OBSOLESCENCE IN INVENTORY MANAGEMENT

A guide for Spare Parts Head, Aftersales Managers, General Managers and Business Owners in knowing what to do!

BACKGROUND

From my many years of working in the aftersales environment and training parts personnel, I realised there is a huge gap in awareness and understanding the necessary steps in addressing **OBSOLESCENCE.** The average 3S dealership has a significant portion of their working capital invested in Spare Parts.

When the overall business is good, aging parts may go unnoticed. However today, margin compression in the Sales front has shifted the focus back to the Aftersales department; particularly to Inventory Management fundamentals. Carrying aged and obsoleted parts silently erodes profits in the Parts Operations performance associated with.

I admit that managing spare parts today is more complicated given the model mix, shorter product life cycle compounded by the diversity of parts the franchise dealers must stock and manage.

While much profit can be made selling parts, accessories, lifestyle and merchandise, so much more can be lost if this is not managed and obsolescence continues to balloon.

Read on if you're interested to address this concern.

WHY IS OBSOLESCENCE AN IMPORTANT KPI?

The Parts Department's main key performance indicators makes us aware of Parts Sales, Stock Turn Ratio, Gross Margins and Service Levels. High obsolescence level or aged parts may impede or worse, erode all the good work and profits achieved with driving these first four KPIs.

WHEN IS A PART DEEMED OBSOLETE?

Think of the food you buy that has an expiry date. Likewise, car parts are the same when they exceed their "sell by date" of 12 months (**not 24 or 36 months**). This is almost the point when there is zero demand for the part from your customers.

Industry experts claim that when a part hits the 7th month aging bracket, the chances of selling it drops to between 60-70% and up to 99% when it is still not sold after 365 days.

The chance of selling this aged part now deemed **OBSOLETE** is a mere 1%; so let's not get emotional by keeping it even longer on your inventory. The part remains idle on your warehouse shelf and its cost sits in your balance sheet. This negatively impacts your ROI both in the parts operations and overall dealership.

Here's another piece of bad news. Experts also claim that the average stock holding cost of any part is approximately 25% which would easily wipe out your average parts margin of 25%. Therefore, the longer it stays on your shelf, the deeper it eats into your operating margin.

Basically, a part which has been sitting in your warehouse shelf for more than 12 consecutive months has little chance of being sold and is deemed obsolete by industry standards.

Logistics experts claim the range of holding cost can be from 18% to 50% per year

VISIBLE AND INVISIBLE COST WITH HOLDING/ CARRYING ANY INVENTORY

Variable Costs:

- Cost of Money
- Taxes
- Insurance

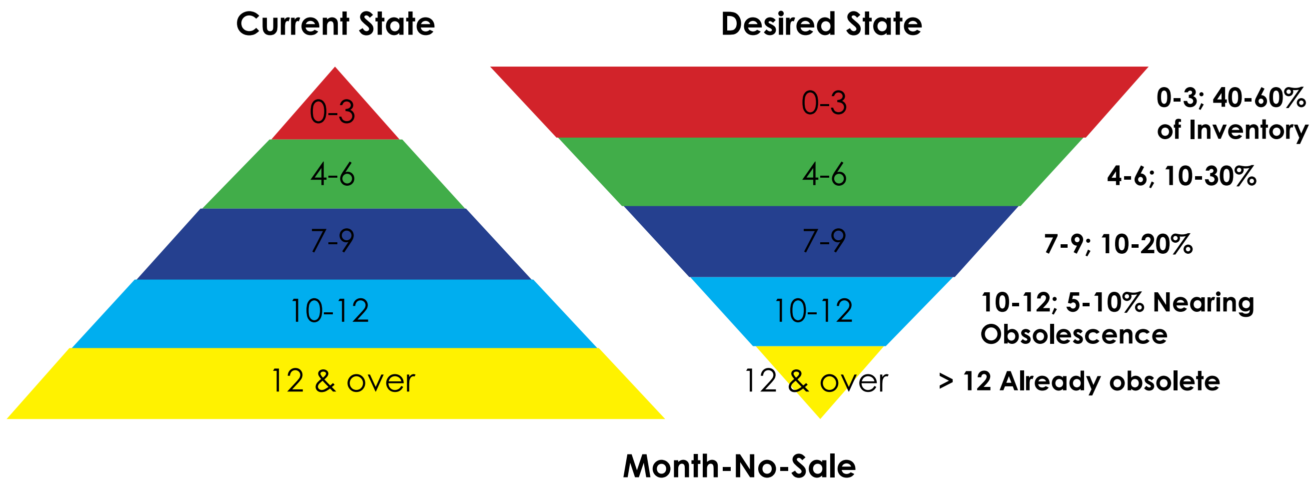
Fixed Costs:

