Introduction - What is the Goal of Effective Inventory Management?

When I was 16 years old, a long, long time ago, I took a driver’s education course. On the first day the instructor walked into the classroom, put down his books, and asked, “What is the purpose of driving? What do you want to learn in this course?”

Several people in the class tried to address the question. They fumbled around searching for words to express the correct answer:

- “I want to be independent”
- “I want to get to school on my own”
- “I want to be able to help out my poor overworked mother”

After listening for 10 minutes without hearing a satisfactory answer the teacher said:

“You have all given me the reasons why you learn to drive, but not what you want to learn in this course. You must understand what you want to learn. That is, you must define your goal if you ever want to experience the results you’ve expressed.”

He continued, “Hopefully, you’re here to learn how to operate a car safely in order to get where you want to go as quickly as possible. That is your goal.” There was a lot of murmuring in the class. Many students weren’t comfortable with the teacher’s response. But no one could say what was wrong with the teacher’s statement or suggest a better definition.

The same problem occurs when organizations describe the goal of effective inventory management. Typical responses include the following statements:

- “Effective inventory management allows me to provide good customer service”
- “Effective inventory management provides a decent return on my investment in inventory”
- “Effective inventory management eliminates dead stock and surplus inventory”

As in my story of driver’s education, these remarks describe the results organizations want to receive from implementing an effective inventory management system. They do not describe the characteristics of that system.

In fact, several of these results contradict one another. For example, the best possible customer service requires you to always have on-hand a substantial quantity of every
item that any customer could possibly want. But stocking large quantities of a wide variety of products often produces significant amounts of dead inventory. And, large amounts of dead stock usually result in a low return on an organization’s inventory investment (or even losses).

On the other hand, if a company just stocked popular items that sold quickly, customer service would suffer. Few companies are willing to say to a good customer, “Gee whiz, we can’t afford to have any item whose stock doesn’t turnover at least six times a year in our warehouse. You’ll just have to go elsewhere to get that stuff.”

Because of the apparent contradictions in the desired results, many organizations have a hard time developing a comprehensive, coordinated, effective inventory management program. They may try to maximize customer service on Monday, and then decide that return on investment is the most important goal on Wednesday. These fluctuating goals cause them to use “SWAG” (scientific wild-ass guessing) as they decide what quantities of which products to stock. Often SWAG purchasing has no basis other than the emotions of the moment.

We want to start this inventory management guide by clearly stating the goal of effective inventory management:

“Effective inventory management enables an organization to meet or exceed customers’ expectations of product availability with the amount of each item that will maximize net profits.”

The first part of the statement involves meeting your customers’ expectations. These may be external customers who buy your products or internal customers who use the products you stock within your organization. The second part discusses finding the amount of inventory, required to meet these expectations that will result in the best return on the amount of money you have invested in these products. The two parts of the overall goal of effective inventory management are not contradictory. In fact, they compliment each other. They also suggest several questions you must ask yourself:

- Who are our customers?
- What products (in what quantities) do our customers expect us to have in stock?
- Does an inventory of every stocked item have to be maintained in each of our branches or warehouses?
- What products can be special ordered from a supplier without causing problems for the customer?
- Is a particular product more profitable if it is stocked or special ordered?
- What quantity of each stocked product results in the lowest overall cost (and therefore the greatest profit)?
- Will customers see value in new product offerings? That is, will each new item added to inventory maintain or improve our customers’ impression of our company?
- Will new products enhance our company’s profitability?
- How can we minimize our warehousing and other operating costs?

Everything you learn in this guide is designed to help you develop an inventory management program for your company that will lead you towards achieving this goal.

Notice that I say that it is up to you to develop a program. It’s unfortunate, but despite a lot of industry advertising, no computer software by itself provides a solution to the inventory management problems faced by most organizations. Successful inventory management is the result of:

- Business policies which promote effective inventory management
- Good computer hardware and software
- The knowledge necessary to effectively use the software

Effective inventory management is not easy. If it were, there would be no need for good software or guides like this one. But if you ask the people in organization’s that have been through the process, they’ll tell you that the results they have achieved, in customer service and return on investment, as well as their mental well-being, have been more than worth the effort.

If you have any questions or comments as you read this the guide (or afterwards), please contact us. And check our web site, “www.EffectiveInventory.com” each month for the latest information and advice on maximizing the return on your investment in inventory.

*May the return on investment in all aspects of your life always exceed your expectations.*

*Yours,*

*Jon Schreibfeder*  
Phone: (972) 304-3325  
FAX: (972) 393-1310  
Email: jons@EffectiveInventory.com