

Minimizing Slow-Moving Inventory

Abstract



Slow-moving and obsolete inventory (SLOB) is a result of inefficiency in the forecasted demand, where supply (materials or product in inventory) exceeds demand over a period of time. Amounting to an average of 3%-5% of revenue, SLOB is a small line item in the budget that offers the opportunity to recoup big dollars, if manufacturers can manage it more effectively. To do so requires the right strategy, the right data, and solid alignment between sales, operations, and finance but if it's done well it can represent "hidden treasure" that can be turned into working capital, warehouse space, or profit on the books.

This white paper provides an overview of SLOB management - what it is, why it matters, and how it can benefit the enterprise - as well as recommended strategies for optimizing this critical business practice.

Background

Inventory management is the lifeblood of every manufacturer. Having the right materials and product on-hand to meet delivery schedules requires ongoing sales and operations planning (S&OP). The focus on gaining an accurate understanding of the backlog (what we have on-hand) versus near-term/mid-term demand forecasts to determine what we need to source or build to meet demand. Having an excess of product in inventory can lead to that product becoming SLOB. SLOB inventory is the "dead weight" of manufacturing, because it impacts several aspects of the business, drawing on resources in different ways.

One of the most obvious issues with SLOB is that it occupies valuable space in warehouses and distribution centers; space that could be housing faster moving and more profitable products. While it sits idle it drives up carrying costs, tying up cash that could be put to better use. It also has to be expensed into an accrual account, reducing

profitability in the period,. Taken together, it's estimated that obsolete inventory can cost 25-30% more than the cost of the goods themselves.

Beyond the hard and soft-dollar costs of SLOB, it often hides other costs to the business that are less evident. For example, sometimes inventory becomes slow-moving because we've lost touch with customers and what they need, designs change, technology shifts. This can erode customer confidence and can result in the need to win back business with existing customers.

Root Causes of SLOB

SLOB can not be avoided, only managed. As customer needs change, competitors retool, product engineering changes or other factors shift, the products we buy and build today to meet the needs we know about may go stale on the shelf. It's part of the physics of being a manufacturer or distributor of physical goods.

What You Can Control

- Demand forecast accuracy
- Customer input and intimacy
- Plan for avoiding or mitigating SLOB
- Design Control for common components
- Managing on-time delivery

What You Can't Control, Only Manage

- Market Conditions
- Changes in customers' businesses
- Fluctuating demand patterns
- Competitive pressures
- Other economic factors



Financial View

To really understand the impact that SLOB can have on a business, it's important to understand the accounting treatment of it. A percentage of annual revenue (typically 3%-5%, unless there is data to support a lower number) will be allocated across 12 months.

As the year goes by the SLOB expense account is funded by net income, effectively reducing the business's profitability. At 3-5% of revenue, SLOB can reduce profitability in a business with revenue of \$10Million by \$300K-500K.

With this understanding, we can look at different approaches to handle slow and obsolete inventory and how they impact profitability. This understanding provides a foundation for evaluating the roles the sales, operations, engineering and finance all play in the process of disposing of SLOB for maximum organizational value, and increased profitability.

Overview of Common SLOB Management Strategies

Many manufacturers lack strategies for proactively managing SLOB. This often occurs in organizations that don't have robust ERP or inventory management in place or where there is a lack of alignment between engineering, operations, sales, and customer service as to the roles each can play in mitigating it. Organizations tend to focus on higher-volume products that drive revenue and profitability and "don't have time" to stop and evaluate how to deal with the slower moving or obsolete products that are cluttering the warehouse. During periods of high growth and profitability SLOB management is often deprioritized and the associated costs are less obvious. However, making time to develop a strategy to convert this inventory to cash on an ongoing basis can prevent the need to make deeper cuts in other operating budgets.

Typically there are two approaches manufacturers take to managing slow-moving and obsolete inventory; a team-based approach or a systems-based approach.

Team-based Approach

This approach can be extremely effective in generating value from obsolete inventory. It involves a multi-functional team representing the disciplines of estimation, purchasing, design engineering, customer service, sales, and operations. This team works together on an ongoing basis to evaluate slow-moving or obsolete inventory (specific items) to determine how they can be repurposed, sold to other manufacturers or otherwise converted to cash.

Following is a brief overview of the role that each person plays in this approach. These roles assume a

Estimating Engineer - Works with the customer and the design team to deliver customer needs around common design components.

Design Engineer - the voice of the product; identifies how we could provide alternate materials to meet a customer need by leveraging SLOB and utilizing standard components for design purposes.

Operations Manager - determines the feasibility of a proposed change in materials, taking into account capacity, bottlenecks, labor, etc. Looks to common design elements to level load the factory.

Customer Service - Looks for opportunities in incoming inquiries to, supply from the SLOB lists and communicates with sales

Sales - Follows up on accounts not performing to forecasted plans. Communicates and negotiates long term agreement, EDI exchanged forecast with firm windows and blanket purchase orders with the end of life strategies.

Systems-based Approach

This approach centers around the integration of key ERP data into the CRM system, to enable sales and service to proactively highlight slow-moving items or adjust forecasts to align with customer purchase patterns. There are two ways to leverage ERP data for this purpose:

- Leverage early warning signs to drive customer engagement
- Drive sales and engineering to collaborate on finding applications for slow-moving inventory

Leveraging Early Warning Signs

In this approach, the goal is to proactively monitor the conditions that tend to lead to SLOB and to take action and engage with customers early and often. By integrating data from the ERP system into Salesforce, sales and customer service can be made aware of notable fluctuations in customer purchase patterns and can engage customers.

For example, a customer that generally purchases an average of 3000 units a month of a particular item may place an order for 30,000 units in a single month. To a salesperson, it might be cause for excitement, but it may also highlight underlying shifts in the business, changes in how they are engineering their product (if yours is a component of their solution) or other changes in strategy that could have longer-term implications for your relationship.

Having this visibility into exceptions - and taking the opportunity to engage with the customer - can have many benefits, including:

- Increased customer awareness leading to increased sales
- Avoid replenishing items that are no longer “in the plans” for your customers
- Increase awareness of the market and customers’ technology roadmaps to help drive competitive positioning.
- Reduce customer churn

Sell-through Strategy

Because of the way that SLOB is accounted for - i.e. its book value is written down over time - selling slow-moving or obsolete items can generate extra profit. Leveraging a sell-through strategy, items identified as SLOB are made known and available to the sales team via the CRM and they are incentivized to find applications for these items, within the engineering constraints of a customer. Under generally accepted accounting principles (GAAP), if an item has been written off as SLOB and a single unit of that item is sold, all remaining inventory of that item becomes active again, increasing the value of inventory and decreasing the SLOB expense account, which increases company profitability.

Conclusion

The central key to success is communication and data. If sales generate detailed forecasts and they are not used to drive supply decisions, the inventory will not meet customer needs. If the forecast is detailed but wrong, the demand will not support the inventory.

Salesforce is well suited to act as the core of a comprehensive SLOB avoidance strategy. By drawing insight from the Sales & Service teams as well as ERP and Financial Systems, Salesforce can deliver actionable insights that will make a measurable impact to the bottom line. Leveraging it to implement a SLOB avoidance strategy drives greater ROI from your investment in the platform.

Company performance demands a vision with business goals, those are common to all functions. Using siloed or offline data to get there creates a risk to execution. In the solution depicted above, forecast accuracy can be achieved within margins of error.

Other advantages- the net results will be measured in increased useable inventory, reduced SLOB expense, increased OTD, reduction in customer churn and an increase in the return on invested capital.



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