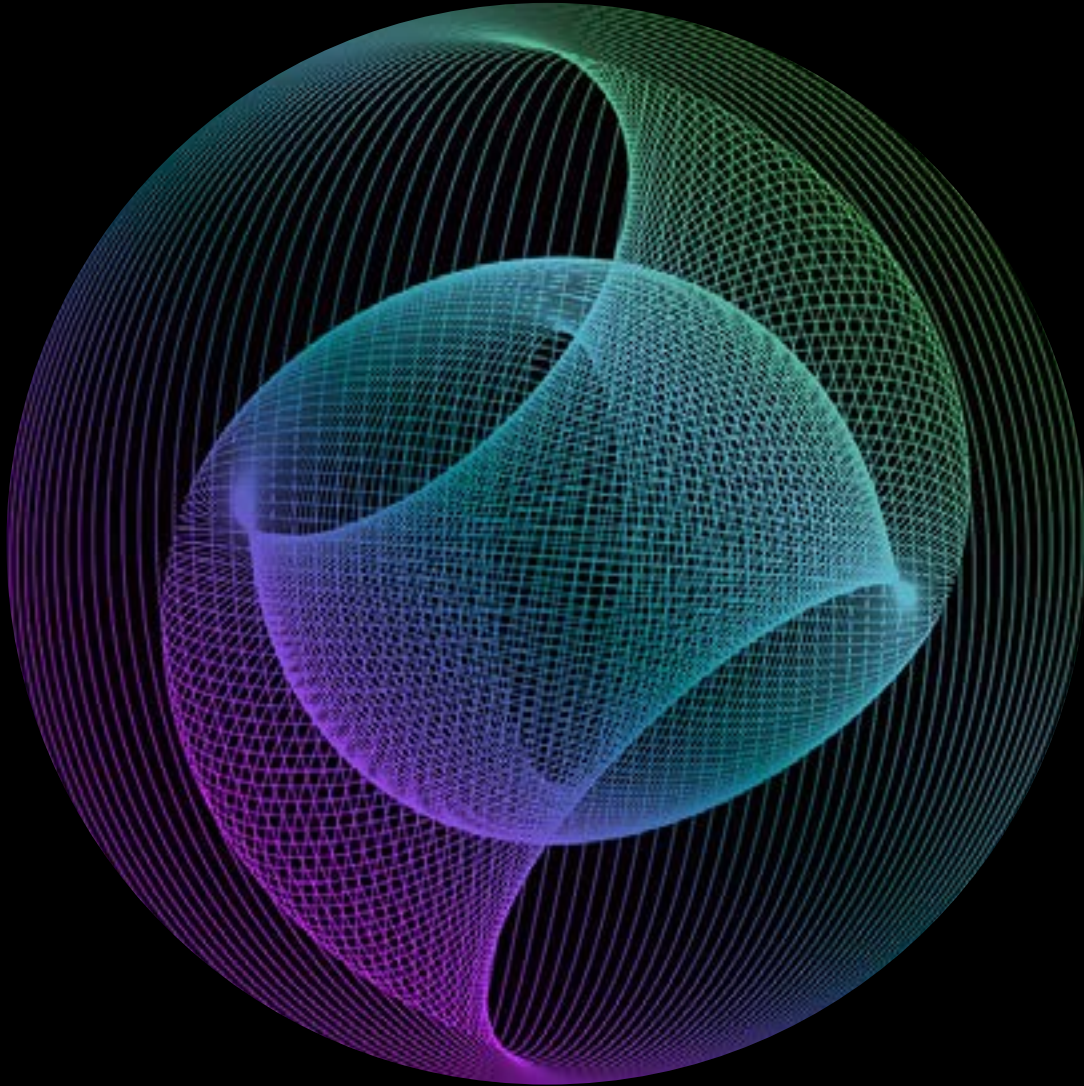
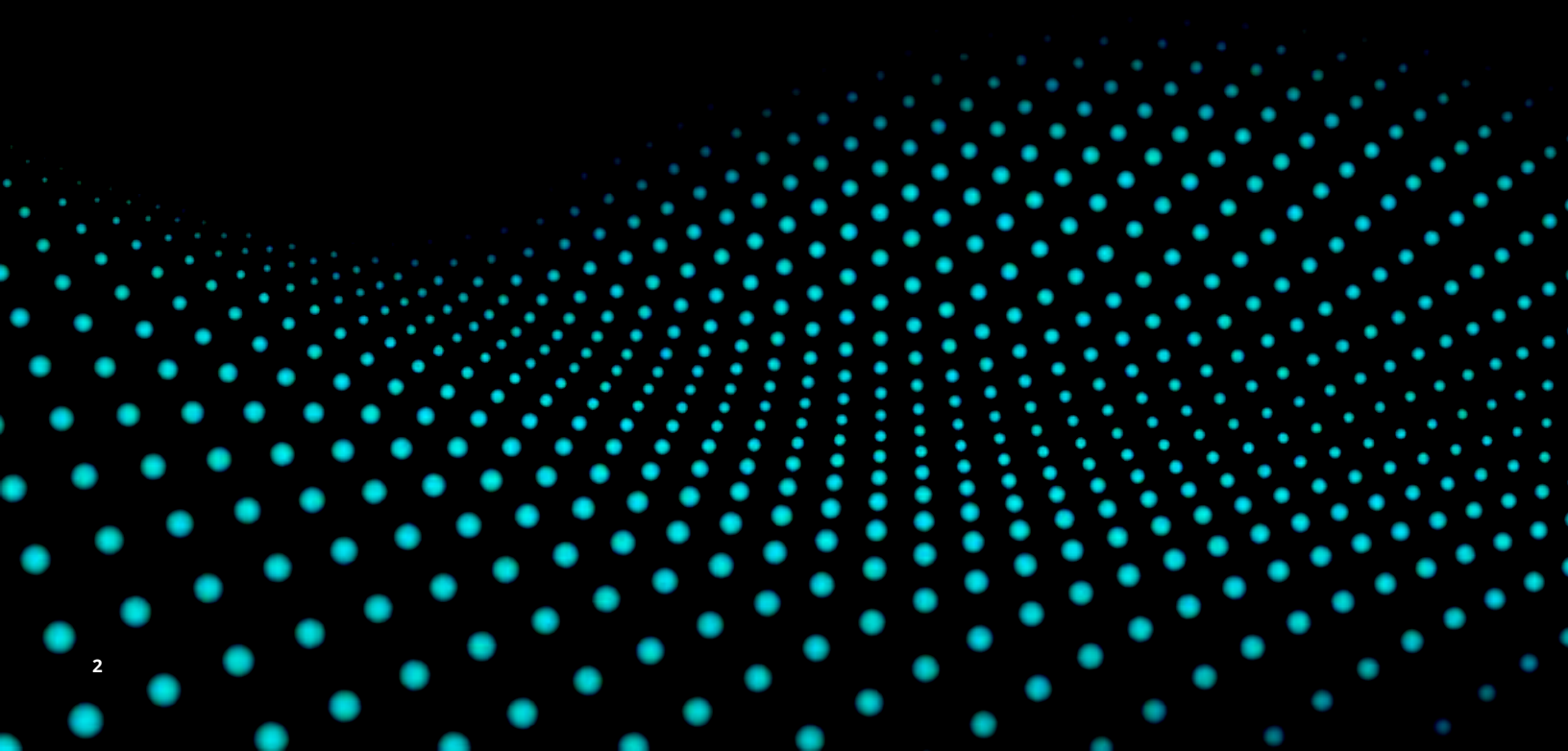


