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5 Ways to Stop Wasting Cash in Inventory

by Betsi Bixby

When we do business valuations for marketers who want to know what their business or someone else's is worth, one of the criteria we measure is inventory efficiency. Why?

Inefficient inventory will reduce the company's value using any asset-based income model. However, more than just reducing the company's market value, it is also a huge waste of cash and most times, is easily fixable.

We find most companies think their inventory is just fine. It's at a level that they're used to seeing and that number becomes pretty comfortable. Unfortunately, comfortable isn't always the right number.

So, what is the right number? To get to that number, we begin by calculating days of inventory on hand. This is simply the inventory dollars on your last balance sheet, divided by the average cost of goods sold for one day over the last month. That is the number of days of inventory you have on hand.

Next, we compare that to what your inventory should be, which is 1.5 times your supplier frequency plus any lead time. For example, if you own stores and your grocery supplier comes weekly, take seven days multiplied by 1.5 and you get 11 days worth of inventory.

Let's use another example of a lubes warehouse. We find for most marketers, given lead-time and customer service issues, the maximum lubes on hand should be no more than 15 days. Yet the typical lubes warehouse will have 30 to 45, even 60, days on hand.

So here are the top 5 actions to reduce your inventory and increase the market value of your company:

1. **Reduce the variety of products.** Customers don't need 10 choices of everything. Figure out what your customers need and get rid of the rest. Major research on retail purchases has shown that by giving customers less choice and reducing decision time, velocity increased - resulting in more sales! In a lubes warehouse, think three brands - a premium brand, a mid-brand, and a value or house brand. Going beyond that scope may be alluring, but brand proliferation will normally hurt you more than help you.

2. **Reduce multiple sizes of the same products.** This isn't just about potato chips, it's about anything that you carry in multiple sizes. And don't always delete the midsize product. Study velocities in all sizes and reduce what makes sense.

3. **Add non-moving, slow-moving automated flags.** The reason why inventory often grows and grows is that customer's buying habits change, but the inventory stocking method does not. With today's software systems, there is no reason you should not get a big red alert when inventory is not moving.

4. **Assign single person accountability with performance pay.** We've noticed a simple trend - those companies with the best inventory levels have someone assigned and accountable. Most people in charge of inventory are worried about run outs more than they are about your cash. You can change this first through education and then with improvement bonuses, which are self-funded through cash savings.

5. **Reduce theft.** Video surveillance has become inexpensive, especially at cardlocks. Theft also occurs in warehouses and retail, both deliberately and inadvertently. Measuring, educating, internal reporting, and bonusing can cure the majority of internal theft and get employees watching vendors and customers on your behalf.

These five actions are not hard to do and they bring wonderful results. We teach additional state-of-the-art inventory methods in our M-Power™ coaching program and it has been personally gratifying to see the results. For example, we've had large lubricant marketers make seven-figure reductions in inventory that catapulted their values.

Action Step - Do the math on your inventory days on hand, then what it should be using Meridian Method formulas. The delta is how much cash you have sitting in inventory that ought to be in your bank account. My guess is that number will get you motivated!

Meridian Associates has been partnering with family-owned energy marketers for over 30 years to remove barriers to business growth and reduce stress levels. We've equipped over 4,000 leaders to grow their business and help their families thrive through our combination of high impact business coaching, Energy focused leadership events including a new and improved PMLI, which is now titled, Energy Marketers Leadership Institute (EMLI). Meridian helps Energy leaders strengthen their legacy.

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