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7 ways to fix your inventory turnover challenges

Tips to reduce your inventory levels while increasing service levels.

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7 ways to fix your inventory turnover challenges

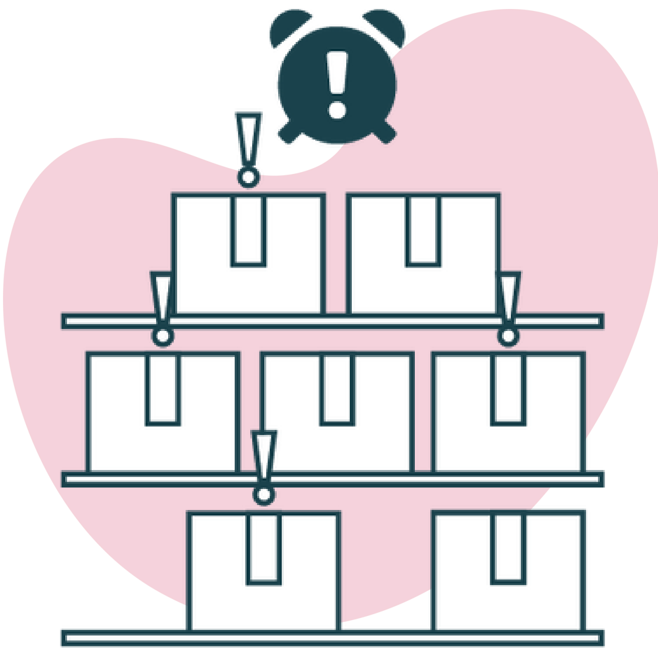
It's difficult to know what to do when your inventory turnover is only three times a year and your competitor's is five...

You might think the logical option is lowering your inventory levels to focus on medium- and fast-moving items as a quick win.

While you might see quick results, such as five turns per year, your expedited purchasing costs will increase, and your service levels (stock availability) often fall.

Rather than optimising a single supply chain key performance indicator (KPI), such as the inventory turnover rate, you need to look at the bigger KPI picture.

To achieve sustainable inventory reductions while maintaining or improving your service levels, you need to consider the variables around your inventory management. Too often, inventory is adjusted to meet financial goals without paying attention to the other KPIs that affect it.



There are several questions to consider when you're creating a long-term strategy for fixing your inventory turnover challenges:

- What are your demand history and demand variability?
- What is your supplier lead time and lead time variability?
- Do you have an efficient and effective supply chain framework?
- Do your manufacturing capabilities and customer purchasing patterns align?
- Are you using the most cost-effective logistics for procurement and delivery?
- What is the right target service level (a measure of product availability) for your business?

In this guide, we'll cover the top seven ways companies can better manage their inventory to reduce inventory levels while increasing service levels.

Why is your boss watching inventory levels?

Senior management teams closely watch inventory levels because they affect the company's financial reports and cashflow.

The bottom line is that inventory is expensive, typically comprising 40-50% of a manufacturing or distribution organisation's capital investment. This includes the stock-keeping units' (SKUs) value and inventory storage costs.

Inventory sits as an asset on the balance sheet and is usually a significant number that the executive management team and the shareholders don't like, as it highlights money tied up that can't be spent elsewhere.

So, what else should management teams consider when it comes to inventory levels?

Many KPIs need measuring and managing simultaneously to get a holistic view of your inventory performance. Some of the top KPIs for inventory management include:

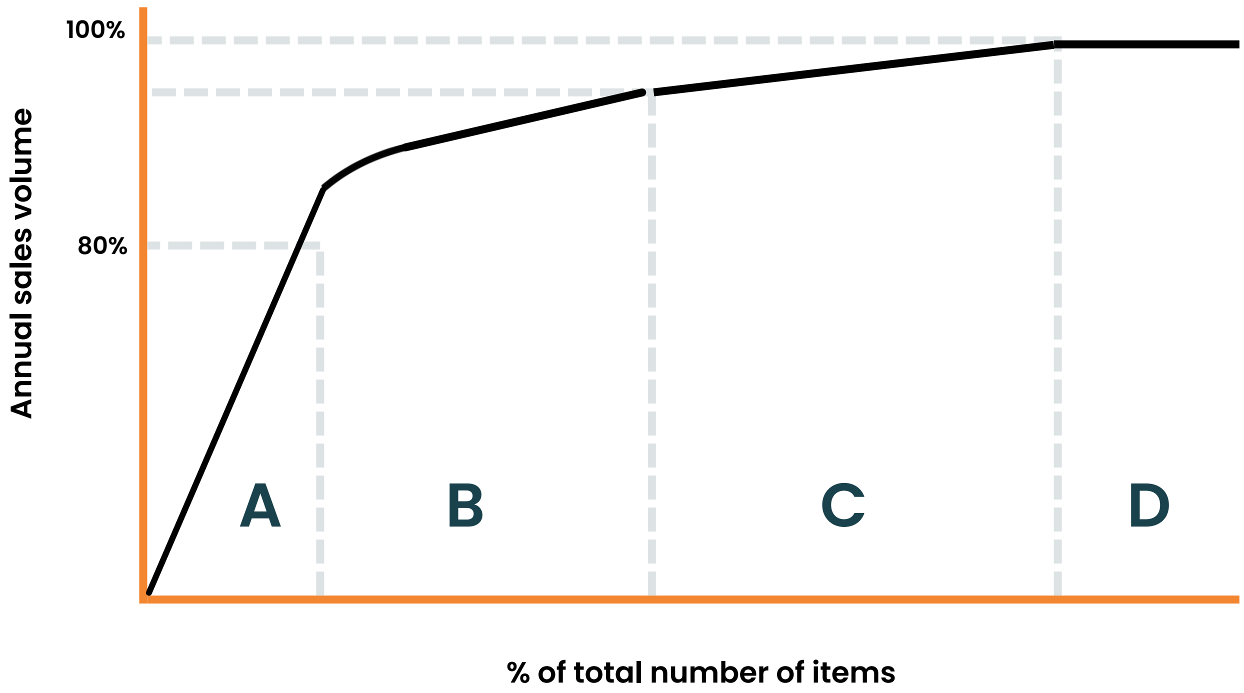
- Service levels
- Amount of capital tied up in stock
- Inventory turnover
- Back-order recovery
- Supplier performance

The key to sustainably reducing inventory is focusing on the input variables. Remember, the overarching goal of any organisation is to maximise long-term profits and success. Any attempt at reducing inventory should be made with this goal in mind!

1
ABC inventory classification

ABC inventory classification is about dividing your stock into different groups based on the Pareto Principle, also known as the 80/20 rule. This means 80% of your annual sales value comes from approximately 20% of your stock items.

With ABC classification, your SKUs are classified into A, B, C, (and sometimes D) segments, split approximately 80%, 15%, 5%, and 0%, based on the importance or the 'value' they bring the business. Value can be quantified differently, but the most common metric used is annual sales volume.



If your stocked A items represent only 50% of your annual sales volume, you may not have enough to meet your customer demand. Therefore, you must ensure that your essential A items account for 80% of your annual sales volume. If your C items account for 40% of your stocked items, they will tie up capital and risk becoming obsolete. For more on ABC analysis, download our eGuide.

2
Revised purchase order cycles and quantities

Another effective approach to increasing your stock turnover rate is making more frequent replenishment purchases in lower quantities, reducing the amount of overall inventory you carry.

Before you slash your re-order quantities, here are a few questions to determine if it's the best option for your business:

- Can your warehouse and your staff handle more frequent purchase cycles?
- Can capacity loss be offset by purchasing lower-demand items less frequently?
- Will transport or delivery agreements be adversely affected if you purchase smaller lots?