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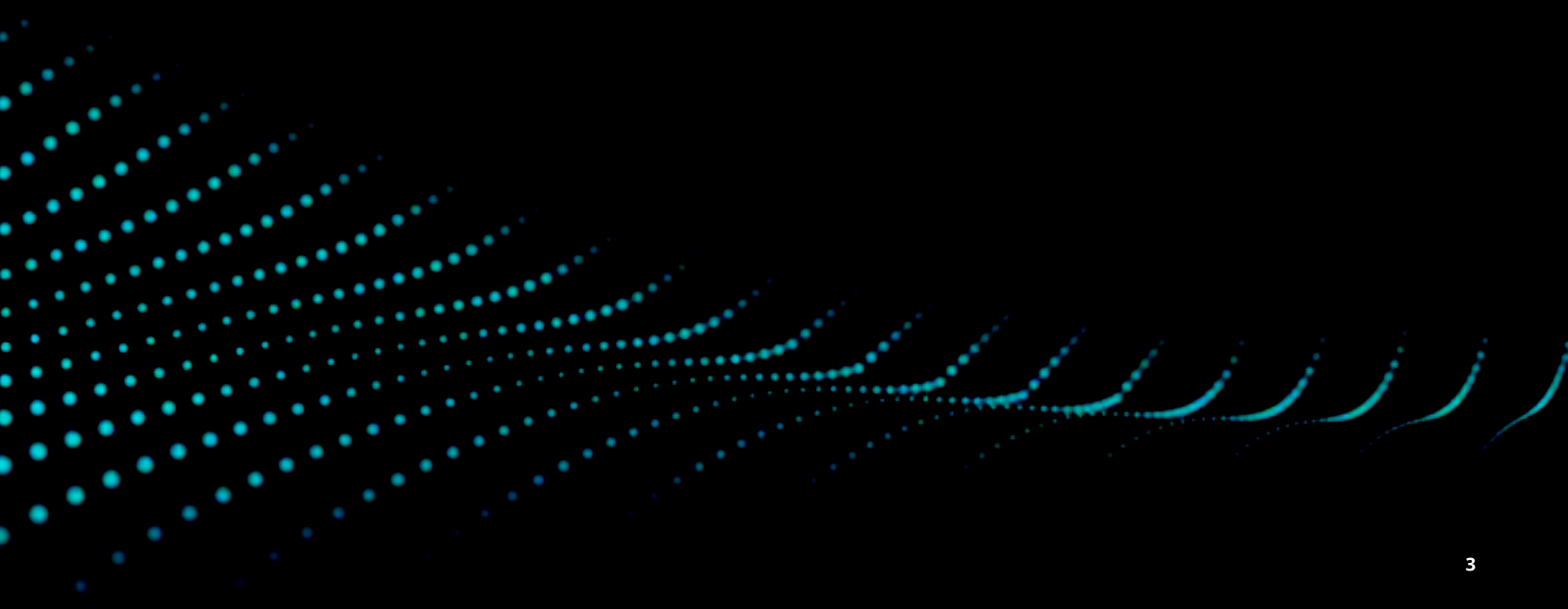
Make your
working capital
work for you

