

LEAN BUSINESS PRACTICES: HOW TO TRANSFORM YOUR BUSINESS FROM IN-CHAOS TO IN-CONTROL

LEAN is the art and science of continuously examining and improving a business's processes, people, and products so that the customer experience is overwhelmingly positive, allowing the business to realize its potential.



“LEAN is about developing an organization. It is NOT about making broad cuts in expenses or people.”

You will never guess how I can tell at a glance if a retail store is generally well run and their people are effective. It's kind of funny, actually. Just by walking around and casually observing how people are acting and reacting, it's easy to tell where operational challenges exist.

Overall, when a home furnishings operation gives the impression that everything is under control, the business is likely to be operationally organized. Where there is a sense of chaos, there are likely to be challenging operational issues.

Signs of A Business In-Control:

- Office people who are quietly going about their work without interruption.
- Warehouse crews that are moving at a steady pace in a tidy environment.
- Smiling salespeople, excited shoppers. On-time management meetings.
- In-control telephone conversations.
- The absence of in-service merchandise.
- Bright eyed and well-spoken employees.
- Tidy desks, clean bathrooms, clean break-rooms, well-kept showrooms.

Signs of A Business In-Chaos:

- Office people who are continually interrupted and forced to over multi-task.
- Too many people in the warehouse either rushing around or sitting around.
- Tired salespeople.
- Frustrated shoppers.
- Unfocused management meetings, constantly being interrupted by the telephone.
- Ballooning service issues.
- Arguments, messy surroundings.
- Excess overtime.
- Lack of proper merchandising.
- Lots of people doing lots of work.

Given two operations of equal sales size, those businesses that are in-control will obviously outperform their counterparts-in-chaos. They outperform in terms of profitability, cash position, workplace environment, customer experience, and future sales growth potential. They outperform because they are more effective and focused on doing their work properly.

IN-CONTROL STORES ARE LEAN

LEAN is a practice of continually evaluating and improving a business. In doing so, value-added activities are supported and waste is eliminated. Similar to other practices such as Kaizen, its roots come from Japan and Toyota. Toyota executed techniques that allowed it to become a dominant force in the world car market. These techniques have since been adapted, modified, and adopted by countless organizations. My goal with this white paper is to create some LEAN techniques that are specific to your B2C (Business to Consumer) environment.

DEFINITION OF LEAN

“The art and science of continuously examining and improving a business's processes, people and products so that the customer experience flourishes allowing the business to realize its potential.”

LEAN is about developing an organization. It is NOT about making broad cuts in expenses or people. It is about making cuts in areas of organizational waste so that business productivity accelerates.



80/20 THINKING

It is important to subscribe to the notion of 80/20 thinking when implementing LEAN. Also called the Pareto Principal, 80/20 thinking says that a minority of inputs produce the majority of outputs. One of the keys to making a LEAN strategy work is using what works – focusing on knowing what does not work – then improving or eliminating the later. Examples in business are:

- The minority of customers (i.e. 20%) produce the majority of revenue (i.e. 80%).
- The minority of salespeople generate the majority of sales.
- The minority of inventory items produce the majority of gross margin dollars.
- The minority of workers perform the majority of work.
- The minority of marketing produce the majority of results.
- The majority of problems come from the minority of areas.

IMPLEMENTING LEAN

Below is my general strategy for implementing LEAN. Subsequent articles in this series will present a LEAN strategy for parts of an organization.

- Establish benchmarks based on performance metrics.
- Measure performance using 80/20 thinking.
- Find solutions.
- Execute to conclusion.
- Continue improving.

ESTABLISH BENCHMARKS BASED ON PERFORMANCE METRICS

Every furniture business should have benchmarks that it is constantly looking to improve. Each department should also set its own benchmarks and improvement strategies. A benchmark should make sound business sense and allow for an executable strategy to be formed to improve it. For this reason, the performance metric chosen to benchmark off of is required. A performance metric is an operational ratio that gauges improvement.

One example of a good LEAN metric to benchmark is Gross Margin Return on Inventory (GMROI). This is because it measures two values that directly affect desired results: Gross Margin and Inventory. Benchmarking either Gross Margin or Inventory solely on their own will not give a full picture. I've seen companies with \$2 Million in inventory either be hugely profitable or go bankrupt. The Gross Margin dollars produced in relation to that Inventory is the key. A good metric to benchmark off of helps an organization consistently measure itself, focus on results, and execute a LEAN strategy.

MEASURE PERFORMANCE USING 80/20 THINKING

A LEAN strategy requires constant measurement of performance. This is where the 80/20 Principal comes into play.

