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Verno's
BEER BRIEF

THE WHOLESALE INDUSTRY'S LEADING
BEST-PRACTICES PUBLICATION

MANAGING OUT-OF-CODE

Out-of-code product (OOC) is a major cost for many wholesalers. Owners and managers can consider some part of OOC cost to be a normal and acceptable cost of doing business. When OOC cost is excessive, it is pure waste and results in a substantial drain on profits. In the past couple of years, many wholesalers have taken steps to reduce OOC costs while other wholesalers have not put enough focus on OOC and their costs have either stayed generally the same or have increased.

In this issue of ***Verno's Beer Brief***, we will discuss the strategies and processes we have seen our wholesaler clients use to reduce and manage OOC. We will also review the results from the OOC-related questions we asked in our **2018 Beer Business Survey** (over 400 beer wholesaler executives gave us their input on a wide range of topics, including OOC).

ECONOMICS OF OOC

The economics of OOC are pretty simple: *When OOC occurs, the wholesaler loses the cost of the product and the cost of selling, warehousing, picking and delivering the OOC*.

In the example featured in **Exhibit 1**, we look at the number of new case sales required to cover the product cost of OOC. As you can see, when you use gross profit per case, the number of cases of new sales needed to cover the OOC product cost of one case of beer is meaningful (3 or 4 cases). The number of new case sales needed to cover the product cost of one case of OOC grows significantly when you use wholesaler operating profit per case (20 to 30 cases).

In many markets, wholesalers are fighting every day to maintain flat sales or even just slightly declining sales. In a tough sales environment, getting additional new sales to cover the cost of OOC is a big ask that often is not realistic. OOC is pure cost and lost profit.

INCLUDED IN THIS ISSUE

UPCOMING ISSUE

FEBRUARY 2019
BEST PRACTICES FOR RETAINING EMPLOYEES

EXHIBIT 1: OOC ECONOMICS

	OOC Cost per Case from Brewery (CGS)	Ave. Gross Profit per Case	Wholesaler Operating Profit per Case	# of Cases of New Sales Needed to Replace 1 Case of OOC *(using Gross Profit per Case)*	# of Cases of New Sales Needed to Replace 1 Case of OOC *(using Operating Profit per Case)*
Premium Light	$20	$5	$1	4 cases	20 cases
Craft	$30	$10	$3	3 cases	30 cases

HOW MUCH OOC IS ACCEPTABLE?

We have looked at various industry data sources regarding OOC cost. We questioned the way the OOC cost were calculated, so we developed our own average OOC cost benchmarks using client data and various industry peer group data that we knew we could trust. The following chart shows our data for the average OOC for AB and MC wholesalers.

EXHIBIT 2: OOC AVERAGES

Average OOC as a Percentage of Net Sales

0.11%	0.19%
MILLERCOORS	AB-INBEV

Additional Findings:

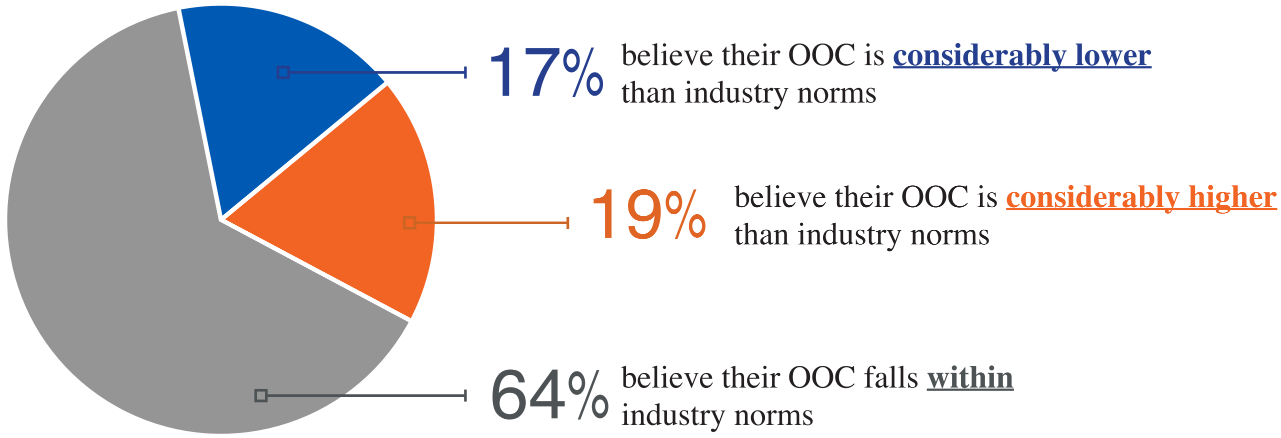
- **MillerCoors**: The best MC wholesaler we found had OOC costs equal to **0.02%** of net sales (about one fifth of the average MC wholesaler).
- **Anheuser Busch:** The best AB wholesaler we could find had OOC costs equal to **0.07%** of net sales (about one third of the average AB wholesaler).

