STRETCHING EVERY DOLLAR FURTHER

Turning inventory into cash through the working capital cycle is fundamental to sustaining and growing any business

It is also critical that the conversion of inventory into cash is as quick as possible, and if not that quick, then at least as big as possible (ie: with higher gross margins).

The aftermarket however is characterised by a lot of inherently slower moving inventory. It is all too easy to get it wrong and to have your working capital engine stall. We have to be forever vigilant to stretch every dollar as far we can, to maximise the returns achieved from our inventory investment.

All too easy to waste cash

The worst sin of course is to have obsolete stock and have to write it off.

The problem is that not only do you write off all of your original investment in inventory, you normally write off several years of carrying cost as well. It is like pouring money down the drain and then having the vortex suck in even more to really damage your cash position.

Unfortunately, virtually every business has an obsolescence problem. In part that is because of the way most organisations look in the rear vision mirror to detect that they have obsolete stock. So by the time they recognise they have a problem, it is often too late and a total write off or at least a significant write down is the result.

As we outlined in the June article, ‘Know when to hold ‘em and when to fold ‘em’, it is far better to be proactive. Change the paradigm and don't ever order the stock in the first place.

Okay, let's assume you are on top of write-offs and write-downs. Is at least some of your stock turning over much more slowly than it ought to? Is the slow moving stock clearly identified? Or is it hiding, or rather being hidden by the branch manager ("I'm sure I will sell this soon") or by a workshop technician ("We just might need this") somewhere in your system?

If your overall funding is constrained and excess is clogging up the working capital engine, then the stock that is turning over has to work even harder and somehow generate more cashflow.

Inevitably, that can all too easily translate into discounting of otherwise good stock just to bring in the cash to sustain the business. In that way, excess stock can be particularly pernicious. It takes up too much of your balance sheet, too much space in the warehouse and too much of your time, when you really ought to be focusing on running your business in a positive way.

So, it is essential you quickly identify stock that is in excess and move it to where it can do the most good as quickly as possible. Even more importantly, you need to have the tools and techniques in place to substantially reduce your exposure to creating excess in the first place. And of course, if you are after finance, having good quality stock, without masses of excess, will help you stretch your dollars further by using other people's money. You will however only be able to access that extra finance if you get through the due diligence checks.

Creating more cash

Every dollar saved from write-downs and write-offs and every dollar saved from sitting too long in excess, can be invested in creating more cash.

That can of course be done in multiple ways. If you are constrained by working capital limitations then that will inevitably constrain the range you can stock for sale to customers. Saving a few dollars here and a few there, can enable you to stock one or two more products in the range, or to add a bit more stock to key products to enhance the service level.

Better service and the availability of otherwise slow moving, less popular parts can also lead to an enhanced reputation and premium pricing. And when done right, that can all convert into more gross margin, more cash and a greater ability to grow, where the working capital engine can step up to a new level of performance.

Most of our focus in these articles has been on the inventory perspective and we don't tend to look too much at the accounts payable part of the balance sheet; but let's think about that for a moment.

A lot of accounts payable tends to be done on a 'one size fits all' type approach, for example, 60 days.

But what happens if you get a fast mover and can turn inventory into cash in under 20 days, and collect in 30 days? If you pay in 60 days than you have just created '10 days' of cash. Even better, try to find a way to have your supplier carry more of the stock and then you carry less – convert the inventory on your books into sales and cash even faster.

Okay, you are using your supplier's working capital, but they might not mind so much if you are contributing positively to their growth. Can you be far smarter than a 'one size fit's all' approach? Maybe carrying less stock of your really faster movers can help free up cash to add more slow movers.

With these kinds of approaches, you might say you have shifted the inventory risk to your supplier. That however is win-lose type thinking.

What can be achieved if you can help your supplier by giving them visibility of your medium term forecasts and purchasing plans? It will help them and it will help you. You might even be able to negotiate a better discount or rebate for improved reliability of your order pipeline from the supplier. This means more gross margin, and more cash.

Information drives cash conversion

The catalyst for really efficient conversion of working capital into cash and for driving the working capital cycle is of course information and its effective and efficient use. The smart and disciplined use of information to improve business performance is of course what Horizon Inventory can help you do.

With very large product ranges, it is ultra-important to optimise each and every item in the range. If you want to stretch every dollar further, then you cannot afford to carry any slackers. Every product, every unit of stock, must earn its place in the line-up.

Remember that information is an asset. Not one perhaps that appears on the balance sheet, but an asset nonetheless. Are you using it as effectively as you might to maximise the cash generation potential of your business?

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