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The Financial-Supply Chain Management Connection

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Purpose

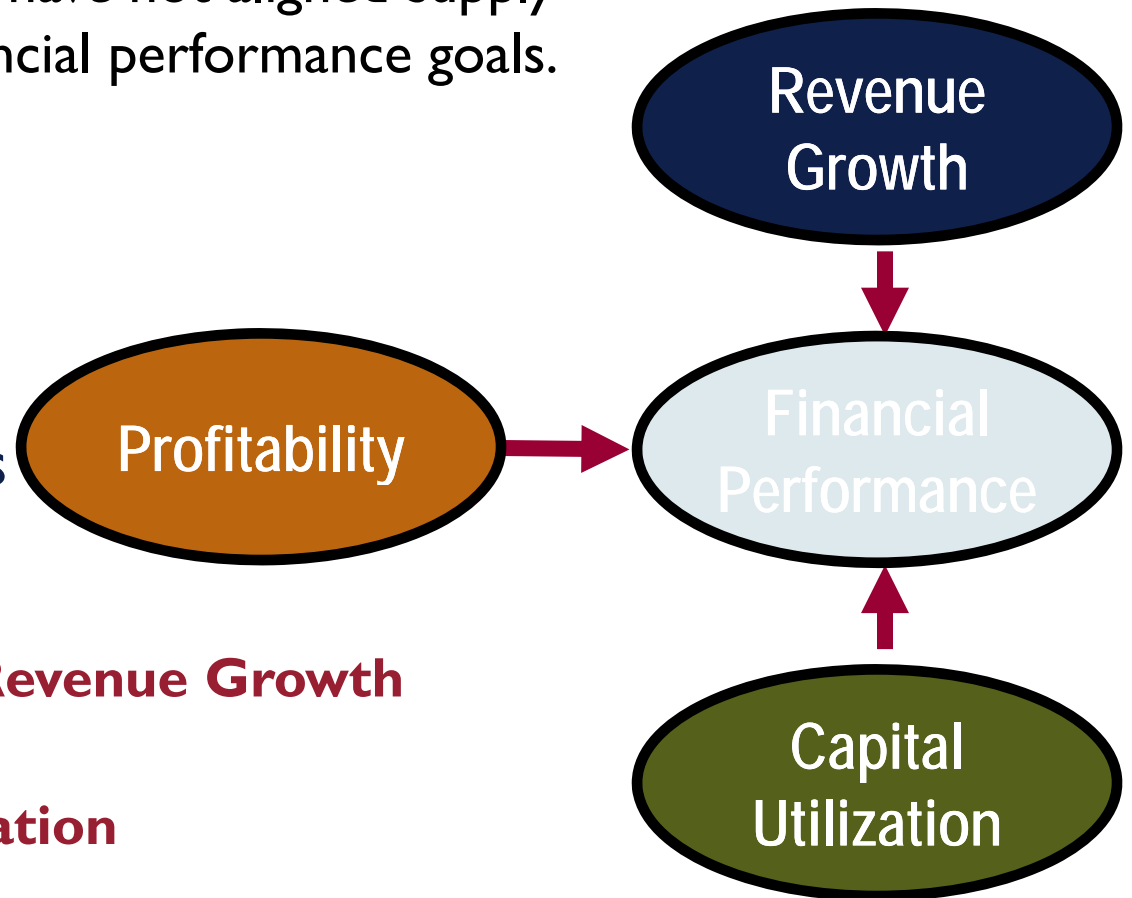
- ▶ What retail executives really want from Supply Chain Management (SCM).
- ▶ The Financial-SCM Connection.
- ▶ Much potential to unlock hidden value.
- ▶ Total cost of holding inventory.
- ▶ Supply chain financing.


The Challenge

- ▶ Many companies historically have not aligned supply chain management with financial performance goals.

