Better Cash Flow Through Tighter Inventory Control

“We have to remember inventory is MONEY, not just pallets, parts and materials. It is a company asset.” - Charles (Chuck) Intrieri, C.P.M., CPIM, VE

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For the Distribution Industry
Excess and Obsolete (O & E) / Slow Moving Inventories (SMI) Management and Disposition:

How tight inventory controls helps maintain cash flow.

A company’s warehouse of inventory gives banks many clues about the operation’s efficiency, cash flow and overall financial health. If inventory controls are not in place, accessing credit lines and funds to obtain additional inventory may not be possible in today’s banking environment. **We have to remember inventory is MONEY, not just pallets, parts and materials. It is a company asset.**

There is a cost to handling inventory, warehousing it and not moving it quickly enough. With banks tightening up, there are less funds available. Companies need to control inventory levels and stock the right inventory.

Sure concentrating on “active” parts is also important, but never forget to manage O & E/SMI parts.

What signs indicate that a company’s inventory is excessive and could harm financial performance?

Companies can compare certain key performance indicators to similar businesses in their industry, looking at measurements such as inventory turns, return on investment and gross profit margin. Excessive inventory may come to light when the company begins feeling financial pains associated with too much of the wrong items or not turning inventory quickly enough. Cash flow might be tight, accounts payable may be excessive or aging beyond what is desirable. When assessing inventory flow and warehouse stock, the executive team should ask: How much inventory do we really need based on lead time to meet customer needs? Depending on the nature of the business, a company may be assembling products start to finish, producing a particular component or acting as a distributor. Regardless, when products are not moving efficiently, companies will struggle with cash flow, therefore limiting their ability to grow and prosper.

How does a company get back on track?

Careful planning, discipline and training are necessary so everyone involved, from purchasing to production and distribution, understands what steps are necessary to be competitive in today’s economy. One consideration is **implementing a lean manufacturing approach**, which will focus on improving the flow of the production process and **elimination of waste**. This process will establish effective controls and procedures that will require the buy-in of all departments and individuals and **improve the company’s bottom line**.

The Supply Chain department should establish a replenishment schedule for each inventory item, which will provide efficiencies in the flow of inventory and reduce overall costs. Establish measurable goals and objectives, such as inventory turns and return on investment, for inventory management, purchasing and sales personnel. Motivate these individuals to reach their goals by tying performance to compensation. Implementing these types of systems is a top-down process, which **requires management’s commitment to putting a process in place and training every employee to follow the system.** It is important to make everyone accountable and responsible.

What can a company do to ensure the processes are being followed?

Establish an inventory locator system along with a cycle inventory system that will improve efficiencies and identify discrepancies on a regular basis. Document all procedures and routinely test that they are being followed. Be sure effective security systems, both within and outside the facility, are in place to protect the company against theft. **It is critical to implement an Enterprise Resource Planning System (ERP) with an inventory management module that will enable management to capture crucial information and evaluate key performance indicators to assist in projecting customer needs. Providing tools, processes and procedures will assist in identifying and carrying items that will reap higher profit margins and improve cash flow.**
What can a company do in the meantime with slow-moving or obsolete inventory?

Implement a system to identify and eliminate slow-moving or obsolete inventory that is consuming valuable warehouse space along with capital. There is value in slow-moving and obsolete inventory items, but if these items pile up and sit over a period of time, they become worthless. Inventory that isn’t turning or is no longer relevant to a company’s process can sometimes be returned to vendors. Offer special reduced pricing to help turn the inventory quickly. Give salespeople incentives to concentrate their efforts on moving that inventory. Determine if there is a market via the Internet or scrap. Or, donate the items to charity and realize tax advantages (though first discuss this with your tax adviser).

Implement a Materials Review Board (MRB) and create a standard operating procedure (SOP) for the MRB’s function. Put together a cross-functional team to analyze Excess and Obsolete/Slow Moving Inventory monthly (include a sales representative). Obtain a list of slow moving, excess and obsolete inventory from Supply Chain/Inventory Management (which should have representatives on the team) and use Pareto’s 80/20 principle to analyze this list wherein 20% of the items on this list represent 80% of the total list. Have a chair person/coordinator of this team as well as a recorder/note taker. Go through each top item and put together an ACTION PLAN (recorder) on how to minimize and remove inventory that is DEAD and/or not moving. Keep moving down the list until you take disposition notes on all the items on this list.

This MRB team should also save space by managing RTVs (Return to Vendor) materials and RMA (Return Material Authorization) goods. RTV and RMA won’t move themselves, they need to be part of the team’s materials disposition plan. Obviously the vendor/supplier has to be aware and approve of the RTV. An RMA needs an RMA number to dispose of it. There should be standard operating procedures (SOPs) in place to manage RTVs/RMAs.

You can find companies that buy and sell excess and obsolete/slow moving material on line and have three (3) of them bid on O & E/SMI inventories. Chose the one with the best value overall for you. The goal is to gain space (LEAN initiative), obtain cash for this category of inventory by disposing of it. What good is it in your racks now? It is a good idea to let top management, and particularly finance about your disposition plans. They should “sign off” on your plans, so there are “no surprises down the road.”

You should continue and FOCUS on MRB monthly, with the same goals, but less items, to continuously improve O & E/SMI disposition, and the addition of new space (LEAN initiative).

The cross-functional MRB team should be acknowledged by top management for their efforts.

Why will banks scrutinize a company’s inventory management before granting loans?

Banks want proof that the money they lend a company for inventory investments will provide a good return. If inventory is sitting, it is not paying off debt. A bank will review inventory turns and ask questions about excessive inventory, slow-moving items, aged accounts payables and how all this affects cash flow. (If the company were moving and selling inventory, it would have cash to buy more rather than approach the bank.) A company will impress a bank if it has a well-planned inventory system in place.

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