**Strategies for optimizing your
inventory management**



In today's business climate, organizations in every sector are under pressure to do more with less. That means businesses cannot afford to squander opportunities to free up their working capital. By giving you greater availability to the cash trapped on your balance sheet, a formal working capital strategy can deliver the added liquidity you need to fund growth, streamline processes, reduce costs, enhance service levels, and seize new investment opportunities as they arise.

While there are three working capital processes that can be improved upon to free up liquidity, this document focuses on freeing up working capital through the optimization of the inventory cycle, which includes the forecast-to-fulfill process from product planning and sales or demand planning all the way to delivery of goods and services.



Managing the inventory balancing act

The main challenge for every business is to determine how to ensure sufficient inventory to meet customers' demand, but not so much that it negatively affects cash flow and costs by sitting in a warehouse or on a shelf.

Resolving this challenge requires a delicate balancing act. Companies must balance the customer's needs and demands for products with the company's goals and supply chain capabilities in an integrated inventory management model where the right inventories are in the right place, at the right time.

A first critical step for businesses to consider prior to embarking on a working capital improvement initiative focused on improving inventory planning is to extend the responsibility for inventory management beyond the finance function. Everyone within the business must play a part—sales, marketing, product management, production planning, supply chain, procurement, finance, and IT must all be responsible in some way.

They must put an integrated process in place to identify shifting customer demands, spot seasonal variations, and identify potential new markets to provide the vital information needed to make informed decisions on material requisitioning, capacity planning, warehousing, and distribution. These efforts must be underpinned by the adoption of a performance improvement and cash-centric culture.

Such a process will enable the business to maintain minimal inventory levels without compromising customer service and being able to meet the needs of their customers.

