Inventory Management: Battle with a Double Edged Sword

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Inventory is usually a company's largest asset and is the lifeblood of most enterprises.

Though inventory management is so important, we often hear such confusing or contradictory phrases as the following:
Inventory is double edged sword
Inventory is a waste
Inventory is a necessity
Inventory is an asset

Too much inventory can destroy a company and too little can do the same thing. Indeed, the problem with a double edged sword is that is cuts both ways.

Having the right amount of inventory is of paramount importance. Everyone knows this: no inventory equals no sales. It is well known that you cannot sell out of an empty wagon.

Customers want it now

Imagine going to your local grocery store and not finding milk, bread, eggs, or the staples for which you visited the store. You would be extremely disappointed and you might never return to that grocery store.

How about this one? Imagine going to a gas station and you learn that they are out of gas. That would most likely be the last time you visited that gas station.

Consumers thrive on consistency. People want merchandise when they want it and if companies are not able to provide it, people will go elsewhere. Shoppers seek physical retailers to provide them with something they absolutely cannot get through online shopping. Whether the retailer uses in-store deals, sales or promotions, or rewards programs that encourage repeat visits, the main thing that retailers need is inventory.

What is the cost of losing a customer? What is the cost of your reputation? How do you quantify that? You need suppliers that can deliver on a deadline. Having inventory allows retailers the flexibility to plan and execute promotions, plan for new product launches, and provide excellent customer service -- which will ensure that customers remain loyal for years to come.

A good inventory management strategy improves the overall health of the business. It saves time and money. More importantly, it keeps customers coming back for more, as the retailer has built a relationship based on trust with the customer.

“Managing for the right sizing of inventory is goal that requires meticulous attention and sustainability to maintain the edge,” notes Stuart M. Rosenberg, an inventory consultant and expert. “The outcomes – improved customer service, increased sales, reduced costs and profitability – are well worth the endeavor.”

How Proper Inventory Saves Money

Money spent on inventory is money that is not spent on growth of the business. Find areas to prevent cash from being tied up in inventory that has little to no chance of moving.

Spoilage of perishables: If you’re selling a product that has an expiration date (such as food or cosmetics), there’s a very real chance it will go bad if you don’t sell it in time. Solid inventory management helps you avoid unnecessary spoilage.

“Dead” stock: Dead stock is stock that can no longer be sold, but not necessarily because it expired. It could have gone out of season or out of style, cannot be returned to the manufacturer, or otherwise has become irrelevant. Dead stock can be avoided via stronger inventory management.

Saving on storage costs: Warehousing is often a variable cost: it fluctuates based on how much product you’re storing. When you store too much product at once or end up with a product that’s difficult to sell – as with dead stock – your storage costs increase exponentially. Avoiding this will save you money.

Walmart fully understands the financial benefits of proper inventory management, even at scale with its 150 U.S. distribution centers and 4,700 U.S. stores. The company recently launched a program called “On-Time, In-Full” (OTIF), in efforts to add $1 billion to revenue by improving product availability at stores. Target implemented a similar program last year as part of a broader supply-chain overhaul.

Walmart will require full-truckload suppliers of fast-turning items, such as groceries, to “deliver what we ordered 100 percent in full, on the must-arrive-by date 75 percent of the time,” according to documents reviewed by Bloomberg Businessweek. Items that are late or missing during a one-month period will incur a fine of 3 percent of their value. Early shipments will get dinged, too, because they create overstocks.

By February, 2018, Walmart wants these deliveries to be OTIF 95 percent of the time. Its previous target was 90 percent, hitting a more lenient four-day window.

“Variability is the No. 1 killer of the supply chain,’’ Kendall Trainor, a Walmart senior director of operations support and supplier collaboration, said in a presentation to vendors earlier this year.

Improving Cash Flow

Not only does good inventory management save money, it also improves cash flow in other ways. Inventory is product that has most likely already been paid for with cash; you’re going to sell it for cash, but while it’s sitting in your warehouse it is definitively *not* cash.

