HUGHENDEN
People and Processes

The Shocking Cost of Holding Stock

Evidence shows us that even today, it is commonly accepted that the cost of holding stock to a business is between 4 and 10% (on top of the stock's value). However, research has shown that the *real* **is nearer 40%!**

This is a long way from 4-10% and gives a more accurate view of the benefits that can be achieved by reducing inventory. Most businesses take into account the costs of storage and capital. However, Hughenden has just completed a study for a customer and the storage costs alone came out at 15%!

But there are other real costs that are being ignored because they are currently not directly attributed to Inventory Management; they do not appear in any Performance Measures; they do not appear in the Balance Sheet; and they are frequently poorly assessed.

- <u>Handling</u>. This is not a fixed cost. The more stock you have, the more handling is involved. When the logical stock rotation has been disrupted and the pallet required is at the bottom of a pile, the forklift driver will often have to do many additional manoeuvres. This means additional time, fuel, risk, and wear. We all recognise this to be a common situation, but do we factor in the real costs?

- <u>Loss</u>. This is another common problem that is rarely accounted for. Many businesses admit that, when the stocks are high, they sometimes 'lose' products for orders. They know they have produced it, but they just cannot find it in the warehouse. So they make it again, with all the additional disruptions involved, and twice the capacity used . Eventually, they will find the original order, which then remains in stock... You can imagine how much additional cost this whole incident has just generated.

- <u>Damage</u>. We all know that the more stock there is, the higher the risk of damage. It happens in all warehouses: the product gets damaged, which means the stock either has to be sold off cheaper, it becomes obsolete or it has to be reworked, generating additional cost in every case...

- <u>Obsolescence</u>. The cost of obsolescence is recognised by most businesses, so it must be factored into the cost of stock. However, the number must be realistic: in our experience, many businesses carry significant amounts of obsolete stock that they have forgotten or that they have not yet had the courage to write off. In other words, the cost of obsolescence is often higher than the figures suggest…

- Capital. We mentioned previously that most businesses take account of the *cost of money* in their calculations. However, one of the main reasons why businesses fail is that they run out of cash. Having money tied up in stock is not just the cost of money, but also the opportunity cost of not being able to use this capital to invest in more capacity, for instance, in order to sell more…

All of a sudden, the figure of 30-40% as the cost of holding stock does not seem so outrageous after all! Several years ago a well known American group adopted a figure as high as 42% and a Hughenden customer, having recently analysed its stock situation, assessed it as 36%. Evidently the benefits of reducing stock levels are greater than most companies recognise. But the real trick is not just to reduce it, but to stop the stock from coming back…

Hughenden specialises in Supply Chain Planning and focuses on the People *(skills, knowledge)* and Processes *(techniques, performance)*. The Hughenden team offers focussed consultancy and interactive education. Its customers include Marks & Spencer, Kraft Foods, Johnson & Johnson, Hallmark Cards, and SCA Packaging.

For help to reduce excess inventory by stopping it getting there in the first place, email info@hughenden.net or visit www.hughenden.net