

INVENTORY MYTHS

Debunking the myths to better your business future

Once upon a time, in the dim, dim, distant past, there were a few branch managers who stood out in the firmament of branch managers. They were always slaying their revenue and gross margin targets. Many looked up to them as heroes.

They received all the kudos, recognition and rewards. What were their secrets of success?

Over time people learned the secrets and they came to believe that:

- 100 percent of orders were required same day
- They must never be out of stock of most or all parts: "We have at least one on the shelf at all times," was the mantra
- New products are only successful if you put substantial inventory out in the branches to start with, and
- If lead time is three months, then you must hold three months of average sales at a minimum

These and other secrets became embedded into the culture and psyche of all the branch, product and inventory managers and purchasing officers. Of course this led to certain behaviours.

So if an item went out of stock, rather than waiting for the normal replenishment, the branch would emergency stock transfer one, just to make sure they had one in stock should someone just come in and want one. This increased the emergency stock transfer load on the DC, which made it more difficult to pick the normal replenishments, which exacerbated the problems.

Debunking the Myths

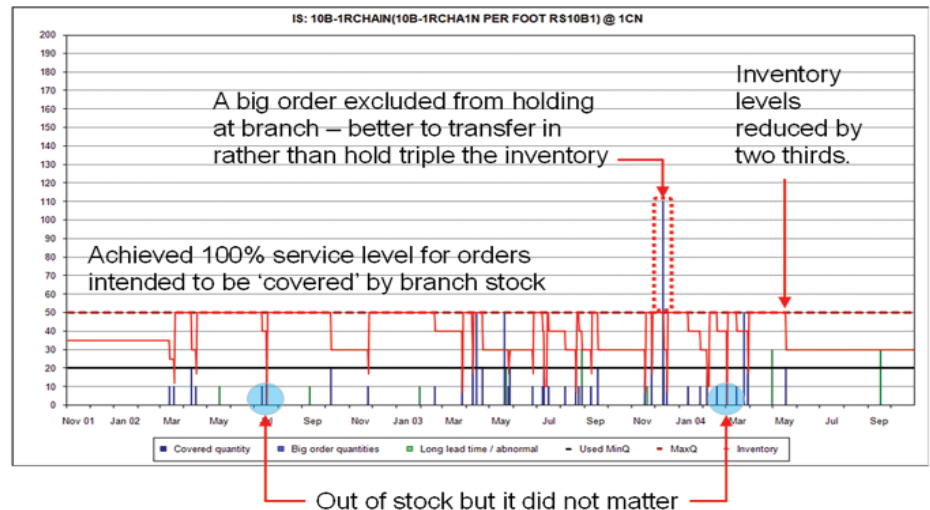
Debunking these myths and behaviours (and ill effects they cause) are critical to improving your inventory and supply chain performance. Education and changing the culture is fundamental. In Horizon's experience, two strategies are critical. You need facts and modeling to demonstrate a better way, and how this model will deliver better outcomes.

For example, are all products required same day? For one of Horizon's clients, the myth was that they were required. When Horizon gathered the statistics and actually spoke to customers, it discovered that only 50 percent were required same day. You can imagine what effect taking advantage of this fact could have on inventory levels.

Facts and modeling results can speak volumes. For example, the graph shows the inventory level over the last three years for an item with a min of 20 and a max of 50.

It demonstrates that although it would have stocked out on two occasions with these settings, it would have still achieved a 100 percent service level for all the orders intended to be serviced from the branch inventory.

It is also important to note that a couple of orders



have been excluded from consideration, one in particular. If the big order were to be serviced from the branch's stock, then it would require three times the level of stock in the branch. It is in this case better to transfer in the stock - much better profitability and Return on Inventory (ROI).

Using graphs can show that better min-max inventory levels can work and can improve financial performance substantially. In fact, one of Horizon's clients was able to reduce inventory by half for its most popular product and still deliver very high service levels. This also allowed it to invest in a broader range.

Modeling at the individual item level can definitely help debunk myths. Unfortunately however, you may still get the naysayers who can recall one time when it did not work.

The trick with this is to be able to model across thousands of products and evaluate the effects of different policies on service levels, replenishment and transfer volumes, costs, profitability and ROI.

It is important that these stories get told widely because there are often many people who have sat at the foot of the hero branch manager and learned the myths of how to succeed. They need to unlearn the myths.

You need to properly explore questions like: If you have 100 percent accurate forecasts and 100 percent reliable supply, how much safety stock do you need?

The answer of course is zero, although you can still have a difficult task convincing those who were brought up to believe in carrying three months of stock if the lead time is three months.

Through modeling and presentation of hard facts however, you can eventually sway the doubters. You can demonstrate how much better you can be by applying smarter practices, rather than primitive one size fits all methods.

The Myth Makers

Unfortunately some of the myths are perpetuated by story tellers and itinerant minstrels. "You must have a consensus based demand statement in monthly

buckets out over the next 12 or 24 months," say some. This can of course fall down badly when you consider things like:

- For the really slow moving items on the tail of the range, you don't have a forecasting problem, you have an inventory optimisation problem, where understanding the common quantities in which something is sold is far more important than agreeing whether you will sell one order once every 6.50 or 7.20 months
- You can easily end up with herd mentality as everyone lives in a fairy tale of what is needed to make the targets without the evidence to support this. If the underlying risks in such a situation are not mitigated by strategies such as more frequent replenishment, then you can really create some monsters in your inventory portfolio
- How much time and effort is put into such approaches, and does that add or detract value from the business? For many items, statistical forecasts, perhaps informed by Vehicle on Road and Sales data, can perform far better and prove much more sustainable over the long term. You can be proactive and adjust your inventory policies throughout the lives of these products. The trick is to do this across thousands of products.

New heroes are needed

You can create a new world - it will require a renewed understanding of the fundamentals and people need to share that understanding too. Don't accept that it will be alright if you can just apply some disciplines, the disciplines that you have been so far unsuccessful in applying.

Your data may not yet be perfect, but you can often achieve a lot well before you achieve master data Nirvana. Facts, fortitude and a new faith are keys to a new Future. You can tell a new story.

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