Suppose you are measuring GMROI. If inventory was \$2 Million and Gross Margin produced is \$4 Million, the GMROI is \$2.00. You know where you are overall. However, realize that there are a minority of factors that pull up your performance averages and a majority of factors that pull you down.



Using 80/20 thinking, you can identify which factors to maintain and which to improve or remove. A LEAN strategy uses 80/20 principals to separate top performing areas from weaker ones. For example, you might find that 4 of 20 vendors are producing the majority of your return. First, know what is important to track. Then you can understand what elements within it are producing or reducing.

FIND SOLUTIONS

This is the strategic and tactical part of LEAN. Strategy involves big-picture goal setting and sets the direction of the business to improve performance. Tactics define the specific actions that must be undertaken day-in and day-out for the strategy to be achieved. For example, if a business decides that GMROI is a primary metric to benchmark and measures the result at \$2.00, it may set this strategy: Achieve a \$2.5 GMROI by transferring inventory investment into its most profitable vendors and from its under-performing vendors.

GOOD STRATEGY, RIGHT?

There is more to it than that. Strategy alone does not produce results. With LEAN solutions, defining the specific tactics to be performed in "the trenches" are required. For this example, tactics may be:

- Increase stock of best-selling items in Vendor X.
- Source a quick-shipping vendor with extended terms that can capture a better margin to replace Vendor Y.
- Decommission small capacity delivery resources in favor of fewer higher capacity resources.

EXECUTE TO CONCLUSION

Expect results. If you are benchmarking and measuring a worthy metric and have a solid strategy with people who can execute on time and on budget, you will get results. Some say that execution is the art of getting things done. Ensure that your management team has the right people in place and that they, themselves, can execute your strategy and perform specific daily actions so your desired conclusion is realized.

Execution involves regular training, monitoring of progress, improvements in processes and systems. For example, if you wish to improve your GMROI by speeding up your supply chain in Vendor X, you may need to invest resources in systems and training to make that possible.

LEAN is not about trimming overall expenses. LEAN is about better allocating resources. Many times increasing expenses to become better is required to execute a LEAN strategy to conclusion.

CONTINUE IMPROVING

Guess what? Once you achieve your improvement goals your LEAN journey is just beginning! This may seem tiring. Yes, and, it is a fun and a necessary part of long-term success. LEAN is about never-ending improvements. For example, if you reach your goal of \$2.5 GMROI, it's time to "up the bar" or focus on improving another business metric. Then the whole strategic LEAN cycle begins again. Continue to navigate the ups and downs. Enjoy your continual journey of success.

PART 2: LEAN SALES FORCE

Consider two stores: Store A and Store B. They are in the same region and belong to the same corporation. They have the same store layout, share the same marketing program, and have the same number of salespeople. They are separated by 15 miles on the outer ring road of a mid-sized US city. You would think their performance would be similar, right? Store B however, always, without fail, outperforms Store A in terms of revenue and gross margin percent. Furthermore, Store B always has fewer customer service issues. How is this possible?

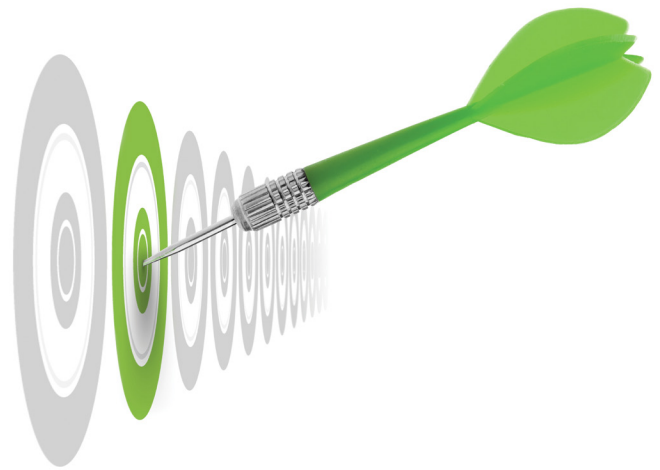
Could it be that Store B is just getting better customer traffic and Store A is getting a bunch of "tire-kickers"? Not likely. Maybe Store B is located in a better market area? Not in this case.

The likely answer for the performance difference is basic: Store B is LEANER than Store A.

In the case of Store A vs. Store B, B is LEANER because it is more efficient. LEAN is the process of continually improving efficiency and effectiveness. It is not about making broad cuts. If that were the case, Store B would be leaner because it had

less expenses or fewer people. LEAN is about identifying and trimming weakness, as well as building upon strengths. That is why Store B outperforms Store A. Store B has a sales force that is better at engaging, communicating, and delivering what their customers need. They are more professional.

