

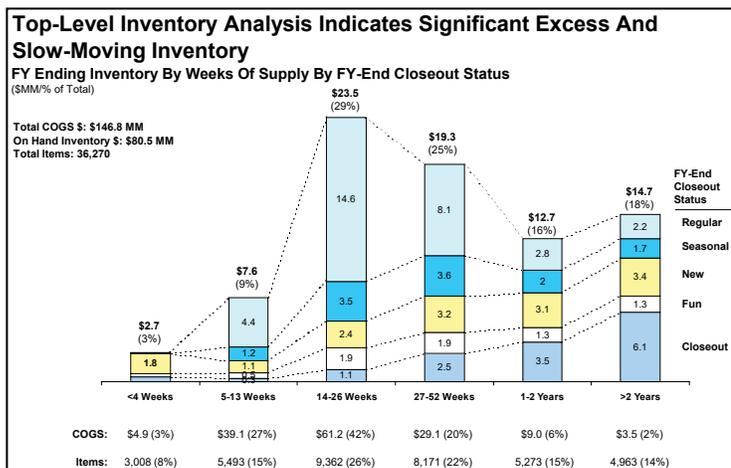
Inventory Optimization At Large Direct Marketing Company: Developing And Implementing Enhanced Inventory Management System

The Challenge: A \$700+MM direct marketing company had been purchased by a PE firm in a hotly contested auction. During due diligence, Gotham had assessed the inventory situation and found an opportunity for significant reduction (\$26-37MM) from higher turns (2.25-2.75). The historical exponential growth in sales and SKUs had reached a critical point where management was concerned that even the recently opened, 600K sq. ft. warehousing and distribution facility was at risk of reaching capacity in the near term. Management had been attempting to refine processes and rules for replenishment to create a focus on inventory performance, but progress had been slow due to a lack of resources/expertise and the complexity and size of the SKU base. While some 12 months later the actual inventory level was \$12.4MM less than the due diligence model projection due to some success in capturing quick-wins, the company management realized it needed help with the more complex inventory reduction initiatives. Management engaged Gotham to help undertake these initiatives and institutionalize inventory management processes and KPI's.

The Partnership:

Analysis: Our initial diagnostic found significant opportunity still remaining due to the client's existing monolithic, "one-size-fits-all" approach to inventory management, whereby:

- Demand stability was not being leveraged (analysis of historical demand patterns indicated that items accounting for 10% of inventory had low demand variability)
- A high number of failed new product introductions were causing a glut of slow-moving and obsolete (SLOB) inventory (more than 17% of on-hand inventory value was closeout, of which 85% was expected to last more than 1 year, and 70% was expected to last more than 2 years)
- Seasonal inventory was being brought in too early given the start of the season and failed to leverage historical seasonal demand patterns (more than 22% of seasonal inventory brought into the warehouse 1+ month before the desired delivery date)
- Inventory management was an item-by-item exercise with each inventory specialist having his/her own, unique approach.



Further analysis determined that CatalogCo had been focusing singularly on fill rates – while average fill rate in its consumer business was 98+%, inventory turns only averaged 1.76.

Strategy: To capture near-term inventory savings and build capabilities and processes to better manage and monitor inventory in the future, the joint Client-Gotham team initially focused on interim actions to deliver savings:

- An "initial order justification" tool and process to minimize overbuying on the initial PO for new items
- Statistically-based targets to leverage the demand consistency for stable, everyday items
- A process to align delivery with demand in conjunction with vendor management to ensure compliance
- An end-of-life (EOL) strategy to minimize and accelerate disposition for discontinued inventory
- A set of KPIs for managing inventory (turns, fill rate, forecast accuracy)
- Forecast methodology changes to fix known issues.

The Gotham team also created a longer-term vision for:

- Developing an item-driven (vs. catalog-driven) forecasting approach consistent with merchandising's shift from a catalog focus to category management.
- An integrated inventory management system enabling a system-wide perspective for effective decision-making
- Reduced supplier lead times once the consolidated, relationship-driven supplier base was in place.

Execution: Gotham worked with management to: implement and institutionalize the 'initial order justification' tool and process; and create a process and decision-support guidelines for the disposition of EOL items. The latter was introduced to inventory managers, along with a model targeting specific levels of disposition, and a strategy for minimizing this inventory. The team also introduced guidelines for alignment of demand to delivery and vendor management principles, and adjusted delivery timing where permitted by vendor reliability. Finally, the team developed and implemented a statistically-based tool and process to leverage stable demand and optimize inventory levels, and realigned the forecast publishing process components to improve forecast results.

The Outcome: Through implementation of inventory management processes and tools, the company was able to improve its turns from 1.76 to 2.15, and its peak inventory was down to \$88MM from \$98MM, even with increased sales.