ANY INTEREST IN INVENTORY?

Interest rates are already at record lows and are heading lower

Interest rates are of course one component of carrying costs, so cheaper funding costs ought to be helpful.

However, you still have to pay for warehousing, security, stocktakes and obsolescence so your annual carrying costs will still be north of 15 percent and possibly more like 30-35 percent for less popular items.

More importantly however, lower interest rates are harbingers of problems ahead. We are likely to see another couple of rate cuts by year end and some have even spoken of getting down to zero: that does not engender confidence.

We are certainly not in GFC territory but the indices like CommSec's Luxury Car Index have been down for a couple of years and so far are not recovering. You will have also seen from the first quarter AAAA Dashboard report that new car sales are down eight percent relative to the same time last year.

Although some commentators are speaking of a turnaround in house prices in 2020/21 as people re-enter the market, right now it appears that people are being very careful with their dollars – they are more likely to spend a little to repair something, than a lot to replace it.

Now for the auto-aftermarket, that counter cyclical behaviour ought to be good news and an opportunity, but of course that all depends how you react to the shifting demand.

Lessons from the GFC

When the GFC hit several things happened. First there was a big fall off in demand. This lower demand meant that those industries which had been running at capacity and high utilisations shifted from doing preventive maintenance to more break down maintenance: if you were short of cash, why would you spend money on maintenance unless you absolutely had to?

This however had the effect that customers often wanted a wider range of parts. They held on to vehicles and other assets for longer and more different types of parts had to be replaced; in effect a greater range of replacement parts was needed and for some this could have presented a funding challenge.

However suppliers were experiencing the same downturn in demand and this freed up capacity, leading to a reduction in lead times for at least some product ranges. This certainly helped people react to the downturn by helping them service the demand with less safety stock.

We have not heard anyone suggest that the current downturn is anywhere near as bad as the GFC but certainly it pays to be on the lookout for changes in customer and supplier behaviour, and to ask the right questions to better understand the subtleties.

For example, are certain sectors affected more than others? Are your customers exposed to a still burgeoning iron ore industry? If you sell parts, like suspension components which typically only need to be replaced much later in the life of the vehicle, then as people hold on longer, you might expect to see a significant increase in demand. The question is, how do you handle these different demand signals and how do you deploy your inventory so it is in the right place at the right time and in the right quantity?

ROA even more important

When interest rates are down, investing in asset classes that return a lot more than bank interest becomes even more important. There is a clear imperative to maximise the return you get from every dollar invested in your business and in particular, your inventory.

It is important to ask questions like:

- If people need the parts more for break down repairs, what gross margin premium can we reasonably capture?
- If the range is broader how much depth should be carried?
- If the part is low in volume but very costly, how much capital do you want to tie up in that one part? Might it be better to locate it in only one or two places and transport it at some cost to where it is needed? Hopefully the transport cost can be paid for by the person or business needing the part.

In a typical aftermarket parts business, you could easily have tens of thousands of parts where you might need to ask such questions.

ROA Ride Adjustment

Setting up your business to handle the inevitable ups and downs for each product, and the different reactions needed for different market segments, can be a real challenge. In simple terms you need three things to tackle this challenge most effectively:

1. You need good market and product intelligence. Things will not always behave exactly as they did in the past. You may need to position yourself to be more opportunistic at times and more pessimistic at others (see last month's article on losing your inventory inhibitions). You may need to adjust your sensitivity to different signals. Some of that can be helped through tweaking your planning system but you may also need to put more effort into working with your customers to understand how you can best support them. You may need to understand how your suppliers are being affected by a downturn and how, together, you can stay on the right line.
2. You have to be able to consider all the relevant variables when you are planning the right inventory locations and levels. At times that will include up to twenty different inputs, so you land somewhere close to the optimum result. What is the gross margin, unit cost, demand supply variability, common quantities, matched items, popularity and position in the life cycle? There is a lot to consider. And then because you have to do this for thousands of items, you need to be able to easily tune the service levels and the planned profitability and Return on Assets for your whole portfolio and its various parts.
3. Then you need to be able to put everything in cruise control – it needs to go into auto pilot for most of the time. After all, you cannot be absorbed by system admin and transactional trivia when your focus needs to be on navigating the road ahead.

With the right sort of interest, you can certainly improve your returns.

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