Key considerations

The balancing process is unique for every company and varies depending on the industry and geography it operates in, market position, and company goals. There is no one-size-fits-all solution. The following considerations should be taken into account when optimizing inventory:

- **Product/service portfolio:**

Companies introduce hundreds and thousands of new products every year to gain a competitive advantage and boost sales through new products, product lines, variants of an existing product, or facelifting of an old product. Through mergers and acquisitions, the portfolio grows in complexity even more, contributing to multiple substitutes and duplicates. To increase portfolio performance, companies must put the revenue volumes into perspective with contribution margin, inventory-carrying and distribution cost, existing substitutes, variants, and other factors. Retiring the right product can be a delicate decision, especially so in rapidly changing environments. Products temporarily unavailable due to supply chain disruptions can be substituted by a similar product to avoid losing revenue or even the customer. By optimizing their product portfolio, businesses can reduce their lead times and cost, better serve their customers, and focus on products that bring long-term added value to the business and its customers.

- **Sales forecast/demand planning:**

Inventory levels: The right inventory level protects the business against sudden demand surges and inaccurate market forecasts while providing a short response time for the customer. Insufficient inventory can lead to financial losses, but also, in some industries, for example, health care, stock outages may have a significant impact on the patients and the company's reputation. Companies must find the right balance between acceptable lead times, lead time reliability, and inventory cost. The right set of planning variables and targets reflect demand variability, forecast accuracy, production lead times and utilization, and production changeover cost including delays in the supply chain.

- **Make to stock vs. make to order:**

Excess and obsolete inventory: Excess inventory is usually a result of poorly managed product management, disconnected demand and capacity planning, inaccurate sales forecast, or outdated inventory targets. To avoid excess and obsolete inventory, companies must align their inventory strategy to the product life cycle stage. A different made-to-stock vs. made-to-order strategy will apply to a product in its introduction, growth, maturity, and decline phase. The same applies to safety stock, which needs to be regularly reviewed based on the actual demand and monitored very closely in the maturity and decline phase of the product life cycle. Often, excess inventory results from overproduction to maximize capacity, workforce, and equipment utilization. A diligent trade-off calculation must precede any decision about overproduction to avoid excess inventory. Flash promotions, product bundling, free shipping, and other strategies are used to tackle excess and obsolete inventory, and the key to success is to prevent the front-end processes from generating it.

- **Warehousing and distribution strategy:**

Centralizing inventory through regional or national hubs reduces overall inventory levels and warehousing costs but also helps to optimize shipment to end customers, regardless of the channel they use to place orders. As an added advantage, centralizing inventory can often provide you with greater insights into customer purchasing patterns.

- **Capacity utilization:**

Inventory management and capacity planning usually stand on the opposite ends of the same equation. While inventory management strives for the right level of inventory to service the customer while protecting cash, the main goal for capacity planning is efficiency. This means maximizing production, workforce, and equipment utilization, which can only be achieved through bigger production batches, long production runs, lower changeover frequency, and optimized product sequencing. All these factors contribute to excess and potentially obsolete inventory and suboptimal service levels. That's why companies must regularly conduct a standard balancing evaluation during the sales and operations planning process.

- **Material requirements planning:**

A critical factor for material inventory management is the integration of material requirements planning (MRP) into the sales and operations planning (S&OP). Visibility of the production requirements is the key. The next step in the process is ordering and receiving inventory, which involves selecting between a centralized and decentralized inventory approach; determining when it makes commercial sense to place individual orders vs. ordering in bulk to keep shipping costs down; timing orders to take advantage of discounts; and deciding whether to place orders in advance or arrange for just-in-time delivery. For instance, if you source goods internationally, you may be required to place bulk orders in advance. Conversely, if you work with local suppliers, you may have greater flexibility to have individual orders delivered just-in-time. In the procurement process, it's vital to avoid early ordering, air freighting at the last minute, and ordering above the required volumes. Closely monitoring and updating the planning variables in the company's MRP system allow for early postponement, acceleration, or cancellation of an existing purchase order.

- **Monitoring supplier performance:**

Supplier scorecard became a standard tool across industries used to assess and manage supplier performance and to build a stronger relationship between vendors and the company. Consider tracking metrics such as delivered on time and in full, supplier errors, product quality, response times, prices, and departures from contractual terms. All this helps vendors to better understand your goals and priorities, improve performance, and strengthen the relationship in the long run. Your business can profit from improved delivery reliability, higher quality, and shorter lead times, which all lead to increased inventory performance.

