid business case for technology investments, ensure that the benefit being proposed is in fact related to the technology investment rather than to a change in operating processes, warehouse layout, or other non-technology-related attributes.

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