WHY MANAGE INVENTORY?

Can you have your cake and eat it too?

Everyone knows that you cannot have your cake and eat it too. And that is certainly the way many approach inventory management. Many believe that if you want high service levels, you must have high inventory levels too.

Unfortunately that sort of thinking perpetuates a lot of bad behaviours and outcomes. It is all too easy to add some extra buffers just to be 'safe', and then, not surprisingly you end up with too much inventory, and the excess makes you sluggish and raises your costs. The CFO says we need to tighten up, so you cut back the category 'A' items by 10 percent and damage service levels, or cut back on the category 'C' items where you make so much of your gross profit.

These sort of overly simple responses to the challenges of managing inventory have no place in best practice inventory management. The fact is that you can have your cake and eat it too when it comes to how you manage your inventory – you just need to approach it differently.

You need to start by re-examining 'Why you have Inventory?', a question we explored in the August edition, and then explore, if you have inventory, 'Why you need to manage it?' and then 'How?'.

Inventory Management Priorities

For some enterprises, inventory is actually critical to their very existence. An interruption to the availability of medical supplies or military hardware could well be life threatening. In such a situation it would be patently obvious why you needed to manage inventory. It is also likely that people will pay substantial premiums for critical products, which in turn tends to relieve you of some of the inventory management pressure.

However, what about the situation where you have an exclusive agency or distributorship for a brand? Failing to maintain service levels and properly manage inventory could well imperil the brand's reputation, and in turn your role as the preferred route to market. A major part of your revenue could well be at risk, and even the very survival of your business.

Similarly you might be in a situation where maintaining service levels is absolutely critical to how you are perceived in the marketplace. If you are first on the speed dial then you will tend to enjoy a premium price, you will get a greater share of your customers' purchases and you will grow and enjoy the benefits of scale. In such a case, service levels and range will tend to dictate your inventory management priorities.

Make every dollar go further. For most businesses however there is a bit more discretion. You can choose how much you invest and just how you manage that investment. In this case, return on the inventory investment tends to become the ultimate goal and measure of your inventory management – you want to make every dollar work as hard and go as far as possible. So what sorts of things tend to become important? It will depend on the relativities of the different parts of your business and financial model.

If you are trying to grow and you can make high gross margins, then that will suggest higher investment, more range, perhaps more depth and more rapid replenishment. It is worth risking more in order to go after bigger rewards. While there is a place for some good gut intuition, it is also important to have a balanced and disciplined view, lest you put on too much weight, figuratively speaking.

It is important to focus on costs. That should start with cost of goods, but avoid the temptation to stock up on that deal when carrying costs could well wipe out any advantage. It is possible to optimise your buying strategies, but are you taking advantage of such capabilities? Then of course there are opportunities to manage all the costs associated with processing, moving and storing inventory. Together they could easily represent 20 percent of the final price, and as such make a very large impact on profitability and ROI.

And unfortunately you have to allow for mistakes and issues, like the late (or early) delivery or a last minute cancellation. In our imperfect world you have to be realistic and find ways to also stay on top of excess before it gets out of hand and destroys all your hard earned gains. Before you order externally, is there excess that can be moved cost effectively? Recognise the shortages before they become major emergencies and incur high transfer costs.

You can have your cake and eat it too!

Clearly there are many variables to consider ranging from your business strategy and imperatives, to the effort you put into forecasting, to how well you manage product transitions and to the way you trade-off freight and buy-breaks against processing and holding costs. In fact there are over twenty variables to consider if you want to get close to having your cake and eating it too.

If you have been using the same old models for how you manage inventory in the past, and you would like to set a new set of benchmarks and performance levels, then we would encourage you to take a fresh look at exactly how you manage inventory and what your strategy, policies and priorities are. You could be surprised at just how much better you could do.

For further information consult www.horizoninventory.com.au or email info@horizoninventory.com.au