"A contagious passion for Supply Chain Excellence"

Inventory Management is Hot

Inventories will remain hot

A lot has been said and done on working capital in 2009. Due to the crisis, many companies have substantially reduced their working capital in general and inventories in particular. We believe that working capital will remain a hot topic in 2010.

Why ? On the one hand, working capital remains on the agenda of the CFO's: although it is not as hot anymore, the benefits that have been obtained are monitored and need be guaranteed for 2010 because the recovery is uncertain.

On the other hand, in 2009 many companies have been working on the low hanging fruit and have cut their inventories on those items that were easy to intervene on: the high runners. However, not so many companies have worked on the basics to structurally improve their working methods in inventory management. This has become visible now that the business recovers. It is difficult to keep the low inventory levels without hitting the customer service. Companies are uncertain. What is the right inventory level and how should it be maintained?

Why inventory is important

Why should inventory be on the agenda? Inventory is a topic where shareholders can win 3 times when improving it.

Referring to the Dupont Model that decomposes the Return on Net Assets (or Return on Investment), inventory will improve the return by reducing the required assets. With the same profit, but with reduced assets, the return increases. This is the first direct benefit.

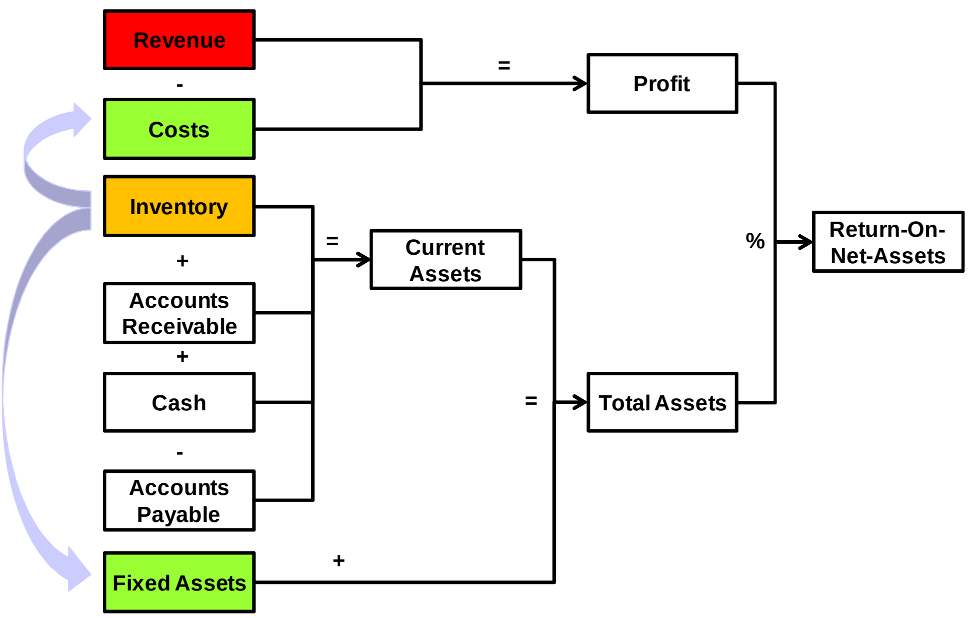

Figure 1 - Dupont Model

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But an inventory reduction also reduces the costs and the fixed assets. The costs will be reduced through reduced insurance costs, reduced risk of obsolescence, reduced storage costs if an outsourced warehouse is used, and reduced financial costs. Reducing costs improves the profit and the return. This is the second benefit of an inventory reduction.

Additionally less warehouse space will be needed, reducing the need for warehouse infrastructure and its related investment. In some cases, this means a reduction of need for fixed assets in the short term, but anyhow in a longer time perspective the same warehouse will still be used with increased sales (and thus revenues). Whether the fixed assets are reduced or the profit increases with higher revenues, reducing inventories will allow improving the return. This is the third benefit of an inventory reduction.

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