

Shippers see inventory rising

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From the pages of *Logistics Management*

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By **Susan K. Lacefield, Associate Editor -- 10/1/2005**

When Scott Phillips looks at the stock in his distribution centers, he sees that inventory levels have crept up this year compared to last. As director of purchasing for distribution centers at Airgas Products, a distributor of specialty gases and welding, safety, and related products, Phillips keeps a close eye on inventory. But he's unable to point to a single cause for the increase. Instead, he says, increased sales, recent acquisitions, product-line expansion, and logistics issues have all pressured the company to hold more stock.

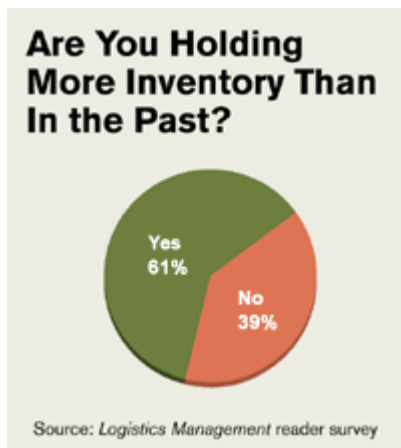
Airgas Products' story is not unique. In a recent Internet-based survey of 497 *Logistics Management* readers, 61 percent indicated that they are holding more inventory now than they did in the past. The rise in inventory levels cuts across all company types, with more than 50 percent of the manufacturers, retailers, and distributors who participated in the survey reporting an increase.

It's not surprising, then, that many third-party logistics companies are saying that their warehouses and distribution centers (DCs) are at capacity, especially in the Los Angeles-Long Beach and New York areas, according to the International Warehouse and Logistics Association (IWLA). Another indication of growing inventory: More warehousing space was added in North America last year than in any year in history, says Theodore (Ted) Scherck, president of analysts The Colography Group.

Many shippers, analysts, and consultants agree with Airgas Products' Phillips that several forces are pushing companies to hold more inventory. Does that mean logistics managers need to revise their inventory practices? At this point, opinions are mixed.

But no matter whether their inventory levels have risen, fallen, or stayed the same, managers will benefit from reassessing their strategies in light of the business trends that are influencing inventory levels today.

Here's a look at some of those trends, along with some of the steps shippers are taking in response.



THE ECONOMY IS COOKING: An increase in inventory levels doesn't always mean that there's a problem. At United Solar Ovonix, a manufacturer of solar panels, inventory levels are up because business is booming. "As it is right now, everything that we are making has already been sold," says manager Lew Podlewski. "Basically we're sold out for the remainder of the year. In fact, we have been [sold out] since the end of the second quarter."

Other manufacturers and distributors who responded to *LM's* survey reported that their inventory levels are up because of double-digit increases in sales. Those observations coincide with inventory trends that third-party logistics providers are seeing among their shipper clients. "Any time our members report that they have what they consider to be a full warehouse, it means the economy is really cooking," says IWLA President Joel Hoiland.

But an increase in sales doesn't necessarily have to translate into higher inventory levels. Pharmaceutical giant AstraZeneca, for instance, has been seeing strong sales growth this year, but process and technology changes have allowed the company to reduce its inventory levels, according to Mark Holder, supply point director for third-party contracts. Those results, he says, can be attributed in part to new software that has improved visibility and allowed the manufacturer to more aggressively manage inventory levels. AstraZeneca has also pushed forward with a demand-driven supply effort, similar in philosophy to lean

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manufacturing, which has helped to further reduce inventory levels.

CUSTOMERS ARE DEMANDING. Rising sales volumes may be one reason why 44 percent of respondents to *Logistics Management's* survey on inventory management cited "customers' requirements" as the main cause of higher inventory levels. For example, one survey respondent reported holding more inventory because Wal-Mart is ordering fewer cases more frequently.

This trend is especially prevalent in the consumer packaged-goods (CPG) industry. According to the *Grocery Manufacturer's Association 2005 Logistics Survey*, retailers are requesting more floor-ready displays, customized packaging, and store-ready, cross-docked pallets than they have in the past. And they are requiring shorter lead times even as more companies implement "zero tolerance" policies for late shipments.