- High performance companies use supply chain management to achieve financial goals through:

- ▶ **Higher Value-Adding Revenue Growth**
- ▶ **Improved Profitability**
- ▶ **Greater Capital Utilization**

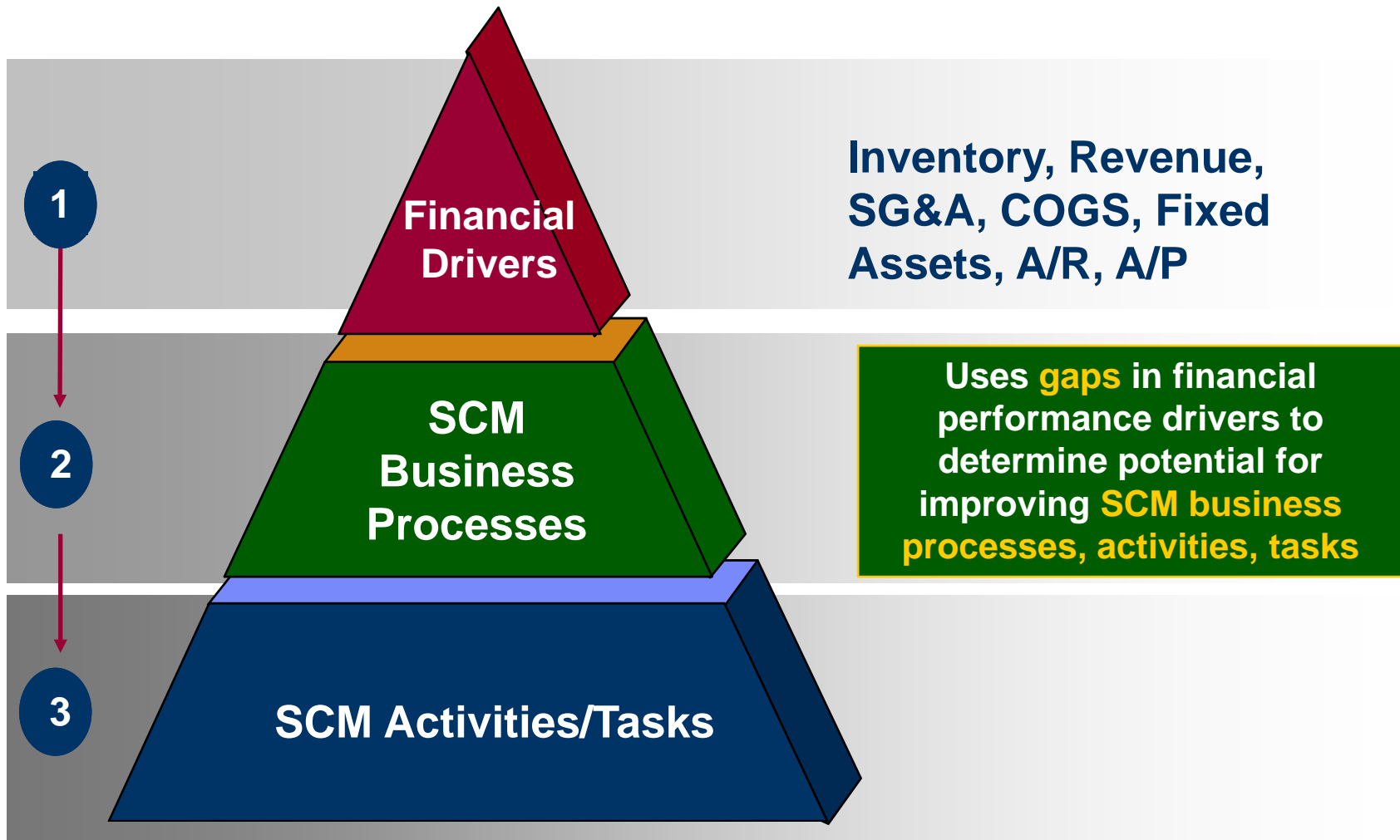




Polling Question

#1

Aligning SCM with Financial Goals: A Top-Down Approach




Financial-SCM Connection

Financial Metric	Examples of How Supply Chain Management Adds Value	
Revenue Growth (Same Store and New Store Sales)	<ul style="list-style-type: none"> •Fill rates •Forecasting •Customer Service 	<ul style="list-style-type: none"> •Lead times •New Product Speed to Market
COGS as a Percentage of Revenue (Gross Profit Margin)	<ul style="list-style-type: none"> •Inbound Transportation Mgt. •Inventory Mgt. •Network Design 	<ul style="list-style-type: none"> •Procurement •Reverse Logistics •Selective Outsourcing
SG&A as a Percentage of Revenue	<ul style="list-style-type: none"> •Warehouse Mgt. •Outbound Transportation •Supply Chain Administration 	<ul style="list-style-type: none"> •Customer Service •Information Technology
Days in Inventory (DII) (GMROII)	<ul style="list-style-type: none"> •Transportation Mgt. •Warehouse Mgt. •Network Design 	<ul style="list-style-type: none"> •Inventory Visibility •Forecasting Accuracy •Demand Planning
