# Is Your Inventory Strategy Undermining Your Margins?

Inventory optimization initiatives promise to reduce inventory and working capital requirements while delivering higher service levels and improving gross margins. Capturing the benefits requires the deft application of the analytical tools combined with effective demand planning and scheduling, and inventory control processes.

## There are three outcomes of an effective inventory optimization strategy:

1. Better Service Levels
2. Reduced Working Capital
3. The Lowest-Possible Cost-to-Serve

Inventory optimization initiatives promise to reduce inventory and working capital requirements while simultaneously delivering higher service levels and improving gross margins. That may sound too good to be true, but as we've helped multiple clients realize, it is in fact possible to improve performance in every one of these areas at the same time.

The opportunity, as I'll explore in more detail, is framed by changing order fulfillment patterns and the capabilities of new inventory optimization solutions. Capturing the benefits requires a clearly defined business strategy and the deft application of the analytical tools combined with effective demand planning and scheduling, and inventory control processes.

When it comes to order fulfillment, the proportion of bulk shipments through distribution centers and wholesalers are flat or shrinking. Direct shipments to stores and individual customers continue to grow. Today, 61% of manufacturers are shipping directly to end customers, according to Aberdeen Group, which increases order fulfillment complexity and cost. Fortunately, as order fulfillment complexity has increased, inventory management capabilities have improved dramatically.

Current solutions can accurately calculate and predict the cost to serve for every product, customer and geographic region. Inventory managers can now identify the difference between actual and optimal inventory levels for each SKU, making it possible to re-balance and optimize inventory across your distribution network on a regular basis.

## Here's what inventory optimization means to your business.

Optimizing your inventory levels maximizes the profit potential from each order by not allowing your order fulfillment processes to undermine your margins. In some cases, gross margins can even be increased by lowering inventory levels and increasing "expedites" to support demand variability. In terms of operating metrics, best-in-class organizations report inventory turns 2X to 3X their industry average. They also report an average cash conversion cycle of 35 days, compared to 64 days for other companies. How does your organization compare?

Calculating the real-world trade-offs between service levels, inventory and costs, requires a combination of software capabilities and effective inventory management processes. Whether integrated into your ERP system or an add-on, your inventory management tool needs to provide guidance, recommendations and what-if modeling capabilities. Without modeling capabilities, managers may understand the high-level impact of proposed changes, but they won't be able to explain the impact on your P&L and balance sheet to your CFO. Effectively executing any recommendations depends on your inventory planning and control processes.

Best-in-class companies foster a true partnership between sales, marketing and operations. A formal S&OP process maintains accountability for inventory, service and cost performance. More specifically, leading organizations will conduct material plan audits to validate bill of material accuracy, routing accuracy and master schedule attainment. For inventory control, they have policies that account for all variables in supply and demand planning. So, yes, starting with a clear business strategy, you can reduce inventory and working capital requirements while delivering higher service levels and improving gross margins. The opportunity is especially significant for manufacturers with a complex product mix, multiple sales channels, demand volatility and varying lead time requirements, all of which have driven up inventory levels in the past. Determining the optimum inventory levels, and keeping them where they need to be, should be an ongoing priority for every manufacturer.

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