

Booznooz

Over-stocked yet out-of-stock at the same time?

Why do you have 2 bottles of Galliano when you haven't sold a Harvey Wallbanger since 1979?

BY IAN FOSTER, REGIONAL VICE-PRESIDENT

An interesting paradox in the restaurant industry is that most bars carry too much inventory – between \$6,000 and \$10,000 too much – yet all too often they run out of something between orders.

Most Bevinco® clients are surprised when our audits show just how often their managers borrow bottles from a neighboring bar or make an emergency purchase from the liquor store. It's almost comical to see how often a bar can run out of brands despite the fact that their overall inventory level is actually way too high. The problem, of course, is that most bars have too much of the wrong things: two bottles of Galliano and three bottles of peppermint schnapps despite the fact that they haven't poured an ounce of either in six months. Why are most establishments over-stocked and yet plagued by out-of-stocks at the same time?

Clearly the ordering process in our industry is flawed. There are three main ways that an operation determines how much to order. The most common is that a manager simply looks at the number of full bottles for each brand and, using their experience

and intuition, orders anything that looks like it could possibly run out. This method is the quickest and easiest. In the hands of an experienced manager, guessing like this can produce surprisingly good results.

Unfortunately, it is also the most likely to lead to massive over-stocking. The manager's main incentive is to make sure that they don't run out of anything. They do not have any real incentive to order efficiently. After all, if the bar runs out of Jack Daniels, the manager gets the blame; but if the bar has thousands of dollars in excess stock, nobody even notices. The other problem with this method is that the manager is basing the estimate on intuition, not hard data, so inevitably mistakes are made and out-of-stocks occur.

The second method is just to let the liquor salesman determine the order. This is just as crazy as it sounds, but it is a very common practice in our industry. The result, of course, is very heavy over-stocking. Liquor salesman are paid on commission, with bonuses for placing new products. Thus, every incentive encourages them to over-order and to add new products, regardless of their suitability for the customer.



“One of our clients bases their order on Bevinco®’s weekly par-order report,” says Tim Anders who runs one of Bevinco®’s eleven Los Angeles offices, “but the Youngs rep. regularly adds extra bottles to the order for no apparent reason. One week she added a \$100 bottle of champagne without the client’s authorization. This kind of thing is a real problem – every one of my clients has what they call a ‘junk shelf’ full of product that they did not order and cannot sell.”

A third, and more effective method, is to set up a par for each brand based on historical usage. For example, if the bar uses two bottles of Jack Daniels each week, then the par might be set at three bottles. Whenever the stock level falls below three full bottles, Jack Daniels is ordered.

Setting pars works very well – at least when the pars are first deter-

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An efficient inventory level has:

- **33¢ of inventory for every \$1 of weekly alcohol sales**
- **a turnover ratio of 35x or higher**

mined. But the process is time-consuming so pars are calculated once and then only re-adjusted when the bar actually runs out of something. Unfortunately, the unintended consequence is that the most popular brands are out-of-stock most often because their usage grows over time. Thus, this method is almost guaranteed to annoy the largest number of customers.

The other problem with pars is they are adjusted up but never down. Unless the bar recalculates all the pars, brands that have fallen in popularity are over-stocked because there is no mechanism to tell management to reduce the par. That's why so many of our clients have two bottles of Galliano despite the fact that nobody has ordered a Harvey Wallbanger since 1979.

We see the exact same problems with ordering based on the number of empty bottles collected during the week ("bottle-for-bottle exchange" is used at most hotels). As a brand's sales increase, the empty bottle method means that the bar will run out. Conversely there is no mechanism for reducing the amount on-hand.

EFFICIENT ORDERING: A "JUST-IN-TIME" SYSTEM

A better method is to establish a par that is re-calculated every week. Thus, pars are automatically raised as a brand's sales go up and automatically lowered if a brand's sales drop. For example, as more margaritas are sold

when spring turns to summer, the par levels for tequila and triple sec are automatically raised. And the process is reversed when the autumn and winter weather arrives: pars are lowered as marg sales decrease. The result is that stock levels are optimized; just the right amount of inventory is on-hand to meet demand; excess stock and out-of-stocks are minimized.

This kind of system is referred to as "just-in-time" ordering. "Just-in-time" ordering, a Japanese innovation, is one of the key management insights of the past twenty-five years. Toyota made it a central part of their cost-control strategy. And Wal-Mart has practically built their business on it. As early as 1966, Sam Walton realized that his lowest price philosophy was unsustainable without computerizing their inventory controls. Their prime concern is to keep inventory to a bare minimum while avoiding out-of-stocks. "Our aim is to grow inventory at half the rate of sales growth," according to their Chief Financial Officer. Today Wal-Mart's computer database is second only to the Pentagon's in capacity.

COSTS OF INEFFICIENT ORDERING

Somehow the financial implications of just-in-time ordering have not been fully appreciated in the hospitality industry.

Running out of a popular product, like Grey Goose or Jagermeister, on a Saturday night is going to result in some unhappy customers. And unhappy customers always have a cost, but it is usually a cost you don't see – like some of them deciding to try out a "new" establishment. Inevitably some unhappy customers become lost customers, or, at least, less frequent ones.

Most of the business world has realized that the cost of carrying excess inventory is a serious concern, too. These costs are not immediately obvious: like the fact that some of your money is tied up unnecessarily and could be invested and productive; but also the cost of physically counting extra stock at month-end and for ordering; insurance and taxes on the

inventory; and the time spent keeping an overflowing stockroom organized. Excess inventory also increases the likelihood of theft: a dishonest employee may be tempted to think that with so much in your stockroom, one missing bottle will not be noticed – and, of course, they are often right.

