General Topics – Reducing inventory for fun and profit

TANGRAM TECHNOLOGY | **Consulting Engineers**

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1.   Why worry about inventories?

The cost of inventory should be an area of constant concern to any business. Too much inventory not only eats up the working capital of a company and creates cash flow problems but it also needs additional space and people to manage it. The opposite problem of too little inventory can cause production delays and poor customer service. Getting the balance right is essential and one knee-jerk but ultimately doomed response is to require Just-In-Time (JIT) deliveries from the major suppliers. A better response is to implement 'The return of the JEDI' where JEDI is 'Just Enough Desirable Inventory'.

The real cost of inventory is estimated to be 30% of the total inventory held and if you hold an inventory of £100,000 then the cost per year is around £30,000. Little wonder that many companies now see inventory reduction as a method of freeing up cash and reducing labour costs. JIT or JEDI production methods can reduce inventory but there are other practical things you can do to start an inventory reduction programme.

Here are seven tips to change your business process to provide higher levels of service with less inventory.

2.   Improve the inventory accuracy

If you don't know how much you have or where it is, then it doesn't exist. A high inventory accuracy (a minimum of 95%) is an essential to starting any inventory reduction process. Inventory accuracy requires well-designed cycle counting systems. These can very rapidly pay for themselves by not only counting things but also identifying and solving inventory system problems. Don't just collect the numbers, analyse them and work to improve them.

3.   Reduce the lead time

Long lead times automatically mean more inventories as Work-in-Progress (WIP) in the system. A former client had a 16-week lead time (for windows!) and had 16 weeks worth of production on the factory floor at any one time – their main concern was to keep the saws going! The space used was enormous; orders regularly got 'lost' in the factory and close to £750,000 of cash was tied up as WIP. They didn't listen, they ran out of cash and they are no longer with us. Don't start to produce an order unless you intend to do something with it. Don't make anything for anybody, make them come and get it. Reduce your production lead times to a maximum of 2 days (it only takes about an hour to make a window so 2 days in the production system is actually excessive) and issue production orders only when needed on the shop floor.

4.   Increase the speed of operation

Inventory levels often have little to do with the level of customer service. They are more dependent on the time taken to replace the materials used. If it takes 4 weeks to replace an item, you need to reorder when are down to 4 weeks stock at minimum (JEDI) or you risk a running out of materials. Purchase from suppliers with short lead times and inventories can drop dramatically. Make lead times a key factor in the purchasing process. Short lead times can save more money than reduced prices.

5.   Eliminate process misalignment

Watch out for the 'economies of scale' argument. Buy in the same units that you sell in. If you sell tens of products per week then buy tens of the raw materials per week. Buying thousands of the raw materials to get 'economies of scale' is a recipe for disaster. It creates large quantities of inventory, slow stock movement, possible product obsolescence, possible product damage and it locks cash up as inventory. Buy what you need to match the customer consumption rate.

6.   Specialise and throw it out

Have you ever heard: 'If we don't carry that item then the customer won't buy from us', but where else can they go if no one else stocks it? What about 'We keep the mis-measures and quality rejects, someone will buy them some day' or 'We paid too much for it to throw it away' or 'It is written off so it doesn't owe us anything'. The simple fact is that the products will all still be sitting there: taking up

space, clogging the system and confusing people: get rid of them. Sell them now to generate some real cash (however small) for the business.

7.   Get rid of the stores area (and the store man)

Stores areas are great hiding places for inventory and you actually pay the store man to hide it! Make the operators and supervisors who use the parts responsible for ordering the parts and storing them in the production area (which is where the materials should be anyway). When they know that if they run out of parts then they stop work and don't get paid, they will order the right levels at the right times.

8.   Replenish based on market demand

Forecasts are simply educated guesses and their accuracy gets worse as they extend into the future. Use the market demand (and your high inventory accuracy) to replace the inventory as customers are actually buy products. Forecasts are always wrong and will either cost you money as excess inventory or customer service through lack of product.

High inventory levels are not a necessity; they are a failure of management to actually manage and are a real cash drain on your business. An inventory reduction programme can pay for itself by releasing real cash into your business, releasing space for production and at the same time improving your responsiveness. An inventory reduction programme will pay for itself many times over so what are you waiting for?