Even though Store B is LEANER than Store A, there may be competitive stores in the same trading area that are even leaner. That's why Store B can't rest on its laurels. A LEAN sales force continues to improve itself. If it doesn't, it will stop growing sales.



Every furniture store needs a strategy for implementing LEAN and applying it to their sales teams. Here are the steps to take to implement LEAN sales force management:

- Establish benchmarks based on performance metrics
- Measure performance using 80/20 thinking
- Find solutions
- Execute to conclusion
- Continue improving

Sales metrics rate a salesperson's effectiveness. Sales volume produced is a crucial metric to track, but it does not tell the story about how you got there.

Sales metrics should be established around the sales production equation:

Average sale x close rate x number of customers.

MEASURE PERFORMANCE USING 80/20 THINKING

After you have a core metric in place, it is time to use it to improve. There is no value in just tracking a metric without taking further action. The first action to take is measurement using the 80/20 principle. 80/20 thinking is at the core of implementing a LEAN sales force. It says the majority of results are produced by the minority of sources. So, in the

example of the metric RPG, the principle dictates that the minority of salespeople are probably producing the majority of revenue per guest. You may find that in our operation the number isn't exactly 20% of the people producing 80% of sales per guest. The important thing is to know who is producing a consistently high RPG and who is pulling the averages down. Once you have this information, you have the power to develop a plan to improve.

FIND SOLUTIONS

Now that you have your metric (RPG in this case) established and you are tracking results, you implement LEAN by defining solutions to improve the metric. Consider the results shown in the chart below for sales associates in one store over a 3-month period:

SALESPERSON	RPG
John	\$620
Judy	\$600
Fred	\$450
Jane	\$300
Jack	\$275

In this example, John and Judy produce the majority of results for this performance metric. Fred is average, and Jane and Jack are pulling the team down. John and Judy together would in fact produce over 100% more sales dollars than Jane and Jack for every customer they deal with. Knowing this, you can learn from what John and Judy are doing better than the rest of the team.

Making small improvements in the right areas can have sizable impact. For example, from this information you may set an overall strategy on improving the minimum RPG standard to \$400. From there, specific tactical actions can be put into play.

Examples include:

1. Re-train in the custom-order selling process
2. Improve the customer qualifying process
3. Work on the customer solution close

EXECUTE TO CONCLUSION

Once you put your LEAN strategy in motion, follow through. Consistent action gets results. Repetition of the right actions leads to the right results. Managers should demonstrate proven best practices over and over again until they are adopted by the sales force. If positive results are not realized in a specific

time frame, the actions taken, the manager's ability to execute, or the salespersons ability to progress should be questioned. More often than not, a solid plan combined with people who have the right attitudes and commitment will produce results.

CONTINUE IMPROVING

Congratulations! You've improved your metric and your business. You have become more competitive in your marketplace. This is not the end of the LEAN process, however, because LEAN never ends. It is continuous. From a sales force perspective, suppose you have achieved your strategy of reaching a minimum RPU of \$400 - now what? The answer is simple, keep on improving that metric, or look for a new metric to improve.

Here are 10 other examples of worthy sales metrics to focus on to begin a LEAN strategy:

- Average gross margin dollars/ sale.
- Percent of house calls or design sales.
- Average sale.
- Close rate on new customers.
- Percent of repeat customer visits (be-backs).
- Percent of sales with add-ons.
- Warranty as a percent of total sales.
- Percent of sales with customer issues.
- Sales to goal achievement.
- Quotes converted/ quotes written/ month.

Caution: these metrics are all good in their own right, but don't focus on them all equally at the same time. Focus your LEAN strategy on one, or at the most three metrics at a time. There will be less distraction and confusion, and you will have a greater chance of success.

Whatever you decide to do, the path to success is to keep your focus on what matters. Keep tweaking the strategy and follow the never-ending road toward maximizing sales using LEAN.

PART 3: LEAN MARKETING

To review, LEAN is about developing an organization. It is NOT about making broad cuts in expenses or people. It is about making cuts in areas of organizational waste so that business productivity accelerates.

LEAN MARKETING EXAMPLE - TWO STORES: ONE LEAN

To illustrate how one business can be viewed as being LEAN in marketing versus another, take 2 mid to upper price point operations that are 1000 miles apart geographically: ABC and XYZ. Their market demographics are similar in population, competition and average household income. They both have their stores located on the ring-road retail areas of their cities, have similar street exposure and drive-by traffic.

