Optimizing Results with STEP1 PO Module Using 12 Item Classes

Step1's PO Module was built with functionality to embrace the purchasing strategies of inventory control expert Gordon Graham. It was also built with the flexibility to modify his teachings and/or go your own way. Now that most users are using the functionality to one degree or another, we have been asked regularly, "How would Gordon use the module?" This document lays out the parameters and the reasoning behind his Classification Method of procurement. Before you decide to implement this method it is critical that you understand and agree with the following principles:

A. You never want to backorder a bowl mop. The revenue will never exceed the redelivery cost or the operational costs associated with back order generation.

B. If you overstock bowl mops you will never notice it on your Inventory Valuation.

C. If you overstock an Auto Scrubber you will.

D. The number 1 reason for escalating inventory dollars (other than obsolete items) is being forced to place a vendor minimum order before most items have reached the reorder point.

E. You never want bowl mop stock-outs to be the cause of "D" (above).

F. If you procrastinate ordering because you have a "D" situation⋯Your Fill Rates will decline.

Classification Steps

1. Separately for all stock items, multiply annual usage in units by unit cost to determine annual dollar throughput. (100 units sold in a year x $5.00 cost = $500.00)

2. Sort all stock items in descending order by total dollar throughput.

3. Decide where the "Dead" item breakpoint should be. This can be subjective (we really don't need this item) or objective (any item with less than $50 throughput).

4. Remove all "Dead" items from your list.

5. Assign each item remaining on the list an Item Class Code as follows (Table 1):

Table 1

% of the Items	Class
Top 7 ½ % of the items	Class A
Next 7 ½ %	Class B
Next 10 %	Class C
Next 10 %	Class D
Next 8 %	Class E
8 %	Class F
8 %	Class G
8 %	Class H
8 %	Class I
8 %	Class J
8 %	Class K
Last 9 %	Class L
100 %	

Note: Any New Item (less than 6 months of Sales history) should be placed in the *best guess* Item Class after reviewing the history you do have.

The Item Class of each item is developed by relating the money moving through the inventory in a year to the same figure for all other items. Classes A and B represent lots of money running through. Classes K and L represent not much money at all.

Set up the following Item Classes (Table 2) with the appropriate parameters.

Table 2

Class	Days' Supply	Safety Allowance
A	30	50%
B	60	50%
C	90	50%
D	120	50%
E	150	50%
F	180	50%
G	210	50%
H	240	50%
I	270	50%
J	300	50%
K	330	50%
L	360	50%

Results to Expect

When you review your sorted list you will see that Classes A & B represent 15% of your *non-dog*, stock items but account for about 65% of the annual dollar throughput. Classes C & D add 20% more items and 25% throughput. Consider that. Classes A, B, C and D account for 35% of your good stock items ⋯but 90 % of your cash requirements. Conversely, Classes E through L represent only 10 % of your annual inventory cash requirements. "Over-stocking" these items will not break the bank nor require a new line of credit. What overstocking will do is prevent you from backordering and redelivering to a customer because of a stock out of bowl mops. It will also prevent the need to prematurely order a truck load of Class A and B items (big dollars) because you ran out of a class L item. To emphasize this last point, once implemented, we have found that the 12 class method has almost eliminated the need to use the "Auto-Fill" function in Step1.

By the nature of the 12 class method, you can expect your total inventory valuation to go up for a period of time. This is because all at once you are ordering up to 12 months' supply of items for the first time. On Hand will then decline because you will not be reordering these items for quite some time.

You will save time in generating POs because you will be ordering 65 % of your items (Classes E thru J) less often. More importantly you will have more time to order your important items on time with fewer errors (direct influence on Fill Rates).

Over time you will notice that it will be easier to get Fill Rates up while keeping Inventory Values down and have more time to get POs done in a timely manner.

Disclaimer

The numbers presented in Results above are averages similar to the "80-20" rule. Your results may vary. It is easy to see expectations after you have generated your list and once you have drawn your class lines. Subtotal "$ Throughput" for each class to test your mix.

To gain the full benefit of Gordon Graham's philosophy, read his book "Distribution Inventory Management".