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Making Inventory an Asset in a Challenging Economy

If you are experiencing shrinking margins, cash flow may become your primary concern. Increased sales will produce increased cash input, but purchases and investments lead to cash outlays, and what about inventory? Inventory sits in the warehouse. Inventory not only freezes cash flow but generates expense by requiring handling and storage space. Unless it is on the way out the door to a customer, inventory contributes nothing of value to an organization.

Inventory management is a tradeoff between the ability to meet customer expectations and the necessity of keeping assets fluid to meet unexpected demands and higher costs. Before investing in more storage space or warehouse management tools, consider using resources in ways to decrease inventory.

1. Time is money
   The inventory level needed to achieve a given customer fill rate is roughly related to the square root of the lead time. That means that if all other impacts are the same, inventory levels can decrease by 50% when the lead time shortens from four weeks to one week.

   One of the strategies to reduce lead time is to develop the ability to customize products at the final stages of production. This allows for the flexibility needed to respond to changes in customer demand. This not only reduces the lead time, but decreases the risk of producing the wrong products.

2. Forecasts are always wrong
   Forecasts, by definition, will always be wrong. If forecasting must be used, avoid using financial projections to plan production. Although finance is a vital function in any organization, financial projections do not capture demand. Understanding demand is the key to having the right products in the right places. If a demand forecasting and deployment system is not in the budget, a simpler spreadsheet model can be used quite effectively. Even better, develop relationships with customers to directly access their needs.

3. Negotiate with vendors
   Many vendors will manage inventories. Some will replenish daily, leaving only a small safety stock on the premises.

4. Standardize components
   Fewer components needed across product lines mean a lower overall inventory. Examine the bills of material for similar types of components and work with engineering to consolidate wherever possible.

5. Get rid of obsolete products and components
   Obsolete parts take up valuable space and require handling. If a component is custom made and may be used in the future to service product, move it to after-market stocks. Otherwise, find a buyer on the internet or simply throw the parts away.

The value of an investment in inventory is measured only by how quickly it disappears. The optimal amount of inventory is no inventory at all. This is not a realistic expectation, so the next best strategy is to minimize it wherever possible.

Articles of Interest

This column features relevant news stories for today's busy executive.

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wsj.com, June 9, 2008
Executive perquisites can carry plenty of punch, helping to recruit management stars even as they outrage investors who oppose treating top brass like royalty.
Link to article

Chief Executive Officer

Keeping the CEO Safe Can Be Costly
wsj.com, June 9, 2008
The disparity in security sending for big-company CEOs emerged in an analysis of 247 recent proxy statements….
Link to article

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SEC Chief to Press Global Rules
wsj.com, May 28, 2008
The head of the Securities and Exchange Commission is expected to call for creation of a body to oversee the setting of international accounting standards….
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Chief Information Officer

The Practical Visionary
strategy-business.com, June 10, 2008
Today's chief information officer must enable the organization to meet its strategic goals and to envision goals that were never before possible.
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