Even though MC wholesalers typically have more suppliers and larger portfolios, they perform better than the AB wholesalers with regard to OOC. Crafts may often be the biggest contributors to MillerCoors OOC problems. In many AB wholesalers, the biggest contributor to OOC is often major AB brands.

2018 BEER BUSINESS SURVEY RESULTS

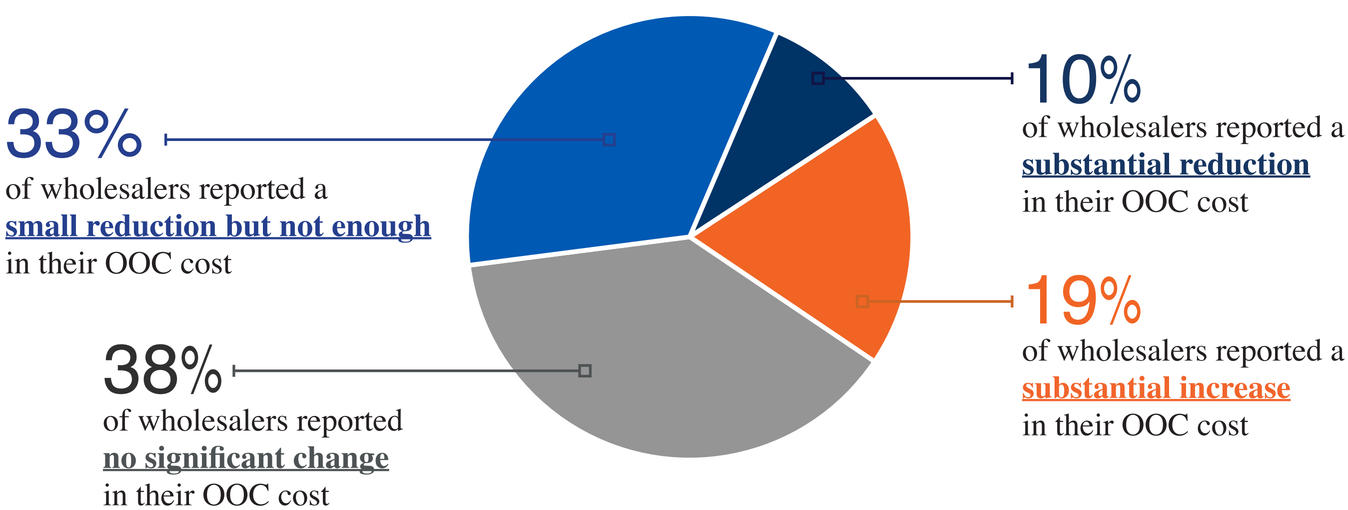
In our **2018 Beer Industry Survey**, we had over 400 wholesaler execs answer a series of questions regarding OOC. The following charts shows how the wholesalers sureveyed rated their OOC versus industry OOC norms.