ABC and XYZ have identical monthly marketing and advertising budgets: \$50,000 / month.

You would think these two businesses would be similar in other areas, especially their sales volumes. Well, logic does not always apply in the "real world". Operation ABC produces average monthly sales of \$625,000 while operation XYZ produces \$1,000,000.

XYZ is LEAN compared to ABC, even though they spend the same amount of dollars on marketing. XYZ is more efficient with its use of dollars. Their respective marketing efficiencies can be seen in 2 ways:

1. ROI (return on investment) of marketing dollars with respect to gross profit produced:

$$\text{ROI} = (\text{Benefit} - \text{Cost}) / \text{Cost}$$

$$\frac{\text{Store ABC} = (\$625,000 \text{ @ } 50\% \text{ gross margin} - \$50,000)}{\$50,000} = \$5.25$$

$$\frac{\text{Store XYZ} = (\$1,000,000 \text{ @ } 50\% \text{ gross margin} - \$50,000)}{\$50,000} = \$9.00$$

Assuming both businesses produce a 50% gross margin, XYZ returns \$3.75 more gross margin dollars per \$1 invested in marketing. Expressed as a percentage XYZ produces a 900% return on marketing dollars while ABC produces a 525% return.

Of course there is always the issue of which portion of sales and margin was directly attributed to marketing activities. If you are able to get reliable information here, an even better ROI calculation would be: gross margin dollars produced due to marketing activities / cost of marketing. The ROI would be lower for both with this formula however XYZ would likely still be the leanest of the two.

2. Marketing expense as a percent of sales dollars:

$$\text{Expense \% of Sales} = \text{Expense} / \text{Sales}$$

$$\text{Store ABC} = \$50,000 / \$625,000 = 8\%$$

$$\text{Store XYZ} = \$50,000 / \$1,000,000 = 5\%$$

Operation XYZ has a 3% lower marketing cost structure than ABC. This goes directly to the bottom line and to cash flow before tax. 3% does not sound like much, but when applied to the bottom line of a \$10 Million dollar operation, this equates to \$300,000 in additional profit dollars.

The burning question is, why is it that XYZ can produce this higher ROI on its marketing and be so much more efficient than ABC?

The answer is that they follow a LEAN strategy. I'll explain this using my strategy for implanting LEAN:

- Establish benchmarks based on performance metrics
- Measure performance using 80/20 thinking
- Find solutions
- Execute to conclusion
- Continue improving

"Operation XYZ has a 3% lower marketing cost structure which for a \$10 Million dollar operation, equates to \$300,000 in additional profit dollars."

ESTABLISH BENCHMARKS BASED ON PERFORMANCE METRICS

The first step is setting the measures that will guide your organization to improve. Above I've mentioned two great macro performance metrics that you should definitely track monthly: ROI and % of sales. When it comes to becoming LEANER in marketing, get specific as well. Here are three performance metrics suggestions that you can use for either in-store or retail online components:

- **Traffic Related:** Unique Customer Visits vs. Previous Customers (including be-backs). Here you split the total traffic your marketing produces, into two categories, first time and repeat. The number of unique visitors or first time customers are important because they show you how effective your campaigns are at generating new leads. Previous customer visits are important because it is a measurement of your level of customer relationship building. Together they represent total traffic mix produced by your advertising mix.
- **Engagement Related:** Bounce Rate vs. Conversion Rate. Bounce rate is a measure of the customers who visit, then just leave without any meaningful interaction. Alternatively, conversion rate is a measure of the customers who visit and interact (either resulting in a sale or some sort of meaningful connection has been made with follow-up required). Tracking engagement can be an indicator of what type of customers are visiting, and how well you are connecting with them.
- **Media Related:** Specific Source vs. Unknown. Understanding why a customer is visiting you, and if a specific ad campaign brought them in, is an age-old challenge for retailers. Often there are no clear cut answers since a mix of different media types, or other factors, can be responsible for bringing in a customer.

I believe that an excellent piece of information to determine is how many of your customers went to the internet first (Google, web-site, Facebook, Houzz, etc.), versus those who saw a recent off-line campaign such as a TV ad, direct mailer, catalogue, radio spot, or billboard.

Many retailers ask, "How can I get this information?" The simple answer is: CUSTOMER ENGAGEMENT. As you improve the engagement selling processes, and LEAN selling techniques (discussed in the last article), you will gather information that can be used to measure your marketing efforts. Those operations that connect meaningfully with customers generally get better information. Use the good data you collect, and disregard unknown sources to make your media judgments.

