

INVENTORY MANAGEMENT

A Better Way to Manage Inventory Dollars

Senior management measures inventory performance in dollars. Yet all of our inventory management tools are quantity driven. It's time for a better way to manage inventory dollars and to improve inventory performance in our supply chains.

By Gary Gossard

Inventory turns, the most widely used measure of inventory performance, is a dollar-driven metric; but the systems we use to plan and manage inventories, such as MRP, DRP and ERP, are all quantity-driven. These systems focus on having enough of the right parts at the right time, but when is enough too much? These quantity-driven planning systems aren't very helpful in managing inventory investment or the inventories we already have on hand.

As important as inventory turns can be to accountants, they are of little use to the materials planners and buyers who are actually controlling inventory levels on a daily basis. This is because inventory turns is backward looking—reporting the score after the game is over. It usually lumps all inventories together and includes factors beyond the control of the inventory planners or managers. Planners would be better served by knowing which inventories they need or don't need to meet future demand.

A number of companies are now using days on hand as a more dynamic metric because it can be based on future requirements rather than past usage. A recent survey by the *Inventory Management Report* shows that inventory turns is used by a two-to-one margin over days on hand, however, 20% of larger organizations now use both to report inventory performance.

Regardless of the specific systems used, senior management still evaluates performance of inventory managers in terms of dollars. Have you ever heard a CEO or a CFO say, "We have too many *parts* in the storeroom"? It is more likely that they have said, "We have too many *dollars* tied up in inventory." Since top management measures inventory performance in dollars, shouldn't we be using tools that do the same?

Perhaps it is time to consider a more effective method of managing inventories. One that is dollar-driven yet within the control of the planner; one that considers both future requirements and past usage; one that identifies good and bad inventories; one that measures performance by inventory segment; one that prioritizes reduction opportunities; and one that actually helps planners improve performance while making their jobs easier. Is this possible?

Yes. The Inventory Quality Ratio (IQR) is a simple technique for measuring inventory performance *and* for managing inventory dollars. The IQR logic was developed by the materials managers of 35 companies and was used by them to reduce excess inventories \$500 million while improving on-time deliveries. It has since been used by planners, buyers and supply chain managers in manufacturing and distribution companies worldwide to reduce inventories an average of 25%, most of it in the first six to nine months.

Consultants use the IQR logic as a diagnostic tool to assess inventory performance and identify opportunities for improvement. Its wider use, however, is as a continuous improvement program for inventory reduction. One well-known company was already turning inventories 30 times when it started using IQR. Within six months they increased to 40 turns and later to 42 turns. Whatever a company's current inventory performance may be, there are improvements that can be made by focusing on the dollars. Typical results are to reduce excess and obsolete inventories, increase turns, improve cash flow and profits, and avoid future write-offs.

There are more effective ways to use the data in your current MRP/DRP/ERP/SCM system. The IQR logic turns that data into useful information that can help you move beyond planning part quantities to actually managing inventory dollars.

Details of the IQR methodology have been presented at eight APICS International Conferences. Gary Gossard is President of IQR International. Other articles on this topic include: "Improving Inventory Performance and Bottom-Line Profits", "A Best Practice for Inventory Reduction", and "Improve Inventory by Working Smarter, Not Harder".

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