This is why it’s important to factor inventory into cash flow management. It affects both sales (by dictating how much you can sell), and expenses (by dictating what you have to buy). Both of these factor heavily into how much cash you have on hand. Stronger inventory management leads to better cash flow management – i.e., money on hand.

When you have a solid inventory system, you’ll know exactly how much product you have, and based on sales, you can project when you’ll run out and make sure you replace it on time. Not only does this make sure you don’t lose sales (critical for cash flow), but it also helps you plan ahead for buying more so you can ensure you have enough cash set aside.

Techniques for Better Inventory Management

Inventory management is a highly customizable part of doing business. The optimal system is different for each company, based on the knowledge and experience of the staff overseeing inventory operations.

According to Rosenberg, the inventory consultant, this is the #2 of his 10 Deadly Sins of Inventory: having unqualified employees manage inventory. “Recognize that inventory management requires professional job skills, assign accountability for inventory management and unify inventory planning,” adds Rosenberg.

As such, every business should strive to remove human error from inventory management as much as possible. Let’s look at some methodologies.

1. Set Par Levels

Par levels are the minimum amount of product that must be on hand at all times. When your inventory stock dips below the predetermined levels, you know it’s time to order more.

Ideally, you'll typically order the minimum quantity that will get you back above par. Par levels will vary by product based on how quickly the item sells, and how long it takes to get back in stock.

Although it requires some research and decision-making upfront, setting par levels will systemize the process of ordering.

Of course, conditions change over time. Check on par levels a few times throughout the year to confirm they still make sense, and if needed, adjust your par levels up or down as needed.

2. First-In, First-Out (FIFO)

"First-in, first-out" is an important principle of inventory management. It means that your oldest stock (first-in) gets sold first (first-out), *not* your newest stock. This is particularly important for perishable products so you don't end up with unsellable spoilage.

It's also a good idea to practice FIFO for non-perishable products. If the same boxes are always sitting at the back, they're more likely to get worn out. Plus, packaging design and features often change over time. You don't want to end up with something obsolete that you can't sell ("dead" stock, mentioned earlier).

In order to manage a FIFO system, you'll need an organized warehouse. This typically means adding new products from the back, or otherwise making sure old product stays at the front. Warehousing and fulfillment companies typically do this already.

3. Manage Relationships with Good Communication

Whether you need to return a slow selling item to make room for a new product, restock a fast seller very quickly, troubleshoot manufacturing issues, or temporarily expand your storage space, it's important to have a good relationship with your suppliers. That way they'll be more willing to work with you to solve problems.

Obviously, the more you sell, the more you will order from them, and everyone makes money.

In particular, having a good relationship with your product suppliers goes a long way. You may be able to negotiate the quantities of minimum orders, so that you won't need to carry as much inventory -- reducing risk and saving on warehousing costs.

A good relationship isn't just about being friendly. It's about good communication. Let your supplier know when you're expecting an increase in sales so they can adjust production. In return, they should be in a position to let you know when a product is running behind schedule so you can pause promotions or look for a temporary substitute.

Rosenberg counts poor communication and lack of collaboration as the #4 Deadly Sin of inventory management. Rosenberg advises coordination first between internal departments – sales, marketing, customer service, finance – and further collaboration with outside suppliers.

4. Contingency Planning

A lot of issues can pop up related to inventory management. These types of problems can cripple unprepared businesses. For example:

- Sales spike unexpectedly and you oversell your stock – the opposite of having too much stock
- You run into a cash flow shortfall and can't pay for product you desperately need
- The warehouse doesn't have enough room to accommodate your seasonal spike in sales
- A miscalculation in inventory means you have less product than you thought
- A slow moving product takes up all your storage space
- Your manufacturer runs out of your product and you have orders to fill
- Your manufacturer discontinues your product without warning

It's not a matter of *if* problems arise, but *when*. Figure out where your risks lie, do some forecasting, and prepare a contingency plan. How will you and your team react when? What steps will you take to solve the problem? How will this impact other parts of your business?

For example, your marketing department may have already paid for advertising or prepared several campaigns for a product that has run out or that has been discontinued. Even your marketing department can be made aware of the risks inherent in inventory management and can plan accordingly. They might be able at the last minute to swap out advertising creative for another product, thereby maximizing marketing spend.