80/20 THINKING

Measure performance using 80/20 thinking. As you probably know at this point, 80/20 thinking focuses on identifying the minority of inputs that are producing the majority of outputs. Applying the ROI formula to media related sources collected from customers, you can use the 80/20 rule to better understand and improve your marketing mix. The following five steps will help you to do this:

1. Record the sources of all traffic over the period of one month.
2. Calculate the proportion of each source to the total traffic.
3. Figure the total advertising dollars spent on each media.
4. Identify the proportion of sales and margin that where unknown or not attributed to any one media.
5. Using the known dollars produced from marketing, you can now figure the ROI produced for each media spend.

This will be a work in progress, and the quality of the information you collect will get better over time as your systems improve. The only alternative to tracking is guessing. Once you start to get more usable information, you will see certain media that are simply not producing acceptable standards of return. Others may surprise you by showing sizable returns. Focus on the minority of marketing that produce the majority of trackable results. This will give you some support when making decisions for future advertising investments.

FIND SOLUTIONS

Now that you have decided on your metrics and have systems producing usable data, it is time to improve. Improvement involves making educated incremental changes in your business. I've seen so many businesses that do the same things over and over again and expect different results. Those that never modify their customer marketing strategy eventually spiral downwards. So, doing nothing is not an option.

Here is a short list of common actions / solutions that various clients have taken recently (which may or may not be right for you):

- Commit a greater proportion of the traditional media budget to select morning TV spots.
- Commit a greater proportion of the total marketing budget to digital media.
- Outsource AdWords to an expert agent in the industry.
- Build seasonal catalogs (magalogues). Print and digital.
- Pay for Houzz to increase special order and interior design business.
- Outsource the entire marketing program to an industry agent.
- Buy Facebook Ads.
- Join a performance group and share marketing best practices.
- Use more segmented email campaigns vs "blasts".
- Blog. Publish content online.
- Move away from price marketing and toward branding.
- Increase targeting segments of the internal customer database.
- When there is a Very Good reason, outsource a high-impact event sale to an industry expert.
- Focus on improving Customer Relation Management (CRM), sales systems and procedures to decrease your necessary marketing spend.
- Hire an internal digital media specialist.
- Establish a customer loyalty program that links offline and digital worlds.
- Recognize the move in this industry to Omni-Channel retailing. (The consumer's use of a variety of offline and online channels in their shopping experience and the merging of the various channels).

Remember, the best way forward will depend on your unique situation.

EXECUTE TO CONCLUSION

After you put your LEAN strategy into motion, keep moving! Don't drop the ball. Follow through as a business manager. For example, if you decide to move your Radio budget into TV spots, track the results of that decision closely for at least three months to get an idea of whether the move was good for the business or whether the strategy needs to be tweaked. The last thing you want to do is just make a decision to change and sign the checks for the next year. Just switching from one media to another may not be the answer. It may be your message that needs improving rather than the media choices. Or, it may be both. Execute, track, recalibrate.

CONTINUE IMPROVING

Congratulations! You are on your journey to becoming a LEANER marketing organization. This means that you will produce better results. Maybe your total spend actually went up, and you are producing greater sales and gross margins; maybe spend went down and sales remained unchanged. Both instances move toward LEAN.

Consistency in improvement-minded actions get results. Subscribing to the notion of LEAN is just the beginning. It is a road without an end. When you think you've got it all solved, look again.

PART 4: LEAN INVENTORY

In this section on LEAN retailing, we continue our discussion with a look at how to use LEAN techniques to make your inventory more efficient and productive.

By now you know what LEAN is, but what does it mean with regard to inventory?

LEAN inventory is a balancing act between holding too much inventory and not enough. To be successful, retailers must find their LEAN-ZONE of efficiency. This is where the inventory investment is appropriate, and sales growth is supported. It is commonly expressed with the metric: Average Inventory to Annual Sales Percent.

A LOOK AT THREE BUSINESSES

To illustrate, let's look at three businesses that carry similar merchandise lines and have the same retail footprint: Operations Charlie, Delta, and Bravo.

For this comparison, I will use a target inventory to sales percent LEAN-ZONE of between 16-18%.

Operation Charlie: Too High

First, Operation Charlie has 22% inventory to sales. They are well above their LEAN-ZONE. They carry too much inventory for their particular operation. This results in the following issues:

- Higher payable levels
- Tighter warehousing causing more damages
- Higher inventory carrying costs
- Tighter cash flow
- Slower re-buying of best sellers due to tighter cash flow
- Greater best seller stock-outs causing sub-optimal sales
- Greater percent of "Dog" merchandise causing downward pressure on margins
- Less than optimal merchandise mix

Operation Delta: Too Low

Next, Operation Delta has 13% inventory to sales. They are well below their LEAN-ZONE. They carry too little inventory for their business model. Some may think this would not be an issue, however, if their business model dictates that they must carry back-up stock for their customers, the following issues result:

- Supply shortage for products that customers want now.
- Sub-optimal sales due to best-seller stock-outs of back up merchandise.
- Greater customer order lead times and back-orders.