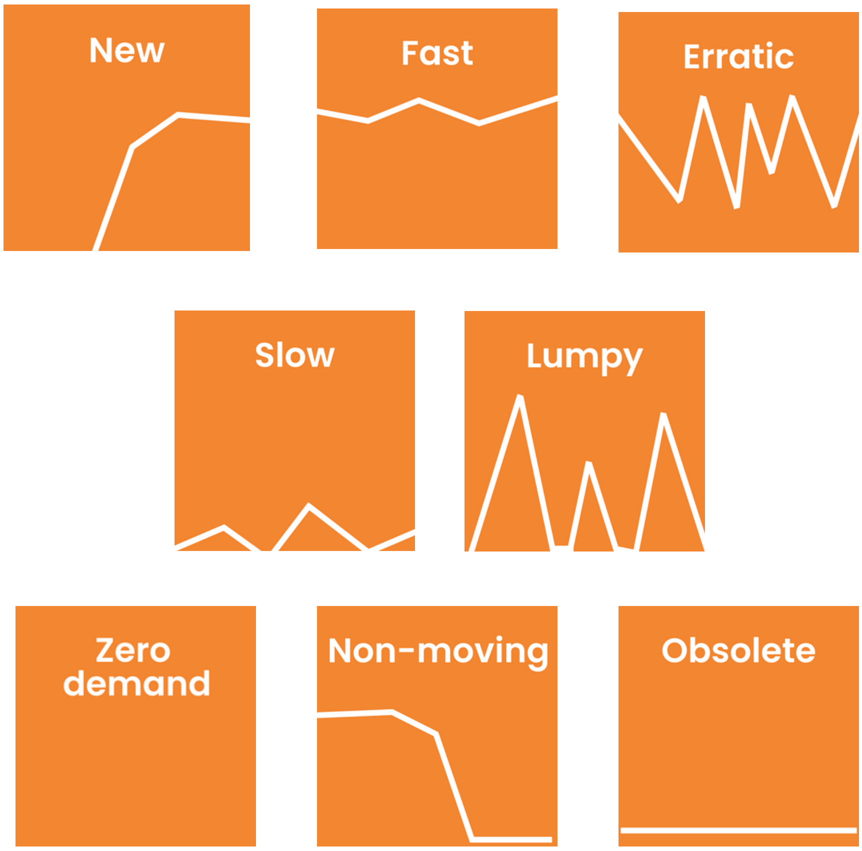
Determining order frequencies is one of the key variables in the supply chain. One way to adjust them is to keep the same number of annual orders but reallocate them among A, B, and C items while evaluating demand frequency to manage your order cycles and quantities more intelligently.

This strategy gives inventory managers more flexibility to align purchasing patterns with actual customer demand.

3
Know your demand types

If you analyse the historical sales data of every product in your warehouse, you'll find that the demand for different items varies considerably. Some products will have consistently high demand over time; others will have sporadic or low demand.

Managing their forecasting in the same way will lead to inaccuracies that could result in stock outs or excess stock. At EazyStock, we categorise all items into eight different demand types:



Identifying inventory demand types is essential as it should determine the type of calculations (or algorithms) you use for forecasting. For example, it makes statistical sense to use different algorithms to calculate the demand of a product with an erratic demand type to one with slow demand.

Demand types drive the techniques needed for accurate forecasting and help determine accurate safety stock and service level calculations – all of which help improve inventory turnover.

4
Improve inventory forecasting and forecast accuracy

When it comes to forecasting, the only thing we can really be sure about is that the forecast and the outcome rarely match 100% - so there's always room to improve its accuracy!

The starting point for a good demand forecast is ensuring data accuracy. First, you need to understand the factors driving the core of your demand. Then separate seasonality, trends and qualitative information, such as competitor activity or marketing campaigns. Finally, remove demand outliers. Use demand data as close to actual customer demand as possible, preferably point of sales data.

When you have the right inputs and clean data, it's time to review your forecasting methods. Accurate forecasts need continual analysis and calculation, so it's important to update data regularly as products move through their product lifecycles. By regularly calculating forecast accuracy, you can ensure your forecasting with the latest and most accurate demand types. Learn more about forecasting in our demand forecasting eGuide.

