Top 3 Financial Metrics You Need to Drive Distribution Success

Aligning Supply Chain and Finance

By Bill Denbigh

During these surreal times of supply chain management, I've talked to many distributors and a common question I'm asked is, "What should we do now?" I'd like to suggest that the real answer to that question is tied to the metrics you are measuring. Your metrics will tell a story, therefore, what you measure is what you manage to. It's clear that getting by is no longer enough and distributors must look at their data in order to be successful.

But sometimes, the hard part is deciding what data matters.

How can supply chain justify and measure process improvement initiatives using a metric that finance can relate to?

Indeed, superior supply chain performance does drive business success in very measurable ways. As cash management is a top priority for finance, sharing the cash conversion cycle (CCC) metric allows supply chain and finance to speak a common language when measuring business success.

The Three Metrics That Finance and Supply Chain Can Agree On

According to Investopedia, the CCC metric “measures how fast a company can convert cash on hand into inventory and accounts payable, through sales and accounts receivable, and then back into cash.” The CCC is combined of three separate financial metrics:

DIO

Days inventory outstanding (DIO); how long it takes to turn inventory into sales.

DPO

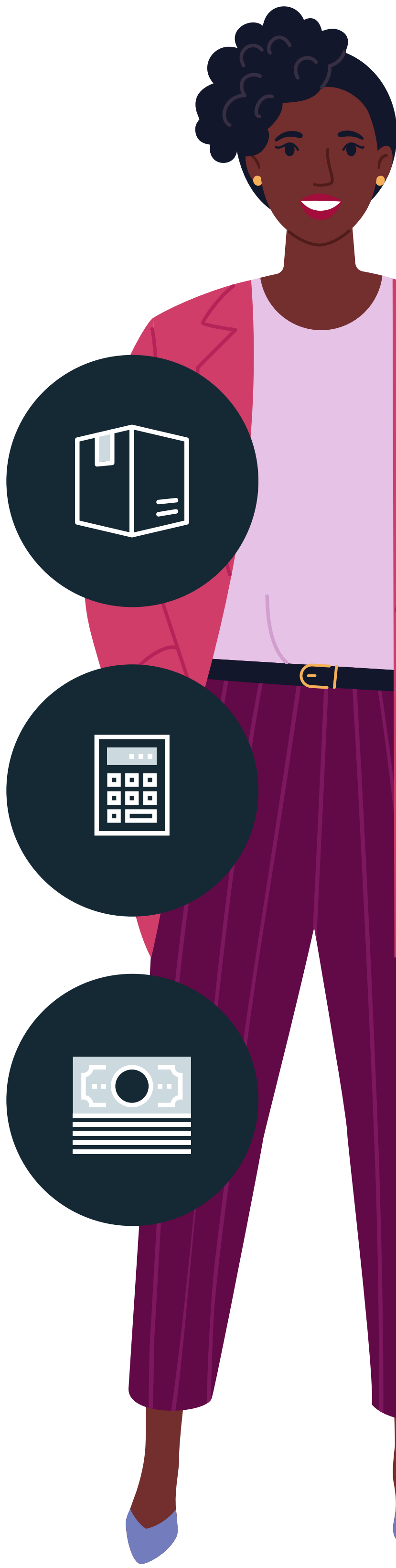
Days payable outstanding (DPO); how long it takes to pay invoices from creditors, such as suppliers.

DSO

Days sales outstanding (DSO); how long it takes to collect payment after a sale has been made.

All three metrics indicate how long an organization will be deprived of its cash – the lower the number of days, the better. So how can supply chain improve DIO, DPO and DSO?

Let’s look at the top three financial metrics that supply chain leaders need to drive distribution success:



1. Days Inventory Outstanding and **Just-in-Time Replenishment**

Just-in-time (JIT) replenishment has the potential of releasing a ton of capital previously tied up in inventory because goods are received only when needed. With JIT, lead-time demand does not figure into your safety stock calculation (i.e. goods sold/consumed from the time the order is issued until the goods are received) because the system can project the rate of depletion, determine when safety thresholds would be impacted and then backdate the replenishment order accordingly.

For example, a SKU with a 14-day lead time is projected to reach its safety threshold on May 10, therefore, an order must be issued no later than April 26. Achieving JIT requires SKU-level forecasting and inventory accuracy, both of which fall under the domain of supply chain.

2. Days Payable Outstanding and the **Perfect Purchase Order**

Achieving the perfect purchase order at the lowest possible cost requires item data quality, automation, vendor engagement and efficient receiving. Quality item data will prevent costly errors – this includes up-to-date vendor pricing. An automated procurement process allows for a continuous review of inventory levels to protect safety thresholds in support of JIT. Furthermore, the system should look for consolidation opportunities to reduce overall procurement costs.

With a truly integrated system, all the information relating to a vendor transaction is available in real time to procurement, warehousing and finance. With the right tools, supply chain will transform this transactional data into performance metrics that help provide direction on potential optimization opportunities.

3. Days Sales Outstanding and the **Perfect Customer Order**

The fastest way to turn a sale into cash is to deliver in full and on time – error-free from start to finish. Again, supply chain plays an important role by ensuring the right balance between monies invested in inventory and desired service levels.

Data accuracy plays an important role in shortening order cycle times. In fact, data errors are often the reason the wrong product/quantity was shipped. Picking errors occur for a multitude of reasons; the wrong product in the right bin, a pack was picked instead of an each, the list goes on.

Key Takeaways

When you think about it, almost all supply chain processes affect either DIO, DPO or DSO in some way. At the end of the day, supply chain and finance both aim for business success – both can and should be considered business leaders.

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