Days Sales Outstanding (DSO)	<ul style="list-style-type: none"> •Shipment Integrity •Fill Rate •Proof of Delivery 	<ul style="list-style-type: none"> •Invoicing Accuracy •Internal Communications
Days Purchases Outstanding (DPO)	<ul style="list-style-type: none"> •Procurement Terms 	<ul style="list-style-type: none"> •Payment Practices
Fixed Asset Utilization (Revenue / SF for stores)	<ul style="list-style-type: none"> •Warehouse Management •Transportation Management 	<ul style="list-style-type: none"> •IT Management •Selective Outsourcing

SCM – Who’s View?

CxO	View of Supply Chain Management
CEO	<ul style="list-style-type: none">▶ Deliver value-adding growing revenue.▶ Like merchandise availability, new merchandise speed to market and customer service.
CFO	<ul style="list-style-type: none">▶ Better manage the balance sheet primarily in terms of inventory and fixed assets and the income statement in terms of SCM related expenses.
Merchandisers	<ul style="list-style-type: none">▶ Sales, sales and more sales.▶ Like visibility into current and future demand including both quantities and required lead times or replenishment times.
VP Supply Chain	<ul style="list-style-type: none">▶ Better plan and fulfill market demand for goods and service and do so more efficiently.▶ Like SCM buy-side, sell-side, planning and execution.