- Increased reliance on customer deposit financing due to back-orders.
- Best-seller stock-outs due to selling hot items off the floor.
- Less than optimal merchandise mix.

Operation Bravo: Just Right

Lastly, Operation Bravo consistently operates at 17% inventory to sales. They are in their LEAN-ZONE, carrying the appropriate amount of inventory for their sales volume as dictated by their business model. As a result Bravo:

- Maximizes best-seller in stock days.
- Minimizes "Dog" merchandise.
- Carries a good retail merchandise mix.
- Backs up best-sellers appropriately.
- Fulfills their customers' needs fast.
- Minimizes inventory carrying cost.
- Generates higher return on inventory investment and profitability.
- Maximizes their cash flow.

Obviously everyone wants their inventory to be at optimal levels like Operation Bravo. The burning question: What must a retail operation do to enable itself to produce results day-in day-out like Operation Bravo?

LEAN STRATEGY

The answer is to follow a LEAN strategy. I'll explain this using my strategy for implanting LEAN:

- Establish benchmarks based on performance metrics.
- Measure performance using 80/20 thinking.
- Find solutions.
- Execute to conclusion.
- Continue improving.

Establish benchmarks based on performance metrics: The first step is setting measures that will guide your organization toward improvement. Every functional area in your business should have metrics that guide its purpose (Typically fewer than six metrics for focus). Examples of great inventory metrics include Inventory to Sales, GMROI, Gross Margin, Turns, and sales per square foot.

To illustrate this point, let's use the metric mentioned above: Inventory to Sales %. Let's suppose an Operation has annualized sales of \$10 million. If an average inventory of 17% is desired, that means that it should focus operations around keeping inventory close to \$1.7 million.

Understandably it will be impossible to keep inventory cost at exactly this level. There are always fluctuations in receiving and delivered sales. Thus, a responsible range or LEAN-ZONE should be established. This may be, for example, 1% of sales on

either side of 17%. So, that's 16-18% inventory to sales, in dollar terms it's a range between \$1.6 million and 1.8 million provided sales are targeted at \$10 million and there is little seasonality. If sales levels show a trend toward increasing or decreasing, inventory should follow suit as quickly as possible. It is not a perfect science, but it is far better than the alternative of not having or tracking the LEAN-ZONE.

When establishing your LEAN-ZONE it is important to note that your individual business model must be factored in. The range I used in my example would be totally inappropriate for some companies. It may be far too high or too low. An Ashley Homestore for example has a model of value-priced, fast-turning inventory that is pulled from corporate distribution centers. They would operate with a lower LEAN-ZONE of inventory to sales. Alternatively, a customizable contemporary operation selling premium products with a true interior design focus may require a higher LEAN-ZONE to operate efficiently. Whatever your business model, seek to establish metrics around your most productive inventory level.

MEASURE PERFORMANCE USING 80/20 THINKING

80 / 20 thinking, with respect to merchandise, can be used in a variety of ways:

- Determining the minority of vendors that produce the majority of return on investment.
- Determining the minority of categories that produce the highest returns/
- Determining the minority of SKU's that produce the majority of gross margin dollars.
- Determining the minority of SKU's that produce the majority of customer service issues.

For example, in the case of SKU's that produce the greatest gross margin dollars, you can rank your inventory top down by margin dollars produced for a given time period, say 3 months. This will let you easily see which products are your cash earners and which are your cash burners.

You can then establish an inventory class ranking system assigning a numeric or alpha rating to highlight the importance levels within your line-up. This allows you to focus on the big picture and then execute ongoing tactics to keep inventory flowing.

FIND SOLUTIONS

After deciding what your top performance metrics will be and analyzing merchandise performance, you can focus on solutions and systems to help you improve.

Here are a few common practices and solutions that businesses perform to enable a LEAN inventory:

- To avoid overstock situations and keep inventory in your LEAN-ZONE: Create an open-to-buy for new merchandise that revolves around inventory to sales percent.
- To maximize vendor performance: Set a minimum standard for vendor GMROI in each category.
- To push the "fat" out: Use a routine item aging system to identify slow merchandise so you can take appropriate action sooner.
- To keep your top inventory items producing: routinely check their gross margin, display status, merchandising, current availability, price point, and sales person awareness.