EXHIBIT 3: HOW WHOLESALERS RATE THEIR OOC COMPARED TO INDUSTRY OOC NORMS



We also asked wholesalers how their OOC cost changed compared to the previous year (see **Exhibit 4).**

EXHIBIT 4: HOW WHOLESALER OOC COST CHANGED FROM THE PREVIOUS YEAR



WE HAVE FOUND THAT WHOLESALERS WHO REALLY MADE OOC A PRIORITY HAVE BEEN ABLE TO MAKE MAJOR IMPROVEMENTS IN OOC COSTS.

HOW OUR CLIENTS ARE REDUCING OOC COSTS

Numerous wholesalers we have seen make major reductions in OOC costs also used similar methods. The following are some of the best practices our wholesaler clients have used to realize major improvements in OOC.

✓ ORDER LESS SEASONALS

If the supplier asks these wholesalers to order 1000 cases, the wholesaler only orders 70% to 75% of the supplier's request.

> THEY PREFER TO RUN OUT RATHER THAN HAVE SEASONAL BEER LEFT OVER WHEN THE NEXT SEASON STARTS.

✓ TIE A MEANINGFUL PORTION OF THE MANAGERS' BONUSES TO OOC IMPROVEMENT

This is effective because all departments have to work together to earn their OOC bonus or PFP. When we say "managers" we are talking about the top managers in the company that oversee operations, sales, marketing, and admin. If they have money tied to reducing OOC, they are more likely to keep OOC top-of-mind amongst the management team and with all of their subordinates.

Note: Tying sales rep and sales supervisor compensation to OOC cost reduction doesn't have a substantial inpact on OOC. Tying upper level managers' compensation to OOC reduction has a greater impact.

✓ MAKE OOC TOP-OF-MIND WITH ALL EMPLOYEES

The best wholesalers have their supervisors communicate with every rep, every day, and review each specific rep's close-to-code (CTC) and OOC from the previous day. When supervisors review CTC and OOC with each of their reps, they review CTC and OOC by package, by account. Action is taken to prevent recurrence of OOC. Likewise, sales managers review the same information with the supervisors on a daily basis.

✓ ADJUST SALES COMPENSATION

Sales reps with a meaningful portion of their compensation tied to volume have a higher propensity to having OOC in their accounts than reps that don't have a large portion of their compensation tied to volume. Wholesalers need to move away from commission or pay-for-performance (PFP) tied to volume-based quotas.

> MAKE SURE YOU ARE NOT FIGHTING YOUR OWN COMPENSATION SYSTEM AS YOU MOVE TO HAVE BETTER CONTROL OVER OOC.

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✓ FIRE-SELL CTC EARLY

The majority of CTC can be worked through the system and placed in faster moving accounts to realize full margin to the wholesaler. The CTC product that can't be sold through the system often needs a hot price in order to sell (where legal). The best wholesalers act quickly to fire-sell close-to-code product that they know won't sell through retail.

THEY DON'T WAIT UNTIL THE LAST MINUTE TO INITIATE THE FIRE-SELL PROCESS. GETTING A PORTION OF THEIR PRODUCT COST IS BETTER THAN EATING THE ENTIRE COST OF THE CTC PRODUCT.