Polling Question

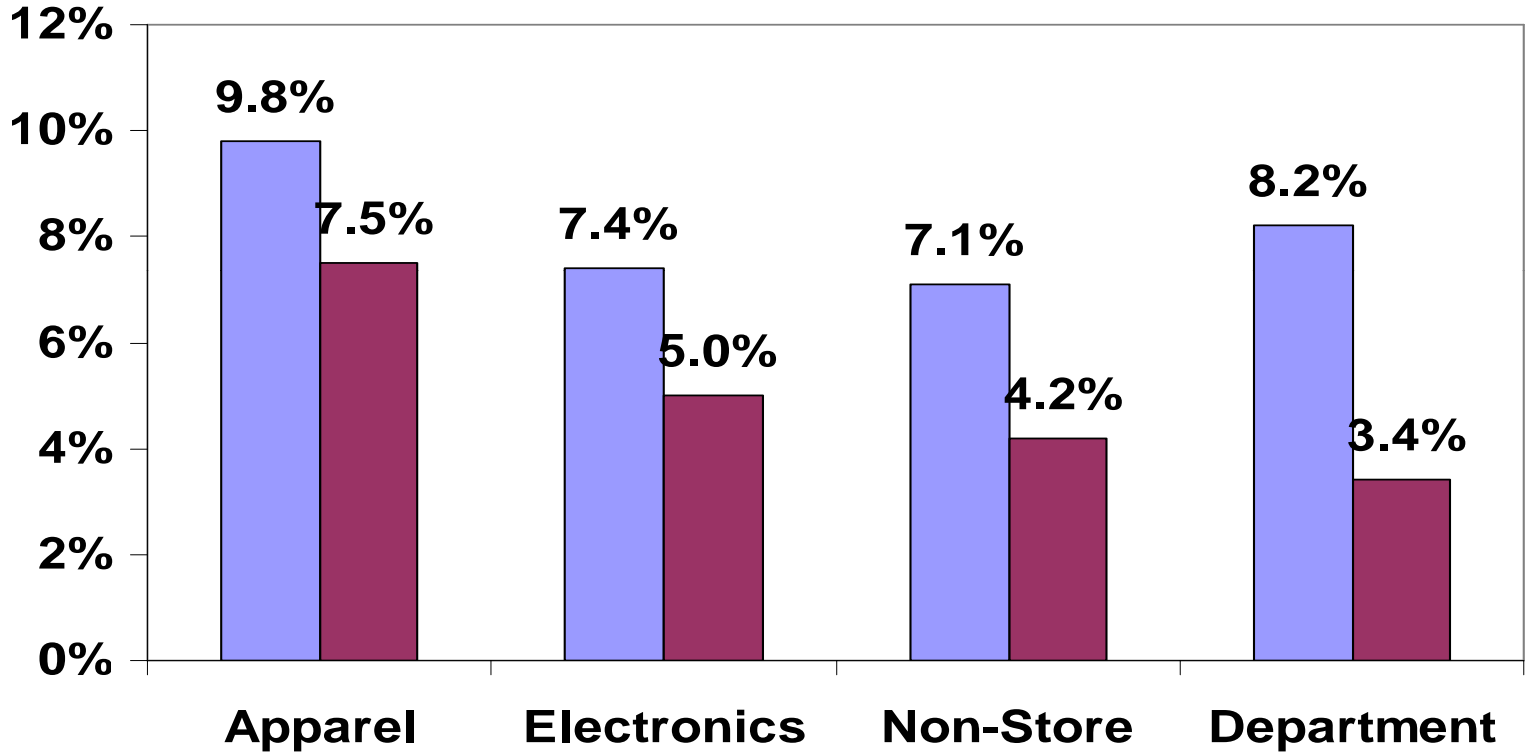
#2

Much Potential to Unlock Hidden Value



Much Potential to Unlock Hidden Value: Retailers' Operating Income Margin

