

How slashing inventory can cost your business cash



BY TIM MCLEAN

We are in the midst of a global economic crisis, a major cause of which is restrictions in the availability of credit. All over the world companies are taking steps to preserve cash in order to reduce their need to lend from reluctant banks. Reducing working capital, especially inventory, is a great strategy to free up cash. In Lean Enterprise terms, inventory is waste because it does not add any value to customers. It also is the main cause of the long production lead times that we Lean Consultants seek to reduce. How is it then that the wrong approach to inventory reduction often ends up costing the business cash rather than freeing up cash?

Your inventory is a reflection of you

The inventory in your business is a reflection of how your business runs. Your batch sizes, product range, minimum order quantities, ordering and shipping processes, planning systems and the relationships you have with your suppliers all determine your inventory. When you first look at inventory you are likely to find some "low hanging fruit" that you can fix quickly such as obsolete items, stock in the wrong geographic location or items customers have promised to take but not received. Get beyond these obvious items and things get a bit harder. Chances are your inventory will be pretty close to the level you need to maintain the service you currently offer your customers.

Slash finished goods stock and lose your customers

The most hairy-chested inventory slashers will wield the axe on stock indiscriminately. "We will slash inventory by 30% [regardless of the consequences]". The consequences are that

The lean approach can not only free up lots of cash and acres of space, it also makes your business more flexible and responsive and will improve your productivity and service to customers.

customers don't get their product. This leads to lost sales in the case of stock items where the customer buys a competitor product or lost contracts in the case of many custom-made products. This tends to leave you with a hole in your sales budget and a lot of redundant stock for the customers that you don't have any more. So much for slashing finished goods!

Chop raw material stock and create a work in progress mountain


Raw material stock seems a softer target than finished goods. Slashing raw material inventory does not immediately impact customers and you can revert to expediting the goods to your site before you run out (sometimes). This failed strategy has a domino effect. For example, run out of wheels and you can't make cars. Even if you don't stop the production line you very quickly create a large amount of incomplete work in progress waiting around for parts. The value of this WIP is of course many times the value of the saving you made slashing your material stock in the first place. You will also affect customer deliveries and fitting the parts on the incomplete products is usually a pretty inefficient use of labour. Finally in process industries such as coatings or food, that one missing ingredient will usually mean that the partly completed batch will have to sit in a mixer or be temporarily packed off until the missing item arrives and can be added. This creates more waste and burns more cash.

So should we give up on trying to reduce inventory?

No!! As I said above, inventory is a function of how you run your business. Change those underlying business factors and you can permanently change your inventory without affecting service or productivity. At TXM our Lean

Consultants use a value stream map to help you see the waste in your supply chain and highlight the best ways to reduce it. The steps we typically use are:

- Try to completely eliminate processes. Taking out unnecessary steps can remove huge chunks of inventory.
- Combine processes and create "one piece flow". Put two or more processes into a cell where product flows directly from one step to the next.
- Reduce batch sizes. This often goes hand in hand with set up time reduction to ensure that smaller batch sizes don't lead to an increase in cost.
- Move away from "push" MRP based planning to a "pull" approach. No one in the world seems to be able to forecast anything at the moment so your chances of forecasting your material requirements are pretty low. A pull approach means that you only make and buy what you need when you need it in the quantity you need.
- Order and deliver more frequently. The biggest lever on inventory is replenishment frequency. Moving from monthly deliveries to weekly or daily can reduce inventory by an order of magnitude, even for imported items with long lead times.

In our experience the lean approach can readily reduce inventory by over 50%. Not only does that free up lots of cash and acres of space, it also makes your business more flexible and responsive and will improve your productivity and service to customers. 

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