

Take Back Control of Your Inventory

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My business depends on selling goods out of inventory, and I've got a real problem. I'm not making enough money. Sometimes I don't have the right items on hand. Sometimes I get stuck with things I thought would sell, but don't. I have a warehouse full of stuff, and I need to do a better job of turning that into profits. What do you suggest?

There's real money in managing inventory. Keeping supplies in stock can be a real challenge. Any company that carries inventory needs to know as much as it can, about how to develop systems to keep things under control – whether it's a company that sells wholesale, sells retail, or manufactures and distributes. So, let's get started.

We'll look at the profit killers, the inventory problems that get in the way of making money. Then we'll talk about what you can do with customers to better forecast demand. We'll talk about inventory turns and profit margins. We'll finish up with strategies you can focus on to shift to less loss, more profit.

Dead inventory is stock that is sitting around, with no place to go. There are lots of factors that contribute to dead inventory: ordered in error, kept around too long, promotions or sales requests that didn't meet expectations. Regardless of the reason, inventory without a ready

buyer ties up cash flow, and take up shelf space. It gets in the way of ordering inventory that you can sell, or use to produce goods that you can sell.

Ever wonder what is the cost of dead inventory? It's higher than you think. Divide the cost of dead inventory by your net profit, and that's what you'd have to bring in, from the sale of other inventory or manufactured goods, in order to replace the dead inventory you're carrying. Let's say that your net profit, after cost of goods sold, overhead and salaries, is 5%. And let's estimate your dead inventory at \$1,000. Dividing \$1,000 by 5%, tells you that you'll have to sell \$20,000 of other products, to bring in enough money to pay for that \$1,000 in inventory you've declared as dead.

When planning stocking levels, you want to find the balance between too much, and a safe minimum level. Variables include how often you order, how much you order, quantity price breaks and seasonal price breaks, product availability and lead times, and competition for products. Inventory theory indicates that more frequent ordering cycles, lower quantities on each order, generally result in higher profit. Remember, the greatest discount in the world on a big quantity order won't make up for declaring inventory dead later on. Buy only what you need,

and sell all of it, by ordering in shorter cycles.

As much as possible you want to order specifically to meet known customer demand. That's where your sales people come in. Make it part of their job to predict customer demand, based on becoming intimately familiar with each customer's business plans. Have enough relationship with the majority of your customers that you can get an idea of their plans 6 months – 1 year out. This allows you to more accurately plan a portion of the demand you will have to supply in the future, and for which you will have to buy inventory in the near term.

On the other hand, your sales people may come in with requests for special orders. Or your buyer may identify a great new product they're sure will sell out as soon as you get it. When trying out something new, get a firm order from customers before you place your order. Or, limit the quantity you purchase to a small trial, until you're sure it will move off the shelves. Make money by playing it safe, not by taking big risks.

If you have to order a large quantity of a new product, test the market before you order. Find out how much of that type of product has sold in your market before. Have an advertising campaign, internet marketing program, or other promotion ready to go to support the movement of the

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product. Watch how things move, and if they aren't moving, act fast to promote them more, so they do move off your shelves. Remember, it's cheaper to market and sell, than it is to write off, once you have an item sitting in inventory.

Knowing what your customers want, positions you to shop more effectively. You can look for opportunities to lower cost by substituting goods of equivalent quality but lower cost. You can also look for alternative sources that can provide higher quality or more reliability, at a lower cost. Knowing what you'll need in the future also gives you time and clout to negotiate for lower unit prices costs, since you can commit to specific buying quantities, and have the time to shop for better prices.

One big problem with inventory received is damaged goods. Be sure that you have an inventory receiving process that checks every box that enters your warehouse, and matches it against the original purchase order. Later, on the same day that the goods are received, have someone in the warehouse take the time to sample cartons of goods.

On day one, open 5% - 10% of the boxes received, to sample for damages, and accurate packaging. If items are not intact, make written notes about what you've found. Immediately inform

your supplier by phone, and back it up with a follow up letter to your supplier, informing them as to damages found, and seeking their instructions on what to do with the damaged goods. Don't throw the damaged goods away, or send them back to the supplier, until you and the supplier are in agreement as to what will happen next.

The next thing you want to look for is slow moving inventory. Let's start by looking for inventory that turns over less than twice / year. An inventory turn is related to the length of time it takes you to sell of a specific order of goods. Let's say you ordered three items, and Item #1 sold out in 1 month; item #2 sold out in 2 months, and item #3 sold out in 12 months. If your demand was steady for those three items, and you could continue to get the goods throughout the year, you'd have 3 different turn schedules.

- Item #1 would turn over 12 times (1 time / month x 12 months) during the year.
- Item #2 would turn over 6 times (1 time / 2 months x 12 months).
- Item #3 would only turn over once / year

When it comes to inventory turns, the higher the number, the better, so long as you're not giving the product away to make the turns happen – more on that in a minute. In our example above, item #1 would represent the fastest turn schedule, and item #3 the slowest. Since item #3 is so

slow moving, you either want to stop carrying it, or reduce the quantity you order, so that you turn over the inventory on hand more frequently.

If you can get to 5 – 6 inventory turns / year on your most profitable items and biggest volume of goods sold, and average 4+ inventory turns on your total warehouse, you're headed in the right direction. You may not be there right now, and if you're not, don't try to fix everything at once. Start with reasonable, tangible, short term goals. Focus on increasing your inventory turn by 10%. And expect that it will take a few months to see results, as you are dealing with a process that includes ordering, receiving, and selling – all of which take time.

Why are inventory turns so important? Because it is a measure of how long your cash is tied up, paying for goods you haven't yet sold. Freeing up cash to move product through your shop, by focusing on selling items with high inventory turns, will increase your cash flow. It will also clear space in your warehouse for more profitable goods. Many times business owners think they need a larger warehouse, only to find out that there was plenty of space available, once they got rid of the deadbeats.

What's next? Let's look at profit per item. Once you've identified

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inventory items that turn over at least more than 2-3 times / year, you want to find out which of those items are the most profitable. Each year, weed out 5% of your slowest turning, least profitable items. Add 10% to the top – items that turn frequently and generate good profit. Constantly focus on increasing the sales of the most profitable items with the highest turns. That's where the real money is.

Finally, look for variety, in both items you carry and customers you serve. If you sell only one item to one customer, and either that item become unavailable or obsolete, or the customer decides to buy elsewhere, you'd be in trouble. Of course, it's not usually as simple as one customer and one product.

You do want to regularly evaluate what goods you order and carry, and what customers you serve. Each year, are you testing new products, which may turn out to be contributors to future business profits? Try to implement the 10% / 5% model – weed out of the bottom 5% of your oldest, slowest, least profitable products, and add 10% newer, faster moving, higher profit products on the top. Take the same approach with customers. Focus the majority of your efforts on servicing good customers – high profit / limited demand. Weed out from the bottom the most demanding, least profitable, most troublesome to service clients.

Target for expansion your middle of the road clients who are, or could be, regularly buying the higher profit products that you expect to sell more of in the future.

In general, making money on inventory is a game of inches. You make money by paying attention to the details. Watching how every product moves, at what margin, purchased by which customers, is what you want to get good at doing. To do that, you probably need a good inventory management system, if you don't already have one. However, even the best inventory management system won't make up for a sloppy warehouse, or employees who don't keep track of what's on the shelves, or poor buying practices. Fix the basics, by focusing everyone on the importance of buying the right goods at the right price, and then keeping track of them until they are quickly sold and moved out of the warehouse.

Looking for a good book? Try the Essentials of Inventory Management by Max Muller.

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