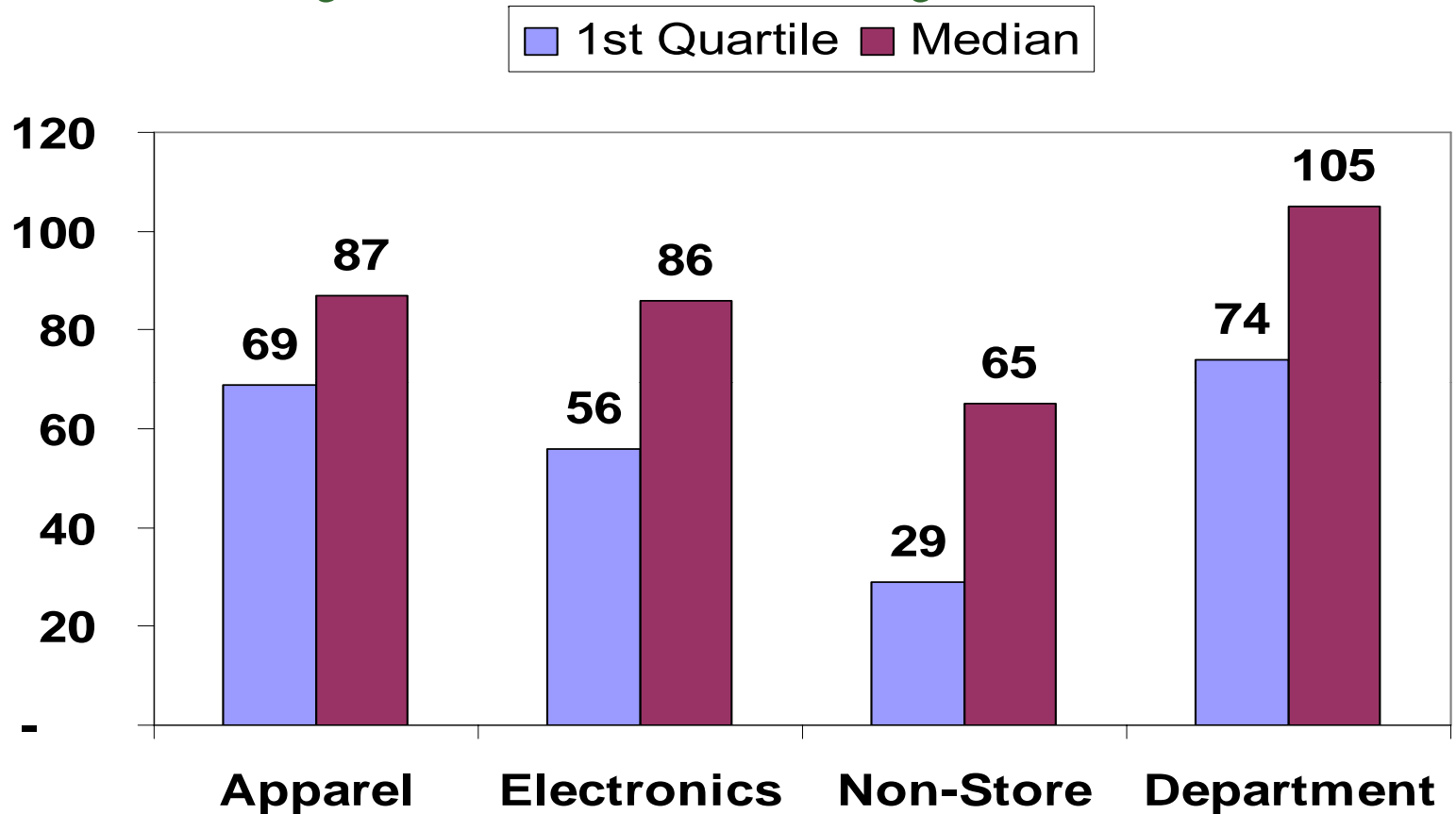
1st Quartile Median



Annual value of improving to 1 st Quartile*	\$23M	\$24M	\$29M	\$48M
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*per \$1,000 million in revenue