Other industries have also been adding inventory recently to meet customers' requirements. Steve Wood, supply chain manager for high-tech manufacturer Siemens Canada, estimates that his company has had to increase its safety stocks by 7 to 8 percent to satisfy customers' demands for specific delivery times. "It always comes back to customers saying, 'I can call your competition and get it there tomorrow. Why can't I call you and get that?'" And there's only one answer to that," he says.

PRODUCT LINES ARE EXPANDING. As a walk through the aisles of any grocery store will confirm, manufacturers are adding new brands and product variations as never before. That means logistics operations today are supporting many more stock-keeping units (SKUs) than they did in the past. A little more than one-third of all respondents to our survey cited product proliferation as one reason they're holding more inventory these days.

Nor is that trend limited to consumer products or high-tech goods. Shorter cycle times are a must as manufacturers turn formerly generic, unadorned products into fashion statements. Airgas Products, for example, now makes welding helmets and hardhats sporting NASCAR and NFL team logos; it produces protective eyewear under the Harley Davidson and Orange County Choppers brands.

That means more manufacturers are introducing new products every six to 12 months and discontinuing products that aren't selling. As a result, says Airgas Products' Phillips, distributors have to continually add new products while getting rid of obsolete styles.

SUPPLY CHAINS ARE LONGER AND SLOWER. Supply chains are not only growing more complex, they're also becoming longer as more companies manufacture, source, and sell their products around the world. "With a company that's shifted production overseas, carrying more inventory is almost a given," says Mike Sullivan of UPS Consulting. "Obviously, the time between shipments may be longer than what they are used to with domestically sourced goods."

Or as The Colography Group's Scherck says, it's hard to be both global and lean. "What I mean by that is that if you have a global supply chain that is as lean as it possibly can be, and you're able to reach that Utopian one-to-one inventory-to-sales ratio, what you end up with is risk of interruptions that are substantially higher than if you maintained buffer stocks," he explains.

That comes as no surprise to Jim Hutchinson, vice president of supply chain integration for Brown-Forman Beverages. Brown-Forman recently added seven days to its safety stock of Jack Daniel's Whiskey in the United Kingdom because of variability in transportation times. "Sometimes we could get bookings and sometimes we couldn't," Hutchinson says. "And sometimes [our shipments] would get bumped."

Port congestion has also added to Hutchinson's headaches. There have been times when the Port of Southampton in the United Kingdom was so backed up, he relates, that the ocean carrier diverted ships to the Netherlands and transshipped his company's containers to the U.K. via the English Channel.

Some companies, moreover, are holding more inventory as a way to mitigate rising domestic shipping costs and transit times. Michael Kilgore, president of the consulting firm Chainalytics, is seeing more shippers hold on to orders longer than usual in order to build better loads. He's also seeing companies shift from truck to other transportation modes with longer transit times. While these strategies do cut transportation costs, they also bump up inventory levels.

Jeff Alfaro, director of purchasing and transportation at Spurrier Chemicals, has seen transit times lengthen for his company's shipments of cleaning products. He attributes that increase to factors such as the new truck driver hours-of-service regulations and driver shortages. While Spurrier's 7-percent increase in inventory is mostly due to a 15-percent growth in sales, Alfaro is certain that the need to compensate for transportation delays has also played a role. "We're better off just planning to have a little more 'air' [when it comes to transit

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times]," he says.



Tactical Responses

Analysts and consultants don't expect these business trends to fade away anytime soon. Some shippers are using technology to address cost and space pressures. Brown-Forman, for example, is installing a "poor man's version" of the track-and-trace software used by parcel express carriers, says Hutchinson. Another example is SVI Systems, which provides pay-per-view movies and Internet digital systems to hotels and patient videos to hospitals. The company plans to install a new warehouse management system. "Hopefully that will help us tighten down our inventory levels and just get a better handle on what we have in-house," says Warehouse Manager John Sering.

Shippers are also working to improve visibility outside their walls by collaborating with their customers, suppliers, and third-party providers. For example, more companies are holding regular meetings with their key customers and suppliers to discuss and plan for demand they have in the pipeline, says Karen Butner of the IBM Institute for Business Value.