Specifics of inventory in service business

Inventory in a service context can be a physical asset you can touch and buy and can also be an asset utilized in the delivery of a service. Spare parts and consumables are examples of physical assets that can be purchased or consumed during the delivery of a service, while seats in a movie theater or on an airplane are a form of perishable inventory used to deliver a service. Unused airline seats are considered excess inventory because no demand existed to consume the unused seat.

Managing the inventory in a service business that utilizes assets in the delivery of a service happens through detailed capacity planning. The unique aspect of assets utilized in delivering a service are the point in time and timing nature of specific assets. Unlike goods inventory, which you can store and sell later, you cannot sell the unused seats on the plane once the plane takes off.

Success of optimization strategies rely heavily on: people, processes and controls, data quality and visibility, and technology.

- **Master data:**

With data mastered and shared from one trustworthy source, the insights provided across businesses will allow for better decision-making and growth opportunities. Customer, vendor, product, production, inventory, and distribution master data and parameters must be kept accurate and up to date at all times to ensure quick, smooth processes without errors and delays.

- **Guidelines, policies, and internal controls:**

Internal guidelines and policies provide clear rules for internal and external stakeholders, and support an efficient decision-making process leading to a more efficient inventory and working capital management. Internal controls around inventory counts, inventory transfers, inventory adjustments, and procurement and sourcing practices ensure that inventory is appropriately safeguarded, replenished, and maintained.

- **Cash-centric culture:**

An awareness of how cash should drive company behavior and decisions and how every function can contribute to those cash goals is essential. Providing training, setting balanced cash targets, monitoring, and evaluating the cash performance, including cash performance into the employee performance plan, is the way to start.

- **Cross-functional teaming:**

To change people's mindset to cooperative teamwork instead of working in silos takes time and more than just implementing a new process or KPI dashboard. The environment of smoother communication, transparency, and constructive conflict resolution enjoys shorter lead times, improved flexibility and innovation, more engagement, and higher productivity.

- **Automation:**

Inventory leaders leverage integrated vendor and customer portals allowing all partners to see orders and future requirements in real time. AI-powered sales and demand forecasting help them to build predictive models by measuring historical data, customer behavior, and shipment data. Systems integrating inventory management, transportation, warehousing, and capacity planning provide real-time inventory visibility, reduce human errors, reduce time, and automate delivery to customers.

- **Visibility, reporting, and analytics with Liquidity/Q™:**

Tracking and reporting on KPIs is just a start to leveraging data to improve your decisions in sourcing and supplying of inventory. Organizations that are best in class focus on having a performance improvement mindset coupled with data analytics capability. Our Liquidity/Q™ toolset and suite of action-focused analytics and visualization provide deep insights into the level of inventory on hand, inventory movement, forecast variances, and planning parameter optimizations.

Choosing appropriate reporting levels

From an inventory perspective, common metrics include Days Inventory Outstanding (DIO), average inventory levels, order fill rates, inventory turnover and back orders, and capacity utilization. Additional KPIs to measure supply chain performance include forecast accuracy; stockouts; and on-time, in-full delivery performance.

The level and type of reports you generate will depend on the metrics you track. For instance, if you look at only high-level KPIs, such as DIO, your reports will be less granular than if you monitor detailed operational metrics, such as capacity utilization, supplier performance, lead times, back orders, and inventory turns.

Either way, the key is to select metrics relevant to your business that provide the right stakeholders with real insight into your operating decisions and working capital performance. Marginal improvements in KPIs can lead to real opportunities in inventory performance and can significantly reduce your working capital investment.



Getting cash fit

Accurately predicting customer demand and working with suppliers to adjust orders in real time are no easy tasks. That's why businesses need standard processes in place to track inventory performance, monitor demand patterns, maintain accurate inventory counts, and ensure suppliers adhere to their commitments. Approached strategically, and bolstered by executive-level support, this type of inventory management initiative can free up working capital and strengthen your balance sheet.

To help you realize these benefits, Deloitte's working capital professionals work with your teams to tactically implement new processes, monitor and track your performance, and share specific action items your staff can take to optimize your inventory management processes. You work hard to earn your cash. Isn't it time to get your cash working hard for you?



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