

Improve Your Inventory Turn

By Mike Hulser

Some ideas for boosting your cash flow through inventory turnover management

Cash flow is always important. When the economy slows, however, it becomes critically important. You need to be able to maintain adequate cash flow even when profits are thin, non-existent, or even negative.

Fortunately, your inventory represents a potential major source of cash. If you can improve your inventory turnover, you can improve your cash flow. All other things being equal, every dollar you can take out of inventory is a dollar you can add to cash on hand.

Inventory turnover is defined as “annual cost of goods sold (COGS) divided by (average) inventory.” For example, \$5 million in annual COGS divided by \$2.5 million in inventory equals two turns.

I encourage the companies I work with to strive for four inventory Turns (annual COGS is four times the average inventory). I won't say this is easy, but it can be done. Accomplishing it puts more money in your bank account, period.

The key tools you will need in your ongoing assessment and management of inventory are:

The 80/20 Rule. Approximately 80 percent of your sales will likely come from 20 percent of your SKUs. Your inventory needs to be stratified accordingly.

Out of Stock Days Measurement. Keep track of the number of days per week you are out of stock on your “sales dominant” items, the 20 percent that drive 80 percent of your sales. If an item is out of stock all week, its out of stock days metric is seven.

Turn and Earn. This index is inven-

tory turnover multiplied by gross margin rate. For example, 2.5 Turns times a 55 percent gross margin equals 1.4 “Turn and Earn.” The higher you can drive this index, the more money you're making on your inventory investment.

A Liquidate and Reinvest Mindset

When an inventory item is not moving, you need to take action to cash out and reinvest in other products that are moving.

Depending on the exact nature of your framing business, your inventory investment in dollars is likely to be heavily comprised of moulding (usually the heaviest), artwork, and possibly framed art. The four tools listed above apply equally well to all three of these product areas. Let's take a more in-depth look at the tools and how to use them.

The 80/20 Rule

If you carry 500 moulding profiles, the top 100 are likely to account for 80 percent of your sales. Check your reports. I'm confident that's what you'll find.

What you want in inventory investment is something approaching the reverse, perhaps not quite 80/20 but at least 60/40. That is, 60 percent of your investment in your top 100 and 40 percent of your investment in the bottom 400. Get to that first, then work toward an 80/20 ration the best you can.

There are some mouldings you need to be deep in, where you might need to reorder when you get down to 10 or 12 boxes on hand. There are others that you want a box of at most, and when that box

is empty you will perhaps want to order one more box when you have a little time. But there's no great need to hurry.

Out of Stock Days Measurement

At Pictures Plus, we track this figure weekly for the mouldings and mats that, on an 80/20 basis, drive the vast majority of sales. This tells us how much out-of-stock situations are likely restraining sales. If four key mats are out of stock for a week, the metric is 28 (4 times 7), a much worse situation than two mats out of stock for three days, a metric of 6.

The key point is that you need to keep your "sales drivers" in stock. When you are out of them, you are probably depressing sales, profits, and inventory turnover. That's not what you want to do.

Turn and Earn

All inventories are not created equal. Basically, using the Turn and Earn principle, inventory items with relatively lower gross margin rates must turn much faster than items with relatively higher margins to make the same amount of money.

Take these two examples:

- A 1" economy moulding with a 40 percent margin doing 4 Turns equals a 1.60 Turn and Earn.
- An 8" ornate moulding with a 70 percent margin doing 2.5 Turns equals a 1.75 Turn and Earn.

The ornate moulding is financially performing better, as its very strong margin rate offsets its relatively slower Turns. The economy moulding needs either another four points of margin or another 0.4 Turns to pull even with the ornate moulding.

Liquidate and Reinvest

Once inventory stops moving, you need to do whatever it takes to get it moving. Normal pricing now means nothing. More emphatically, what the item originally cost you now

means nothing. The only thing that matters now is how much cash you can get for it. If 15 cents on the cost dollar is all you can get, then take the 15 cents.

Some framer companies have a hard time with this idea. Their thinking is that there is simply no way they can sell the items below cost. The unfortunate fact is that if your inventory is not moving, it no longer matters what it cost.

I suggest that you think of it this way:

- I paid for this art a long time ago. That money is long gone.
- If I sell at cost or below (that is, at no profit), I don't have to share any of the proceeds with the IRS.
- Thus, when I sell off non-moving inventory at cost or below, I get to keep all of the cash.

Lastly, consider two alternatives:

- Giclée A cost \$300 and you sell it for \$500 after holding it for two years.

- Giclée B cost \$200 and you liquidate it for \$150 after six months and reinvest the money into mats that have 50 percent margin and 4 Turns.

Which alternative results in the largest pile of cash in your pocket at the end of two years? Giclée B, by a wide margin.

Summary

Turning your inventory can make the difference between a healthy, competitive business and a business headed for extinction. Use these tools, do some analytical work, make some tough decisions, and take action. You'll be glad you did. ■

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