Another tactic involves committing to long-term stocking agreements. Spurrier Chemical has implemented such agreements with its key suppliers, promising to purchase a specified amount of inventory within a certain time period. "That allows [the suppliers] to improve their manufacturing efficiencies by running larger lots, and it shortens the shipment lead time when I issue a purchase order," Alfaro notes.

Some shippers, including Spurrier Chemical, are working on using existing space more efficiently. About 39 percent of the respondents to *LM's* survey, however, said they have increased their warehousing space to accommodate growing inventory levels. United Solar Ovonic, for example, next year will open a new manufacturing plant that has more storage space than does its current facility. Similarly, some of Brown-Forman's third-party service providers have been forced to contract out for more space, Hutchinson says.

When shippers do add warehouse space, says Scherck, "it's not a traditional warehouse, where you optimize your manufacturing cost by building billions of widgets and storing the widgets until somebody buys them. It's a warehouse designed to support rapid fulfillment of customer needs," he explains. "So in some cases, there's light manufacturing and kitting going on in this warehouse. In some cases, it's simply pick and pack. In other cases, it's simply hold and fulfill."

Reassessing Strategy

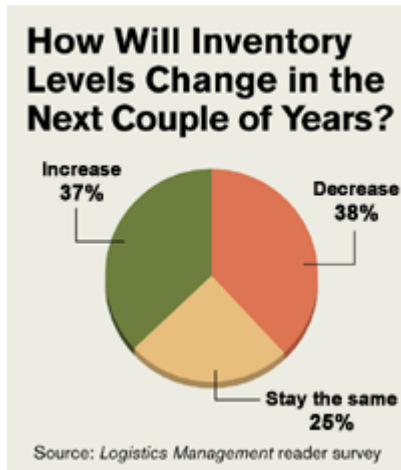
Simply responding tactically, however, may not be enough to address inventory pressures. Chainalytics' Kilgore says that shippers also need to take strategically analyze their individual situations to determine the best balance of transportation and inventory-carrying costs. "I think companies are still focused more strategically on reducing inventory," he says. "I don't think they have really taken a step back in general and said, 'should we rethink our strategy around how much inventory to hold and what our general philosophy should be?'"

In that vein, shippers may need to reconsider policies such as a strict devotion to lean principles or a drive to consolidate distribution centers and inventory. Consolidation may have been beneficial in the past but may not make as much sense in an environment where transportation costs are outpacing other costs, Kilgore says.

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That's not to suggest that companies should pull back completely from lean and just-in-time inventory management, says IBM's Butner. Instead, leading companies are already looking at new models for supply chain network design. "We have to put more inventory in the pipeline in the right places, maybe even open up facilities to store some of this stuff temporarily," she says. "However, we're not going to go back and use old models and just put distribution centers everywhere. We're going to look at new ways to be able to accommodate that. It could be outsourcing ... it could be some kind of shared facilities."

Scherck foresees some companies adopting what he calls a "continental strategy," locating manufacturing capacity or inventory on every continent to ensure that they'll be able to work around supply chain disruptions. For cost reasons, this strategy isn't appropriate for all products, he adds. High-value, low-weight items will benefit from a global supply chain model, under which goods move directly from the point of production to the point of consumption. Low-value, high-weight items, by contrast, will continue to move by ship and then by truck to warehouses. Commodities that fall in the middle will move in a continental or regional distribution model, Scherck predicts.



Sullivan of UPS Consulting believes that shippers will adopt a similar, stratified approach to determining how much inventory to hold. "I think a lot of companies are reluctant to adopt a policy where they build a safety stock across the board," he says. Instead, they will implement inventory segmentation, with different policies for different kinds of inventory. This "inventory stratification" will be guided by a combination of factors, including profit margins and the various products' life cycles, he says.

In short, profitability may have the greatest impact on shippers' inventory strategies in the future. Says Butner: "Companies are not just looking at cutting costs or at where inventory needs to be to meet customers' requirements, but also at how to do that profitably."

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