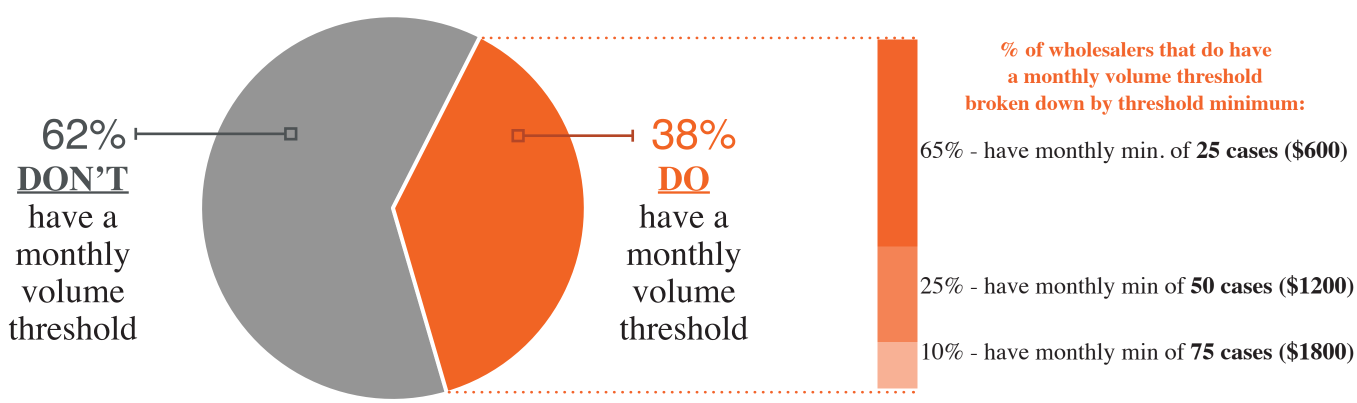
✓ MANAGE SKUs MORE EFFECTIVELY

Wholesalers that have the best control over their OOC also are the best at managing their SKUs. They have monthly sales thresholds for SKUs that need to be hit, otherwise the wholesaler will discontinue the SKU.

THE WHOLESALERS WITH THE BEST CONTROL OF OOC ALSO HAVE THE BEST CONTROL OVER HOW MANY SKUs THEY WILL TAKE ON.

In our **2018 Beer Business Survey**, wholesaler execs shared their monthly volume thresholds required to continue carrying a SKU (see **Exhibit 5**).

EXHIBIT 5: PERCENTAGE OF WHOLESALERS THAT HAVE MONTHLY VOLUME THRESHOLDS REQUIRED TO CONTINUE CARRYING A SKU



As the craft market continues to normalize and be less explosive, many suppliers are trying to improve sales trends with new sizes of existing product and new products/brands. Many wholesalers are just adding the main, key sizes and flavors. They are less accommodating in accepting new SKUs that they know will not sell.

When this approach of limiting new SKUs is *not* used, the marginal new SKUs will become OOC problems down the road and will also consume valuable sales resources (to sell and manage the new SKUs through retail systems when they become CTC or OOC).

> WHEN WHOLESALERS WERE TRYING TO WIN MAJOR NEW BRANDS, THEY HAD TO BE MORE ACCOMMODATING TO SUPPLIERS AND LOOSER WITH SKU MANAGEMENT. TODAY, WITH MOST OF THE MAJOR CRAFTS IN JUST ABOUT EVERY MARKET, WHOLESALERS CAN BE STRICTER ON SKU MANAGEMENT WHILE STILL BEING A GREAT PARTNER WITH THEIR SUPPLIERS.

✓ IMPLEMENT EFFECTIVE MOVE-BEER PROCESSES

Having an effective move-beer process (from one account to another) is another key to minimizing the risk of CTC becoming OOC. Most wholesales have a move-beer procedure, but the procedure is not always correctly or consistently followed. Every employee involved with moving beer (sales, delivery and warehouse) needs to be aware of his or her role in the move-beer process. If any one person breaks down the process, then the CTC has a significantly higher probability of becoming OOC.

✓ REVIEW YOUR DEAL STRUCUTRE

If you use quantity discounts or deep discounting not tied to quantities, then you need to review how your pricing practices are impacting OOC. If you deep discount and encourage bridge buying, you increase your risk of OOC.

> IF YOU USE DEEP DISCOUNTS, DON'T ALLOW THE RETAILERS TO BUY MORE THAN A LIMITED NUMBER OF WEEKS SUPPLY THAT YOU SET. WHEN RETAILERS BUY MORE THAN THE LIMITED NUMBER OF WEEKS, THERE WILL BE MORE OOC OR MORE CTC BEER THAT NEEDS TO BE MOVED.

✓ REVIEW SALES PRACTICES

When your sales supervisors ride with their sales reps, they should be observing the reps' sales process. If a rep is selling too many days of supply or placing products that don't fit the retail account, then the supervisor needs to use this as a teaching/coaching opportunity. Many times, sales compensation in the form of commissions or volume-based PFP will cause reps to sell too much product or the wrong products to individual accounts.