5. Regular Auditing

Regular reconciliation is vital. In most cases, you'll be relying on software and reports from your warehouse to know how much product you have in stock. However, it's important to make sure that the data matches up. There are several methods for doing this.

Physical Inventory: A physical inventory is the practice is counting all your inventory at once. Many businesses do this at their year-end because it ties in with accounting and filing income taxes. Although physical inventories are typically only done once a year, it can be incredibly disruptive to the business. If you do find a discrepancy, it can be difficult to pinpoint the issue when you're looking back at an entire year.

Spot Checking: If you do a full physical inventory at the end of the year and you often run into problems, or you have a lot of products, you may want to start spot checking throughout the year. This simply means choosing a product, counting it, and comparing the number to what it's *supposed* to be. This isn't done on a schedule and is supplemental to physical inventory. In particular, you may want to spot check problematic, promotional, or fast-moving products.

Cycle Counting: Instead of doing a full physical inventory, some businesses use cycle counting to audit their inventory. Rather than a full count at year-end, cycle counting spreads reconciliation throughout the year. Each day, week, or month a different product is checked on a rotating schedule. There are different methods of determining which items to count when, but, in general, items of higher value will be counted more frequently.

6. Prioritize With ABC Analysis

Some products need more attention and resources than others. Use an ABC analysis, also known as selective inventory control, to prioritize your inventory management. Separate out products that require a lot of attention from those that don't. Review your product list and categorize each product as follows:

A - High-value products with a low frequency of sales

B - Moderate value products with a moderate frequency of sales

C - Low-value products with a high frequency of sales

Items in category A require regular attention because their financial impact is significant but sales are low and unpredictable. Items in category C require less oversight because they have a smaller financial impact and they're constantly turning over. Items in category B fall somewhere in-between.

Rosenberg's Deadly Sin #8 is keeping too many SKUs in too many places. He also advises implementing an ABC analysis program in which inventory is segregated by volume of sales; stocking policy is based on velocity; and C items would be centralized in one distribution center or at the very least, separated from the A and B items.

7. Accurate Forecasting

A huge part of effective inventory management comes down to accurately predicting demand. There are so many variables involved and you'll never know for sure exactly what's coming—but you can get close. Here are a few things to look at when projecting your future sales:

- Market trends and the overall economy
- Last year's sales during the same week
- This year's growth rate
- Guaranteed sales from contracts and subscriptions
- Seasonality
- Sales of products sold by your competitors
- Upcoming promotions
- Planned advertising and marketing spend

No doubt, you have access to reams of data that can address all of these concerns. Use analytics and data visualization to have the most complete picture of your inventory forecast. Lean on your current ERP and other software vendors to help you glean the best insights from your data.

8. Dropshipping

Dropshipping is often considered an ideal scenario from an inventory management perspective. Instead of having to carry inventory and ship products yourself — whether internally or through third-party logistics — the manufacturer or wholesaler takes care of it for you. Basically, you completely remove inventory management from your business.

Many wholesalers and manufacturers advertise dropshipping as a service, but even if your supplier doesn't, it may still be an option. Products often cost more this way than they do in bulk orders, but you won't have to worry about expenses related to holding inventory, storage, and fulfillment.

Inventory Management as Your Brand

Your customers may hold the best insights for proper inventory management. The data you collect on shopping habits and patterns can go a long way in helping you provide more accurate forecasts and keep your inventory management in tip top shape.

When consumers are asked why they choose to shop in a particular store, the number #1 response is most likely “unique products” or “attractive pricing.” “Always having an item in stock” could be named as a benefit, but is usually to a lesser extent.

“If your organization is constantly putting out fires on a daily basis to meet customer demand, then you are losing the ‘war’ to keep customers and gaining new sales,” cautions Rosenberg, the inventory management expert.

The pervasiveness of e-commerce has given consumers the sense that a store will always have an item available in stock. In fact, consumers now demand it. Effective inventory management builds relationships with your customers in ways that they may not verbalize, but they trust you to be there for them.