Much Potential to Unlock Hidden Value Retailers' Days In Inventory



Value of improving
to 1st Quartile*

\$34M

\$63M

\$67M

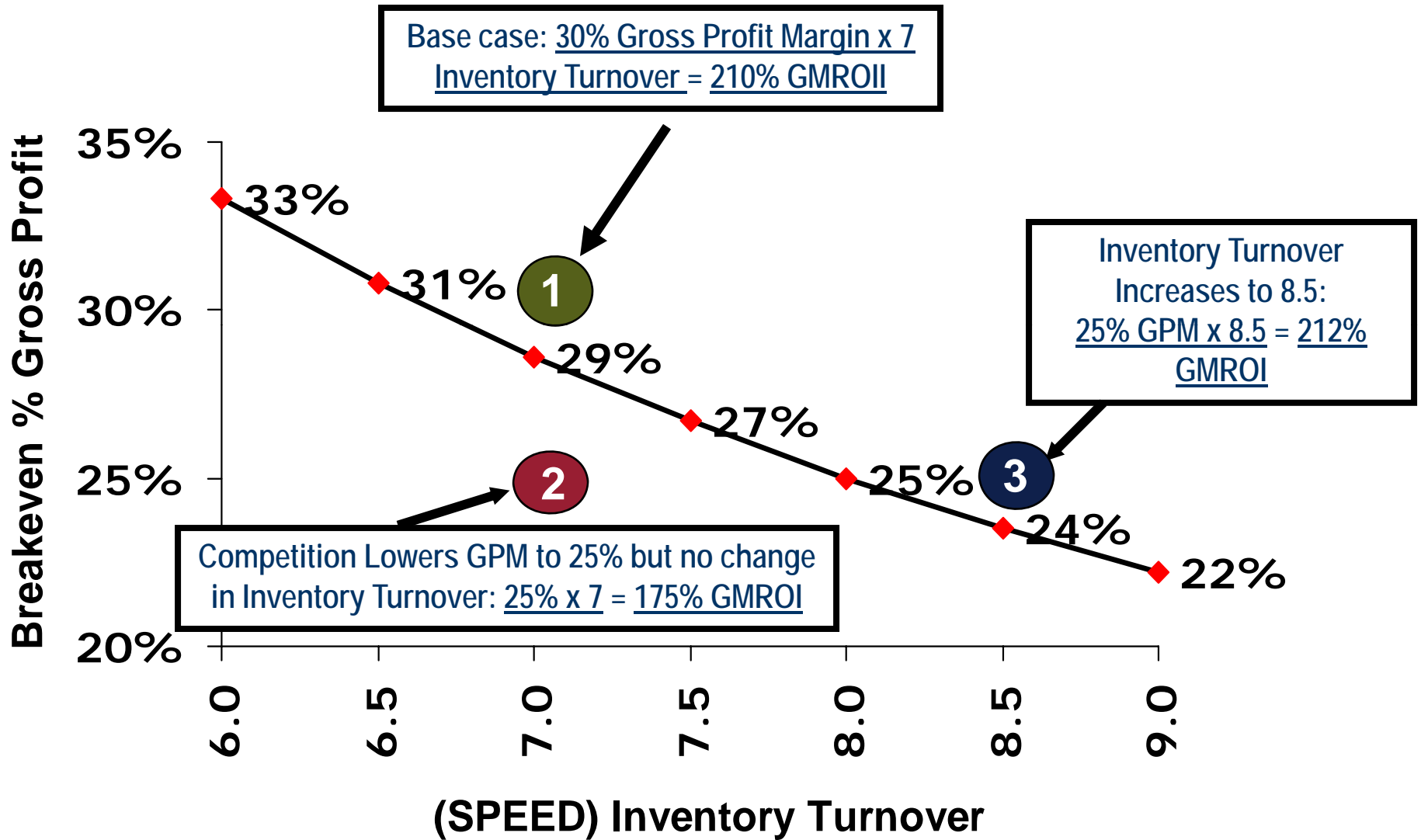
\$60M

*per \$1,000 million in revenue

GMROI – Need for Supply Chain Speed

	Apparel	Electronics	Non-Store	Department
\$Revenue	\$1,000.0	\$1,00	\$1,000	\$1,000
\$Gross Profit	391	319	370	345
\$Inventory	145	159	112	188
GMROI (GP / Inventory)	269%	201%	330%	183%
GP Margin (GP / Revenue)	39.1%	31.9%	37.0%	34.5%
X Inv Turn (Revenue / Inventory)	6.89	6.31	8.91	5.31
= GMROI Profitability x SPEED	269%	201%	330%	183%