Finally there is a real danger of product obsolescence. Many of our clients bought too much Galliano or peppermint schnapps or Frangelico when those products were steady sellers, or their liquor rep talked them into buying a bottle of Pineapple schnapps. But now there is almost no way to sell those brands so the money spent on them was really just thrown away.

HOW MUCH SHOULD YOU HAVE ON-HAND?

The easiest way to monitor your inventory levels is to see how many days inventory you have in stock for each brand. If you get an order every week, then you certainly don't need 90 days of inventory in your stockroom. We calculate the # of days on-hand for our clients and the optimum number varies depending on the popularity of the brand. For example, because you get a liquor order every week, you need less than 14 days inventory of your wells. Very slow selling brands, however, are often going to have a 30- to 60-day

**"In three months
BEVINCO® has
allowed us to cut
our on-hand
inventory by more
than one third and
made ordering a
breeze"**

**Scott Kay, owner,
Press Grill,
Columbus, Ohio**

inventory level without being overstocked, simply because it might take that long to use up a full bottle.

While the number of days of inventory is a good “quick and dirty” measure, it is a fairly subjective measure of efficiency. Most well-run businesses evaluate their stock levels by looking at their turnover ratio. The turnover ratio refers to how many times per year the inventory “turns over” or is replaced. Turnover is simply the number of times you sell your average investment in inventory each year. Turnover is calculated with the following formula:

**Cost of Goods Sold During
the Past 12 Months**

On-Hand Inventory Value

For example, if a bar has a cost of goods sold of \$12,000/year and \$1,000 in inventory, then the inventory will be “replaced” twelve times a year ($\$12000 \div \$1000 = 12x$).

A turnover rate of 6 turns per year doesn’t mean that the stock of every item will turn 6 times. The stock of popular, fast moving items will turn more often. Slow moving items may turn only once (which would mean that you only sell 1 bottle a year) while high volume brands turn dozens of times per year.

Most experts suggest that retail inventories, like clothing or electronics, should turn 6x to 12x per year, depending on the type of business. But alcohol inventory should be much lower and turnover much higher because all the variables are much better in the hospitality industry: usage is fairly predictable; most bars get a delivery every week; alcohol is not perishable; and most does not gain in value over time.

The average bar inventory turns over 21 to 26 times per year (source: Risk Management Association: www.rmahq.org). A review of the best-run Bevinco® clients, however, shows that 30 or 35+ turns/year is easily achievable.

Fine wines would be an exception. They sell much more slowly and often must be purchased in sub-optimal quantities. We recommend fine-dining

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THE CHARACTERISTICS OF AN EFFICIENT ORDERING SYSTEM

Bevinco® now offers a weekly recommended order for our clients. Our software engineers understand that the #1 priority is to make sure that our clients do not run out of a key brand, like Grey Goose or Jack Daniels – there is no excuse for being out-of-stock on consistently high-volume brands. After ensuring adequate stock levels, we

designed the software to minimize the amount of excess stock. The tension between having too much and too little is tricky but the results are impressive. Our clients are seeing their inventory levels drop by \$5,000-\$15,000 with fewer out-of-stocks.

Bevinco®’s system incorporates the four key factors of efficient inventory management:

1 Calculates average and/or peak usage

For most clients, our software looks at their usage over the past three weeks to see the pattern.

2 Builds in an extra “safety margin”

The safety margin is a percentage of usage. For example, for some brands the software adds a safety margin of 100% of the peak usage. So the bar would have to use more than twice as much of their highest recent usage before they ran out.

Higher volume brands need smaller safety margins because their usage patterns are more consistent (in technical terms, higher volume means a tighter standard deviation).

3 Adjusts for changing usage patterns

Because Bevinco is always looking at the three most recent weeks, pars will climb as usage increases and then fall if usage decreases – all automatically and without any extra work.

4 Allows for a lag time until the order is received

If the order is placed on Wednesday but not received until Friday, the extra two days of sales have to be factored in to the order.

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INSIDE:



Too Much? Not Enough?

BOTH ARE BAD...and both happen much too often!

IAN FOSTER examines ways and means to achieve the perfect balance between **OVER** and **OUT**.

(CONTINUED FROM INSIDE)

restaurants calculate their wine turnover separately and target a turnover of between 12x and 20x times per year.

Here is a quick way to look at your operation without doing any calculations. To achieve 35 turns/year, then for every dollar of weekly alcohol sales, an establishment should have less than 33¢ in inventory. To pick a realistic example, if your bar has alcohol sales of \$15,000 per week, your inventory level should be less than \$5,000.

WHAT TO DO IF YOUR INVENTORY IS TOO HIGH

First, don't make the problem worse. Fix your ordering process so that it is more efficient (see "the characteristics of an efficient ordering system" in the highlighted box on page 3).

Second, get rid of your "dead-stock." For spirits the easiest way to productively sell dead-stock is to pour it as your well for a week. For example,

if you are stuck with 6 extra bottles of Bombay gin then use it in place of your well gin. It isn't so easy to sell obsolescent liqueurs. I would start by setting up drink specials that are designed to move them. Use a bartending website to search for drink recipes that call for the over-stocked brand. For example, using the "Search for Drinks" feature on www.webtender.com, I found more than a dozen drinks made with Alize.

If the drink specials don't work then see if your chef can use it in the kitchen. If not then you can only conclude that you are left with pretty useless, and absolutely dead stock. You are better off without it. Consider selling it to your staff at below cost or giving it away to your servers or bartenders in a sales contest.

Bevinco® analysts are dedicated to improving our client's profitability. We can produce a weekly recommended order based on your real usage for every brand. Call us at 1-888-Bevinco for a free consultation. **BN**

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