

Avoiding Obsolete Inventory: Possession is 9/10ths of the Problem

by Rick Pay, as Published in IndustryWeek

Obsolete inventory is one of the largest components of inventory cost and often is larger and more costly than executives are willing to admit. Many suggest optimistically (and often sheepishly) that there is no such thing as obsolete inventory because it will sell ... someday. I have developed a new three-letter acronym for this to go along with JIT, RAW, WIP and FGI. It is "GSM" for "Glacially Slow Moving"! Studies related to inventory cost and inventory reduction prove that obsolete inventory does in fact exist, along with the warehouses, containers and trailers to hold it. Warehouse personnel will express how frustrated they are because the inventory takes up prime bin locations and gets counted, recounted and moved many times during its life. Most companies are busy searching for ways to return, sell, give or throw away obsolete inventory, but the important question isn't how to get rid of it, but how to avoid it in the first place.

Why does obsolete inventory build up? The root cause is uncertainty in both supply and demand. Reduce the uncertainty and you diminish your exposure to obsolescence. Three tools can accomplish this: 1) sales and operations planning; 2) auto-replenishment systems; and 3) "ramp-up/ramp-down" discipline.

Sales and Operations Planning

If you are experiencing growth in obsolete inventory, missed forecasts, reduced earnings and increased backlogs, consider taking major action through sales and operations planning (S&OP). S&OP strategies closely integrate the supply and demand planning processes that allow the business to provide the right products/services at the right time in the right quantity at the lowest possible cost. A tight connection between operations capabilities and sales demand planning enhances profitability, performance, customer satisfaction and return on investment, all while lessening exposure to potential obsolete inventory. Recent studies by the Aberdeen Group show that S&OP can boost profitability, delivery and cash flow, regardless of company size, by as much as 40%.

One of the key traps associated with demand planning is the optimistic view that new products or promotions will generate high sales. Many a company executive has been stranded with major amounts of excess inventory after ordering surplus materials/parts in anticipation of demand. Inflexible operations and supply chains require a gamble of sorts to ensure that the demand can be met. For example, many companies have ordered container loads of parts from China only to see the anticipated demand

fail to materialize, leaving them holding mountains of inventory. Some companies make it worse by renting warehouse facilities to store it all, increasing costs in an already bad situation. Flexible operations, supplier partnerships and agile supply chains help prevent this catastrophe.

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Auto-replenishment Systems

Auto-replenishment systems, which help reduce supply uncertainty, are another valuable means of preventing obsolete inventory. As the name suggests, they automatically replenish inventory without using systems such as MRP. The two most widely used are vendor-managed inventory (VMI) and kanban. Recently I helped a client almost double its inventory turns (from six to 11) in about six months using these methods. During the same period, the client trimmed its average order lead-time from more than 90 days to about 30 days, and the numbers are still improving.

The VMI approach asks suppliers to come on site to determine needed inventory, order it, receive it and often even put it away in point-of-use locations. While such systems must be managed correctly, VMI has the power to reduce not only stock-outs and excess inventory but also handling and transaction costs. Kanban, a Japanese technique that uses a card or other visual trigger to replenish inventory, is usually implemented as a two-bin system. When one bin is empty, the in-house or out-of-house supplier receives a signal to replenish in a fixed quantity. Both approaches can improve overall inventory turns and accuracy, while reducing stock-outs.

VMI is not without traps. If the programs are not carefully designed and monitored, suppliers will over-fill the bins, potentially resulting in excess stock. Many a salesperson, needing to make month-end or

quarter-end numbers, has aggressively replenished customer stock. While VMI can be a strong tool for inventory management, bin sizes and vendor activity must be monitored to ensure that the system is preventing, not encouraging, obsolete inventory.

Ramp-up/Ramp-down

The last technique is what I call "ramp-up/ramp-down." This is the process of introducing new products and parts into the inventory system and eliminating old ones, and it prevents overstock in anticipation of a spike in sales. During the ramp-up phase, buyers should carefully monitor results to determine if sales are meeting the targets and communicate closely with suppliers to update plans frequently and set appropriate restocking levels. Even before the sales process starts, the materials group can collaborate with design engineering to suggest common parts that will help reduce the quantity of part numbers and the potential for excess stock.

Ramp-down is the process of systematically reducing the quantity of products and parts that are going to be superseded. Companies are often hesitant to discontinue old products, thinking that there may still be customers who will need it, or in the excitement of rolling out a new product, they fail to plan the slowdown of the old one. By making last-buy offers to customers, salespeople could actually boost sales levels in the short run. Buyers should adjust their restocking plans with suppliers to flush the entire supply chain. Regardless of how a company implements its ramp-

down, someone specific (usually in the materials group or purchasing) must take charge of the process and remain actively engaged with sales and new product development.

Finally, what gets measured gets managed. Hold people accountable by establishing key performance measures for obsolete inventory, set a level of acceptable obsolescence and measure write-offs against it, and monitor slow-moving inventory through turn and earn reports to help ensure levels don't creep up unintentionally. Use the "ABC" classification to rename obsolete or slow-moving items as "D" stock to help it stand out in reports. Then clean out the old stock.

Do you have obsolete inventory? Are you willing to own up to it? If you're ready to reduce your GSM quotient, take a close look at what S&OP, auto-replenishment systems and ramp-up/ramp-down can offer. These three approaches, properly implemented, can help you avoid

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