Need for SCM SPEED – A Retail Example*



*Graph for 200% minimum GMROI

Total Cost of Holding Inventory



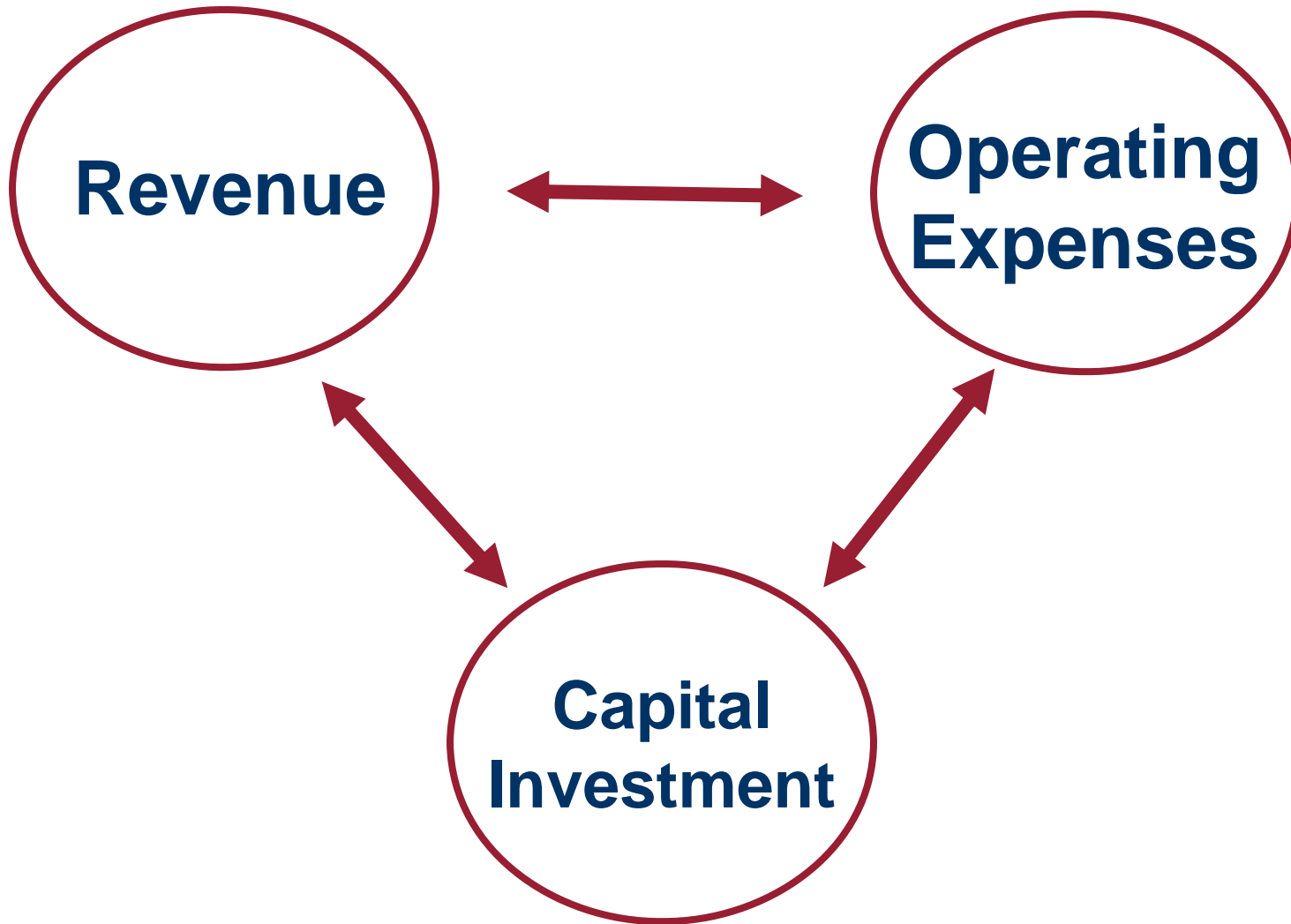
Total Cost of Holding Inventory

Non-Capital Carrying Charges

+

Capital Charges

Inventory Trade-Offs



Total Cost of Holding Inventory: Electronics Stores

▶ Inventory		\$160	
▶ Pre-Tax Cost of Capital	15%		
▶ Inventory Non-Capital Carrying Charge	10%	25%	
▶ Total Annual Costs			\$40
▶ Adjusted Operating Income*		\$66	
▶ Total Annual Costs Absorption of Adjusted Operating Income		60%	

7 months of sales needed to fund total inventory costs.

*Reported Operating Income + Non-Capital Carrying Costs.

Retail Business Processes to Explore Closing Financial Performance Gaps

Business Process	Revenue Growth	% Cost of Goods Sold	% SG&A	Days Sales Outstanding	Days In Inventory	Days Purchases Outstanding	Fixed Asset Utilization
Merchandising	✓	✓	✓		✓	✓	
Marketing	✓		✓				
Customer Relationship Mgt	✓		✓	✓			
Store Operations	✓	✓	✓	✓	✓		✓
Order Fulfillment	✓	✓			✓		
Warehouse Management		✓			✓		✓
Transportation		✓			✓		✓
Finance & Accounting			✓	✓		✓	✓
Human Resources			✓				
Information Technology			✓				✓
Corporate			✓				


 = Growth

 = Profitability

 +  = Capital Utilization


Reduce COGS through Improving Logistics & Warehousing

1. What is major cost drivers in the warehouse and its impact on COGS
 - a) Warehouse cost as a % of revenue
 - b) Warehouse layout and conduciveness to efficient flow of goods
 - c) # of employees required to run the warehouse and labor costs
 - d) average pick time
 - e) Fill rate
 - f) Damage rate
2. How much is inventory costing you?
 - a) % of inventory that is dead stock
 - b) # of SKUs
3. Is your transportation/Logistics strategy aligned with you business strategy?
 - a) How many orders are you shipping that are less than full load
 - b) transportation throughput commensurate with your needs
 - c) Is selection and utilization of shippers, for both inbound and outbound product, yielding the best for your organization
4. What role does information technology play in managing your logistics and warehousing?
 - a) Does the warehouse have visibility into the production schedule or customer order system?
 - b) How do you receive the information for picking orders