5
Eliminate excess and obsolete stock

Do you know how much of your stock is obsolete? Is it only being kept because the company can't "afford" an expense hit to write it off?

Once your inventory reaches the obsolete stage of its lifecycle, it's typically too late to see a profitable return on investment. How can you reduce the risk of writing off obsolete stock? With good inventory management policies and a better understanding of actual customer demand and product lifecycle trends.

Remember, if you don't address obsolete stock today, it will only continue to grow. Don't let the finance department affect operational decisions by enforcing poor rules; get obsolete inventory off the books and use that open warehouse space for productive and profitable inventory.

If you identify excess stock in your inventory – stock you have too much of compared to your forecasted demand – try to accelerate sales with the help of your marketing and sales teams before it becomes obsolete.

Reducing stock levels of items not in demand will often see drastic improvements in inventory turnover.

6 Understand customers' service level needs

A service level is the probability of not having a stockout. So a 99% service level means there's a 99% chance you'll have a product in stock when a customer orders it.

So what kind of service levels do your customers require regarding lead time and availability?

Providing higher service levels than required will cost your company money. Failing to meet customer expectations can also cost money through lost sales and a damaged reputation.

The key to setting service levels is understanding how your customers use your products and what they expect regarding availability and delivery time. For example, if a seven-day lead time is acceptable to your customers, then you might be able to lower your inventory levels and rely on smaller purchase quantities, reducing tied-up capital.

In today's competitive environment, however, you should not forget that customers have control. If you fail to deliver on time, customers won't hesitate to jump to one of your competitors. You might find that you have to shorten lead times and increase product availability to keep up with your competitors.

Whatever the case, it's essential to understand your customers' expectations, as they are crucial to your company's success.

7
Align company KPIs

Does it always seem like leadership, finance, operations, and sales are on different pages? Many organisations have departmental breakdowns when it comes to defining operational success.

Let's look at an example:

1. The finance manager is compensated based on ensuring a certain level of cash flow and keeping current assets under control. He likes to keep inventory low in the warehouse to free up working capital.
2. The sales manager is compensated for selling more products, so she wants all products held in the warehouse, so when a big new sales order comes in, everything is available.
3. The production manager gets a bonus based on operational efficiency, so he likes long, stable production runs resulting in lower unit costs, regardless of the forecasted demand.

See the conflict? Such a scenario can lead to the production manager producing excess stock to hit utilisation targets while the inventory manager stores the finished goods off-site to prevent inflating his carrying costs. When the sales manager closes a big deal and needs to expedite the stock from another location, there's a risk of losing the sale.

The bottom line is that everyone gets their compensation, but the supply chain is anything but efficient!

Create a holistic view

Inventory is the measuring stick of your entire supply chain, as it reflects its agility and profitability. Improving your supply chain processes is the only sustainable way to reduce inventory levels.

To achieve this, your organisation must tear down the walls between departments and create an end-to-end view of the entire supply chain.

Companies that keep a close eye on the following KPIs will effectively reduce inventory levels and improve inventory turnover:

- Target service levels
- Capital tied up in stock
- Back order recovery
- Supplier performance.

Automate forecasting, planning and replenishment

Many software systems, such as enterprise resource planning (ERP) platforms, support planners and purchasers with their day-to-day work. While ERP systems have many benefits, they often lack the functionality to help optimise inventory management processes.

Inventory planning and optimisation software, such as EazyStock, is designed to establish the optimal mix between inventory investment and service levels for every inventory item across your warehouse(s).

EazyStock will update all your inventory control parameters and ensure that all items are accurately forecasted and replenished. In addition, key performance indicators are automatically calculated and updated so you can easily track your service levels, capital in stock, back order recovery and inventory turnover!

EazyStock complements your existing business software. It helps you optimise your inventory levels, increase your service levels and minimise overstocking.

All of this leads to better inventory turnover and greater competitiveness in the long run.