



# **THE NEWSMAKER**

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## **ZERO INVENTORY WITH HUL's DISTRIBUTORS – A case study of Hindustan Unilever's Working Capital management expertise applied to Distributors**

**by Suresh S.,  
Director, DMS Financial Services (P) Ltd.**

- ❑ Hindustan Unilever has achieved a 'zero' level inventory at its Distributor levels in 43 major cities. Considering that it has a sales turnover of Rs.20600 crores, this is no mean achievement. Even if this means a reduction in inventory to the extent of one day's sales, the interest saved in terms of inventory carrying cost @9% cost of capital is Rs. 5.1 crs.
- ❑ At Mumbai, the percentage of stocks damaged in transit from the company's depots to the retailers is also 'zero' percent.

This article summarizes various steps taken by the company and analyses important ratios of HUL on Working capital management and compares with competitors.

- An exercise studying the retail landscape by 2013 was done by the Company. Study revealed a hybrid trade landscape where both traditional and modern retail will co-exist. Although consumers have got exposed to the modern retail experience, the neighborhood grocery will continue albeit with higher consumer expectations. Urban and rural markets which are well-defined now will become blurred, product categories like deodorants which are almost non-existent in rural will become significant part of business. Technology the way it will be used in business will be vastly different.

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- HUL salesman use handheld terminals to book replenishment orders from retailers. When they come back to the distributor this data is synced in with the system at HUL. Accordingly the next day the clearing and forwarding agent will send out the required stocks to the respective distributors who in turn send it onto the retailers.
- Earlier distributors were like a warehouse holding full stocks, now they hold zero inventories. Distributors on seeing the benefits of the system have readily invested in the technology.
- The consumer is more satisfied now as the probability of getting the product is higher at the store.(any store would stock not more than 80 of the 650stockkeeping units [SKUs] of HUL.
- In implementing this system the company moved from a numeric to a value-weighted distribution model. Moving away from width of distribution, the company has for each product, identified outlets which they expect will contribute 80% of sales and have told the distributors to set up channels for retailers. Earlier a single store would interact with multiple HUL vendors based on product categories. Now there will be a single distributor per store. This will work so long as the C&FAs are within a 24-hour radius. Hence the range of products for each distributor will increase to satisfy each store's requirements under it. But this does not matter as the inventory carried by the store is zero and in-transit damage is zero.
- The thrust of the strategy is on boosting growth rather than cutting costs. This is evident as day-to-day replenishment would mean higher transportation and handling costs.
- At Mumbai HUL has tied up with MAHINDRA Logistics to handle the back-end but there is an associated cost with such outsourcing. Hence for other cities HUL plans to impart the capabilities to the distributors.
- The quality of data collected by the 9000 salesmen of HUL is at par with the best globally. For instance using this data it is possible to determine what variant of a shampoo, in what pack size, would sell at a particular store and can be stocked accordingly. They can also predict what new products would work in certain stores and these can be introduced accordingly. This is indeed a very interesting case of mass customization but on a store-by-store basis.
- In a nutshell, HUL looks at each store as a "Perfect Store" and the idea is to build a million of them.

HUL has shown its mastery in Working capital management.They have been able to hold Current assets at the same level for last five years but increased Current liabilities substantially. The Net Current assets which was Rs.1210 crores at the end of Dec. 2003 is Rs. -347 at the end

of Dec. 2007. The Current Liabilities are 102 days' of Sales i.e:- three and a half months of Sales. This is given in the Table below:

Rs. crores

Year →	Dec.03	Dec.'04	Dec.05	Dec.06	Dec.'07
Item ↓					
CA, Loans, Adv.	3879	3671	3102	3555	3681
CL	2669	2731	3078	3363	4028
Net Curr. Assets	+1210	+940	+24	+192	-347
Sales	10647	10152	11364	12887	14471
CL as No.of days' Sales	91	98	99	95	102

Although Current Assets level is maintained at same level, Inventories at HUL have been increasing.

Rs.crores

Year →	Dec.03	Dec.'04	Dec.05	Dec.06	Dec.'07
Item ↓					
Inventories	1393	1470	1322	1548	1954
Total CA, Loans Adv.	3879	3671	3102	3555	3681
Invent. To CA,Loans, Adv. (%)	36	40	43	44	53

Hence HUL has scored in Working capital management through management of Current Liabilities. Now it is transferring the Working capital management skills to its Distributors.

Whilst HUL as compared to its competitors is not outstanding on Net Profit ratios, it is outstanding on Overall Capital utilization measured by Sales divided by Total Capital Employed i.e.: Total Assets. The Table clearly illustrates.

Company ↓	Sales (Rs. Crores)	Total Assets (Rs.crores)	Sales to Total Assets (Times)
HUL	20602	1528	13
Dabur India	2418	545	4
Colgate	1473	167	9
Godrej Consumer	1088	285	4
Godrej Inds.	655	1494	0.4
Marico	1922	586	3
P & G	645	347	2
Gillette India	589	425	1
Emami	651	324	2
Jyothy Labs	372	329	1

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# **Arithmetic's Blind Spot**

## **Taiichi Ohno's Workplace Management**

**By S. Arvind**

It seems to me that the biggest illusion for 'number pushers' lies in departing from sophisticated calculations and thinking that simple arithmetic will show how many units must be sold for costs to drop.