Polling Question

#3



Supply Chain Financing



Retailing Supply Chain Financing

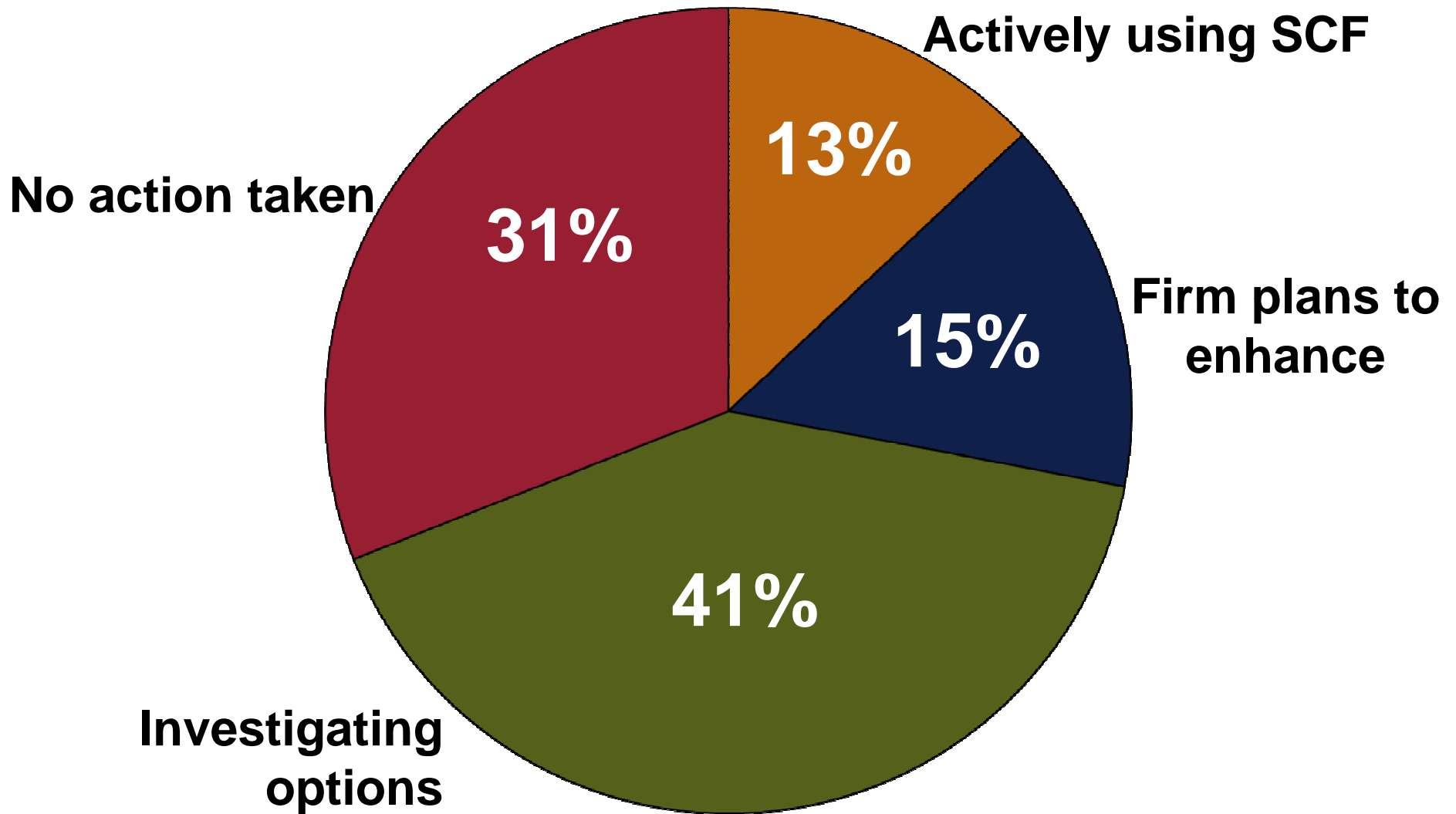
- ▶ Sourcing from Asia-Pacific comprises the majority of spend for many North American retailers.
- ▶ For many retailers, implicit trade financing charges comprise **4%-6% of cost of goods sold**.
- ▶ Reducing these charges **10%** increases Gross Profit Margin **30 bps** for the average retailer - **\$3M per \$1B in revenue**.



Polling Question

#4

Use of Supply Chain Finance (SCF)



Source: "Financing the Chain," CFO Magazine, February 2007, pp 46-53. From study by Aberdeen Group.

Who's view – Top actions planned to improve financing of supply chain

	Buyers	Suppliers	
51%	Negotiate price reduction with suppliers for earlier payment	Implement a program that enables both streamlined transaction processing and access to financing	67%
41%	Implement a scorecard system to track supplier performance	Find a cheaper source of financing	49%
40%	Implement new technology for better automation and visibility	Implement new technology for better automation and visibility	44%
39%	Extend payment terms	Obtain additional financing from a financial institution	37%
32%	Implement program that enables both streamlined transaction processing and access to financing	Use purchase-order performance milestones to trigger buyer payment or export finance	26%

Source: "Financing the Chain," CFO Magazine, February 2007, pp 46-53. From study by Aberdeen Group.

Questions?



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