✓ MANAGE SUPPLIER EXPECTATIONS

With the exception of a few suppliers, most suppliers' volumes are flat or decreasing. During the supplier-wholesaler annual business planning process and throughout the year, suppliers will ask wholesalers to commit to unrealistic volume and distribution goals.

> BRAND MANAGERS AND SALES MANAGERS NEED TO PUSH BACK HARDER ON SUPPLIERS THAT HAVE UNREALISTIC GOALS. SOME BRAND AND SALES MANAGERS MAY THINK THEY ARE PUSHING BACK ENOUGH NOW BUT IN REALITY THEY NEED TO PUSH BACK EVEN MORE.

Exhibit 6 shows how wholesaler execs who took our **2018 Beer Business Survey** answered the question, "What are you doing to reduce out-of-code?" Execs were asked to choose their top 5 tactics from the list we provided. As you can see from the responses, many of the best practices we observed are also the top practices in use by other wholesalers.

EXHIBIT 6: WHOLESALER ACTIONS FOR REDUCING OOC

- **75%** Ordering less seasonals and crafts
- **66%** Moving close-to-code beer from one account to another
- **64%** Being willing to run out of beer rather than have OOC
- **63%** Managing new SKUs and non-performing existing SKUs more aggressively
- **55%** Communicating OOC performance, making it a high priority and holding individuals accountable
- **51%** Monitoring code dates in the warehouse more closely
- **46%** Fire selling close-to-code product more aggressively
- **41%** Checking rotation in stores more
- **28%** Charging sales reps for OOC
- **12%** Providing OOC reducation incentives to sales people
- **10%** Changing the discount structure and how much product an account can forward buy

100% OF WHOLESALER EXECS RESPONDED THAT THEY **ARE ACTIVELY** WORKING TO REDUCE OOC COSTS.

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> THE KEY IS TO NOT JUST USE THE BEST PRACTICESQ BUT ALSO TO USE THEM CORRECTLY AND WITH CONSISTENTLY.

We often say if a wholesaler has an OOC problem, then they most likely have a sales supervisor problem. If supervisors are riding with sales reps three or four days a week, then they should visit all of their reps' accounts at least once every 4 to 6 weeks depending on how many reps report to the sales supervisor.

> SALES SUPERVISORS NEED TO CHECK FOR ROTATION ISSUES IN EVERY ACCOUNT. ALL SUPERVISORS (SALES, MERCHANDISING, AND DELIVERY SUPERVISORS) NEED TO TRAIN THEIR DIRECT REPORTS ON PROPER ROTATION AND IDENTIFICATION OF CTC.

There are many other factors that affect OOC, but sales reps need to catch close-to-code early enough so that actions can be taken to reduce the amount of CTC that turns into OOC.

Note: If your sales supervisors are spending most of their time running relief, doing resets, or other non-supervisory duties, you should think hard about changing this. In many cases, the cost of OOC can pay for relief personnel so that your supervisors can really concentrate on supervising and keeping OOC costs in check. Not having enough support personnel to help supervisors be able to supervise is a matter of pay now (proper support staffing so supervisors can supervise) or pay later (with increased OOC cost).

CONCLUSION

As we all know, OOC is real money. Even the wholesalers who are performing well with their OOC management can't afford to take their eyes off the prize. Out-of-code can quickly creep up and bite wholesalers' profits. Beer wholesaling is a great business - it's profitable, challenging, and can be fun. As the industry matures and suppliers and retailers step up their reach for wholesaler profits, wholesalers have to decide what they are going to do.

Wholesalers need to consider being more aggressive with their service policies, carry less low profit or high OOC risk products, flatten their organization structures, use more discretion in controlling their marketing, and look at alternative sales models. Taking actions like we just mentioned aren't *just* for cost reductions to bolster profits - freeing up unproductive costs allows the wholesaler to reallocate portions of the saved costs into areas that can grow volume and keep up with the changing retail landscape. Getting lean will take a couple of years, so the best time to start is now.

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