D A T A S Y S T E M S

2 Horatio Street • New York, NY 10014 • 212.714.3536 • www.smcdata.com

How to Control Your Company's Hidden Costs

by

Dani Kaplan

Abstract: Many companies don't realize how severely they are being affected by hidden costs until their accounting firms conduct the year-end auditing. When the audit report is submitted the reality settles in, and what looked like a very profitable year turns out to be not such a profitable year.

This article was originally published on CEO Online.

2 Horatio Street • New York, NY 10014 • 212.714.3536 • www.smcdata.com

How to Control Your Company's Hidden Costs

by

Dani Kaplan

One of the major factors that contribute to hidden costs lies in the warehouse. A warehouse that is not automated can create hidden losses. Many companies that do not have automated warehouses take a physical inventory only once a year. When the physical inventory is finished they often get a bitter surprise, finding inventory nobody knew about in the warehouse. In many instances, by the time the inventory is found it's obsolete, which results in its being sold to consolidators. Customer orders that could not be fulfilled because the necessary inventory was hidden were canceled, resulting in lost sales. Even if the excess inventory can be sold, it carries a cost. While being stored in the warehouse collecting dust because no one was aware of it, new inventory was bought resulting in "excess inventory."

Other losses in the un-automated warehouse come from manual picking and shipping. Very often the pickers cannot find products that were misplaced and pick substitute items or the wrong quantities. At the staging point, one person packs the orders while a second person verifies that the right products and quantity are being shipped. Even with the best scenario where the right products were picked and shipped, it takes two people to perform a task that can be done by one person in an automated warehouse.

Non-Automated Warehouse:

Many companies learn to live with these warehouse issues and view them as the "cost of doing business". They are not being aware of the factors that can affect company bottom line profits:

1. Incorrect inventory shipments are often returned and result in duplicate freight bills.
2. When inventory gets shipped its gets replenished. The returned inventory becomes "excess inventory" that might not be sold for a while, resulting in money collecting dust on the shelves.
3. The customers who got the incorrect shipments often dispute the invoices and don't pay them on time.
4. The returned inventory creates an additional workload for the accounting department, which has to issue credits to the customer and adjust the computer records.
5. The additional workload the accounting department has often results in missing the early payments discount date for vendor invoices.

6. In order to improve the cash flow, many businesses borrow money from various lending institutions which charge high interest rates for advancing money against the open receivable.
7. The inventory in the warehouse ends up being financed by financial institutions that use the inventory as collateral and charge high interest for the money being borrowed.

Automated warehouse:

Automated warehouses results in cost savings and increased bottom line profit.

1. Inventory is scanned when it is received at the warehouse and instantly updates the computer. This gives the sales and customer services departments' reliable knowledge of what is available to sales when the customer calls, or visits the company's website.
2. The warehouse people who pick-the inventory are instructed by hand held radio devices what they should pick and at what location. This ensures they do not pick the wrong items or quantities.
3. Before being shipped, the inventory is scanned again, and verified that the right product and quantity are being shipped.
4. Packing and scanning the inventory to be shipped is done by one person vs. two people in an un-automated warehouse resulting in labor cost savings.
5. The inventory gets scanned on a timely basis at various locations and is compared to the computer data for accuracy. If an inventory discrepancy is found, it is addressed immediately and the computer data is automatically adjusted.
6. Accurate shipments result in fewer credits and adjustments, freeing the accounting department to take advantage of vendor discounts for early payment.
7. Not having disputed invoices resulting from incorrect shipments helps shorten the Accounts' Receivable payment received cycle.

Hidden costs of imported products:

Many companies average the product cost since it carries additional charges beyond what was initially agreed to pay the vendor. The additional charges resulting from handling charges such as freight, maritime, US custom, ECT,

The final cost of product received at the warehouse is called "landed cost." Not having accurate product "landed-cost" control will affect the product-selling pricing and result in severe losses. A large distributor who works on a low gross profit margin and did not have accurate control of his “landed cost,” got a very unpleasant surprise when his accountants came to do his year-end auditing and found out that his profit was considerably less than anticipated.

Not having accurate control of the various “landed costs” was a fact of life this distributor learned to live with saying: “it’s the cost of doing business.” In previous years in a less competitive market with a higher gross margin of profit and a stronger dollar, nobody paid attention to the “landed cost” accuracy, assuming it would “averaged itself out.”

The new reality of today’s lower gross margin profits and a weaker dollar resulted in over $1 million dollars less profit than anticipated. Reading the auditor’s report and realizing that the year was not as profitable as anticipated resulted in a panicky searching for ways to improve the landed cost accuracy.

Keeping track of the imported inventory:

Another issue many distributors are facing today is keeping track of imported inventory while it’s in transit and its expected arrival date at the warehouse. Inventory that arrives late at the warehouse often causes customer orders to be canceled. The order cancellations start a vicious cycle of lost sales’ revenue, excess inventory in the warehouse, and borrowing money at high interest to cover inventory cost until it can be sold.

Having a sophisticated inventory tracking system enables the distributor to keep track of inventory in transit, knowing where it is and when it will arrive in the warehouse. Having this information results in a realistic arrival date and enables the distributor to allocate orders to be shipped against the in-coming inventory. Once the inventory arrives at the warehouse, orders pending shipment can immediately be fulfilled and shipped from the warehouse loading dock. The remaining inventory is then put into the warehouse, becoming inventory available to be sold. Using this method saves on labor costs of putting the inventory into the warehouse and then shipping it out.

About the author: Since 1980, Dani Kaplan has worked with corporate executives to improve purchasing, increase warehouse and distribution efficiency and implement the solutions that result in substantial savings and productivity improvements. He is president of SMC Data Systems, Inc. (www.smcdata.com) and can be reached at 212.714.3536