Some solutions you implement deal with an obvious opportunity that you might have. Other solutions may be on-going functions you perform to enable the profitable growth of your business.

EXECUTE TO CONCLUSION

It is important to repeat the same mantra as in the previous 3 sections: After you put your LEAN strategy into motion, keep moving! Don't drop the ball. Follow through on your LEAN inventory way of life. If you decide that you must keep inventory at approximately \$1.7 million for your sales volume, then focus your team on actions to accomplish this, don't assume that it will be done perfectly. Manage your processes and constantly fine tune operations to suit your unique situation. As a manager, ensure that your team flows best sellers at a rate that optimizes sales, and deal with that stagnant inventory immediately. Check the health of your merchandise often and expect results.

Continue Improving: Your inventory is LEAN and your mix is good. Provided you have LEAN marketing practices to pull in decent customer traffic, and LEAN sales operations to service and sell at high levels, your business is ripe for growth in volume, profit and cash flow.

LEAN is a continuous process. If you find that you have become exceptional in one area of inventory management, keep tracking that metric, but move your attention on to another area of inventory management that needs improvement. Then set tracking metrics, analyze, find solutions, and execute to conclusion for that metric as well. Business managers who are students of their operations and are never 100% satisfied, are those that excel. This is the heart of LEAN.

PART 5: CASE STUDY – LEAN OPERATIONS

Here's a look at how LEAN techniques took one retailer from losing money to more than 10% profit.

As a reminder, the definition of LEAN is

“The art and science of continuously examining and improving a business's processes, people and products so that the customer experience flourishes allowing the business to realize its potential.”

As has been mentioned previously, LEAN is not about developing an organization. It is NOT about making broad cuts in expenses or people. It is about making cuts in areas of organizational waste so that business productivity accelerates.

The concept of LEAN and how to use it with respect to improving sales, marketing and inventory performance have all been covered in recent issues. Here, this information will be used to show how to use LEAN to identify opportunities and produce better results within your daily retail operations. To do this, let's consider the case of retailer "XYZ Furniture" that went from constantly being in debt and losing money to becoming debt free and showing profits of over 10% bottom-line. This is the true story of a retailer that joined a performance group I facilitate. XYZ Furniture had little profitability over the five years previous to joining the group. In fact, their best year had been a 3% bottom-line. This is what their net income looked like from 2006-2010:

XYZ had increased their long-term debt load and pushed out their payables to survive. They were living off a line of credit and credit cards. Obviously, there was little cash available to reward the owners or their employees. XYZ was an unhappy organization.

This lackluster performance of this retailer located in middle-America was not due to the housing crisis that led to the Great Recession. Sales were constant through the 2006-2010 period, so volume was not to blame.

By 2010 XYZ Furniture's management decided to commit to turning their business around. Here are the LEAN techniques used to accomplish this feat.

ESTABLISH BENCHMARKS & FIND THE GAPS

First, XYZ Furniture's operational statistics were compared to other retailers in the performance group, as well as to known data from the industry at large. These stats are summarized in Figure #1 below. The gaps are tabulated in the far right column. These gaps showed where there were opportunities for improvement at XYZ Furniture.

Figure #1: Operational Statistics for Retailer XYZ vs. Group Averages 2010

Operational Department	"XYZ Furniture" Ratio to Sales Volume	Approximate Group Average Ratio to Sales Volume	The GAPS
Inventory Margin on Sales (GM)	42.0%	46.0%	4.0%
General Administration, Office, Accounting	14.0%	12.0%	2.0%
Occupancy, Retail Facility	6.0%	7.0%	-1.0%
Advertising	4.0%	5.0%	-1.0%
Selling Commissions and management	9.0%	8.0%	1.0%
Net Customer Service, Damages, Staffing, VCB Income	1.5%	1.0%	0.5%
Warehousing, Staffing, Equipment, Facility	6.0%	4.5%	1.5%
Net Delivery, Staffing, Equipment, Income	2.0%	1.0%	1.0%
Finance, Credit, Interest	3.0%	2.5%	0.5%
Total Operations	45.5%	41.0%	4.5%
Profitability	-3.5%	5.0%	8.5%

From this summary gap analysis, it's clear that XYZ had fallen behind in several areas of their operation:

- Inventory management and sales of product were trailing. The Gross margin being achieved on pricing and selling strategies was 4% behind the group.
- General administration expenses of overhead, accounting and office were 2% greater.
- Selling Commissions and management of the salesforce were 1% greater.
- Customer service expenses less vendor charge back and credit income were .5% greater.
- Warehousing, staffing, equipment and facilities were 1.5% greater.
- Delivery costs less delivery income were 1% greater.

