Operational Excellence: Inventory Management

Inventory is a necessary evil. There are a few exceptions to that rule, but for most the goal is to carry the least amount of inventory possible. Yes, companies still have to service the customers’ needs, but must do it by committing the least amount of dollars to inventory to get the highest return on sales. The objective is increasing the velocity / turns through the system. Inventory velocity translates into a big contributor to a company’s bottom line profitability.

So how is it done? There are five specific areas that can be examined. They are often viewed as trivial, but these five areas hold the key to having the smallest inventory possible. In total, they represent an integrated approach to an inventory management policy.

1. **Assumptions:** There are no assumptions about inventory; every assumption must be challenged. Ask these key questions:
   a. Why is there inventory? Force the team to answer this question.
   b. What’s the real reason the company holds inventory? There are no right answers, only ones driving decisions.
   c. What drives the current level of inventory? Why?
      i. What are the business drivers relative to inventory?
   d. What in the current business model drives higher inventories? Why?
   e. What assumptions regarding how business is done need to be changed? Can they be changed?

2. **Space:** How is the space required to hold inventory calculated? There must be a formula. Ask these key questions:
   a. What is the process for adding space for inventory? Is it difficult or easy for people to add space? Why?
   b. What's the process for determining "how much" inventory to hold? Why? Is it meeting the needs?
   c. What's the process for calculating the space needed to support inventory requirements? Do people use it? If not, what happens? Why?
   d. Is inventory growing faster than sales? Why? If so, freeze all warehouse space and force the skus into the open.
3. **Process:** The first rule is to make sure there is a process for inventory management. The second rule is to make sure everyone throughout the company is using it. The process could be automated or manual because the system itself is rarely the problem. The use of and discipline in the system is what causes the problems. Ask these key questions:

   a. Are numbers provided in a timely fashion? Are they accurate? What are the "cut-offs?"
   b. Is there a documented method for inventory reconciliation in the warehouse? Is it based upon Best Practice?
   c. Do the IT systems "enable" work to be done or do they "dictate" work to be done? If they don't enable, what can be done about it?
   d. How much are the processes driving the level of inventory? Is there a buffer stock to compensate for poor processes, forecasts or systems? (JIC vs. JIT) Why?
   e. Does the demand planning process provide reliable numbers? Why?

4. **Suppliers:** It's important to understand how supplier deals impact inventory levels. The contracts, the side deals and the actual performance of suppliers all drive inventories up or down. Ask these key questions:

   a. How much buffer inventory is held due to suppliers? Is it a performance, quality or a supplier-capability issue?
   b. How much inventory is held due to transportation problems? Is it a performance, reliability or a capability issue?
   c. How much inventory is held due to in-house problems? Is it a performance, quality, reliability or a capability issue?
   d. How much inventory is held due to poor cycle time? Why? What can be done to improve cycle time?

5. **People:** Are the people integrated into the process of inventory management? People are the common thread in every inventory issue. Ask these key questions:

   a. Who is “responsible” for inventory management in the company? It must be a person’s name or the title of a specific position that does the work of inventory. Remember, where everyone’s responsible, no one’s responsible.
   b. Who "owns" inventory in the company? Owning inventory is the individual who makes the overall inventory decisions for the entire company. There will be a chain of individual "owners" but only one major owner.
   c. Who is "accountable" for inventory management in the company? To be "accountable" means that performance in the area of inventory management will be an appropriate part of the annual performance appraisal.
d. Who "pays" for the cost of holding the inventory? The cost of money isn't cheap.

Focusing energy on these five key areas will bear immediate fruit. It takes a lot of work, but it can be done! In the end, simply following the answers found to these questions leads to making necessary changes today, resulting in huge differences tomorrow.