At Toyota, we make only as much as will sell. Although we are always saying that we should not make things that will not sell, arithmetic calculations would lead us to believe we could cut costs by making, say, 20 items instead of 10.

If you are working with strange mathematic formulas, the above conclusion may be correct in terms of those formulas. But if the formulas were correct in the first place, they would show that, in fact, costs do not decline. Maybe this is difficult to grasp. My feeling, however, is that many people fail to see the point.

Let's look at three formulas:

- 1 Selling price – Cost = Profit
- 2 Profit = Selling price – Cost
- 3 Selling price = Cost + Profit

Perhaps the 'number pushers' fail to understand that each of these formulas means something different.

Formula #1 (Selling price – Cost = Profit) means that, given a selling price, profit is the result of having subtracted cost from that price.

Formula #2 (Profit = Selling price – Cost) says profit is what we have left after subtracting cost from the selling price. All we have done here is flip the terms around so that this is arithmetically equal to the first formula.

Formula #3 (Selling price = Cost + Profit) is a bit different because it says that selling price is what you get when you put cost and profit together.

Now, these formulas may all look the same when they are written out like this. In fact, though, each one means something different, an idea that intellectuals seem to have trouble understanding.

The first formula expresses it this way: whenever you have competition or other manufacturers, the selling price is determined by a third party, that is, the customer, who sets a value on the item

in question. The selling price is \$250. So, if the item actually costs \$200 to produce, that means you make \$50 (Selling price – Cost = Profit).

With the second formula, once you have manufactured the item, you want to find a way to make at least \$50 profit. Since you would make \$50 if you were to sell the item at \$250, you might be able to sell it for \$300 if you were to put some gold threads in it. In any case, you decide arbitrarily to make \$50 on every \$250 (Profit = Selling price – Cost).

As an arithmetic formula, nothing is wrong with the third formula. All you have to do is take Formula #1 and move the minus sign to the other side of the equation, where it becomes a plus sign and says that profit and cost together is the price. But the significance is entirely different. Let's say your cost is \$250. If you want to generate \$50 in profit, then for an appropriate return you should set the selling price at \$300. You are not going to get your profit unless the selling price is \$300.

Now, you may say this is a good price at which to sell, but the customer might protest that only a fool would pay \$300, or that he can buy it elsewhere for \$250. If this happens, Formula #3 tells you that it took \$250 to produce and that you would not be making any money at all selling it at \$250.

What does 'cost' mean in the context of these formulas? For me, costs exist to be lowered – not calculated. Formula #3 suggests that all you have to do is make calculations and come up with the correct cost. It seems to me that Formula #3 tells us – and this may sound odd – that the government or somebody has to take care of things from that point. The way I interpret it, the formula implies that if the customer does not go along with the price, somebody else has to step in and impose a \$300 selling price in order to ensure a profit of \$50.

Formula #2 is the most peculiar one of all (Profit = Selling price – Cost). Costs are not going to get any lower by having profit on one side of the equation sign and selling price and cost on the other. What this implies is that you have to make money by increasing added value (that is, lowering the unit manufacturing cost) and producing a high-class product. It says that in order to make money you should move towards luxury goods. Maybe this is what economists mean when they say all you have to do is make things with high added value.

In Formula #1, the selling price is fixed; so the manufacturer has no choice but to lower costs. Only when you have lowered costs will you make money. As a result, it may be possible to produce for \$125 what used to take \$200. Since the selling price is \$250, you are making \$125. Now, the Communist Party may denounce me for this, but this \$125 derives from our own hard work, so it seems to me that the conceptual approach expressed by Formula #1 is the best one. When mathematics professors tell us that all three formulas are equivalent, I think we have reached a point where communications have disintegrated.

Around 1974 or 1975, an economics professor asked me the following question:

**“Rather than making so many of those cheap cars and having the Americans squawking at you, why doesn’t Toyota make more expensive cars? Wouldn’t you have greater profits if you made ten times fewer cars with ten times the added value?”**

My reaction was to think that this economist was being very lazy in his thinking. In suggesting that it would be more profitable to sell a few expensive items rather than a lot of inexpensive ones, he was forgetting that the selling price is determined by a third party. We are dealing again with Formula #2. Formulas may lead you somewhere useful depending on how you approach them – and a single formula will generate a variety of ideas depending on how it is written.

Those of us involved in industrial engineering tend to see things in terms of Formula #1. We are always thinking about ways to cut costs. For us, costs are things to be lowered, rather than things to be calculated. No matter what we do, the single most important issue for us is whether costs have been lowered.

Our company does everything it possibly can to reduce labour costs. It is a common misconception, however, to think that reducing labour costs means that overall costs will be lowered. At the same time, we are plagued by a lot of similar errors in the area of capital investments, especially when it is so difficult to win people over to our way of thinking.

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