Overall, XYZ's operations were 8.5% more costly. This opened the owner's eyes to their massive opportunity. The first step with any improvement is realization through education. The next step is commitment to action.

80/20 THINKING & TRIMMING THE FAT

Trimming the fat with a proper LEAN strategy does not mean slashing all costs. It means getting the microscope and the paring knife out. This is the process of finding the resources that are producing benefits (tangible or intangible), finding resources that are detracting, and then moving resources out of the detractors and into the producers.

The retailer in this story did this by employing 80/20 analysis. Here is what was discovered:

- Approximately 20% of items produced 80% of margin dollars. When looking at these items in detail, their individual gross margins ranged from 43% to 47%.
- Most of the day to day administrative tasks were being handled by a couple of employees. This caused some people to be over worked and ineffective, and others to be under-worked and inefficient.
- A minority of salespeople wrote the majority of business. A few of the top writing salespeople had the lowest margins.
- Most customer service issues came from a few vendors.
- The majority of deliveries happened at the end of the month. This caused under capacity in resources at the start of the month and over capacity at the end.

FINDING SOLUTIONS

Here are some of the policies they set in motion:

1. A new pricing review structure was put into place for best sellers, special order and new untested merchandise. The review focused on continually pushing the upper margin limits of what HOT items could fetch.
2. Administrative tasks were streamlined. The effective Employees were given a "work-buffer" and assigned the proper amount of work at the proper time. Inefficient employees were retrained and reduced. The salary per employee as a result was increased due to fewer people functioning better.
3. Salespeople were placed on a variable commission schedule based on gross margin percent. So, in effect those that could sell at a higher gross margin got a raise, and those that could not got a reduction.
4. Products, with constant credit issues, were removed and replaced. Service issues declined.
5. Delivery scheduling was moved to a coordinator who was incentivized on weekly delivered sales volume and full trucks. This resulted in less overtime, faster turns and fewer resources needed to fulfill customer needs.
6. The latest technology tools and training were deployed. This was critical to helping the various parts of the operation work in sync together day-in-day-out.

Figure #2: Operational Statistics for Retailer XYZ vs. Group Averages 2015

Operational Department	"XYZ Furniture" Ratio to Sales Volume	Approximate Group Average Ratio to Sales Volume	The GAPS
Inventory Margin on Sales (GM)	48.0%	48.0%	0.0%
General Administration, Office, Accounting	9.0%	11.0%	-2.0%
Occupancy, Retail Facility	5.0%	6.0%	-1.0%

Advertising	5.0%	5.0%	0%
Selling Commissions and management	9.0%	9.0%	0%
Net Customer Service, Damages, Staffing, VCB Income	1.0%	1.0%	0%
Warehousing, Staffing, Equipment, Facility	4.5%	4.5%	0%
Net Delivery, Staffing, Equipment, Income	0%	.5%	-0.5%
Finance, Credit, Interest	2.5%	2.5%	0%
Total Operations	36.0%	39.5%	-3.5%
Profitability	12.0%	8.5%	-3.5%

EXECUTE TO CONCLUSION

With any plan, execution is what matters. This business did not always succeed right away in improving the execution of the above solutions. They did, however, persist. They did not take their eyes off the prize. They mandated success. It took time. Some things were achieved faster than others. But in the end they became one of the highest producers in the performance group. More recent metrics for the operational departments at XYZ Furniture are summarized in Figure #2 above. Continue Improving.

KEEP MOVING FORWARD

The improvements that this company implemented in operations translated to greater sales volume at a higher gross margin and forced fixed expenses down. Overall operating costs decreased and fell under 40% for both this company and our performance group as a whole.

There were obstacles along the way. However, they recognize that on any road to success, if there were no road blocks, everyone would be traveling on it. When a new challenge presented itself they would follow a LEAN strategy. LEAN is a never-ending road of self-evaluation, solving challenges and producing results. Winning is a constant pursuit.

These articles first appeared in Volumes 145 and 46 NO.1, 2, 4, 5, 6 in July/August, September/October, November/December, January/February and March/April of Furniture World Magazine. David McMahon is a Certified Management Accountant and Consultant with PROFIT*consulting*, a division of PROFIT*systems*, a HighJump product. If you have questions about this article, or would like to request a similar analysis on your financial statements, you can contact David at david.mcmahon@highjump.com or call 800-888-5565.

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