- Warehouse Expenses
- Permanent Staff

Other Costs:

- Inventory Control
- Obsolescence
- Pilferage
- Clerical costs

WHAT'S AN ACCEPTABLE LEVEL OF OBSOLESCENCE?



Most manufacturers have some standard guidelines for their franchise dealers to be operate within. For dealers who are on a weekly stock order, obsolete parts in value should not be more than 10% of the total parts inventory and those who have a daily stock order; this should be no more that 5%.

WHY DOES IT HAPPEN?

There are many reasons why over time, there is a decline in demand for a part. Some of them prematurely decline in demand due to model updates, part order wrongly diagnosed by workshop technicians, superseded part numbers and/or perhaps the actual part is no longer is a sellable condition due to poor stock keeping.

Other anecdotal findings are:

Wrongly ordered by the OEM Parts counter staff	Increased VEH model mix and shorter product life	Wrong parameter set-up in the Ordering system	Arrived back orders not actioned-off by Service Advisors
Obsession with high Service Levels	Low completion rate of technical campaigns	Principal's objective to incentivize purchase than sales	General poor Inventory Controls at the dealership

WAYS TO AVOID?

1. Trained and Knowledgeable staff
2. Efficient purchasing habits & policies
3. Attention to inventory control guides
4. Monitor special and all back orders diligently
5. Top Management takes a keen interest to review this measurement at monthly department meetings

WHAT SHOULD I DO WITH MY OBSOLETE PARTS?

AN EXIT STRATEGY

1. Doing something now better than later is the best approach.

2. Analyse what parts they are, if you still haven't.

3. Discuss with your Principal available manufacturer's "Returns Program".

4. Consider online special offer sales in the global market place besides the independent workshops network. This should be done with any part when it is already more than 9 months in stock with no sales.

5. Work with your Finance colleagues to make some monthly provisions on aged stock by expensing a percentage of your department's gross profit or part of your aged stock value. For example, your company may have a policy guideline that 50% of the parts cost is written down gradually annually *(see explanation of provision below)* once the SKU has exceeded 12 months, so as not to take a hit on the P&L and Balance sheet at a later stage. This also avoids any significant distortion of your company financials.

6. Carry out final scrapping through a parts tender exercise to interested parties. Unfortunately often recovering no greater than 5% of the inventory cost or scrap metal value for disposal, whichever is higher.

7. Or if it hurts, you may consider "softening the blow" by donating large items (size or value) to technical colleges for the benefit of the future workforce in learning about a steering rack or control unit for example. You may consider this your organization's Corporate Social Responsibility initiative.

8. Removal of obsolete parts should be done at least twice a year from your inventory list.

(A provision is an amount set aside from a company's profits to cover the expected decrease in the value of an asset when later sold at a discount. The Provisions are recognised on the balance sheet and are also expensed on the income statement).

CLOSING

Though obsolescence is an unavoidable cost of doing business, a well-managed Parts Department will keep it under control and within allowable limits.

There is always strong emotion by business owners to hog on to their obsolete parts with the hope of selling it one day; not to mention their resistance in making capital allowance or provisions to write-down the parts over time.

However, the fact is that there is almost zero demand for this part and therefore the advantage of scrapping/disposing the part far outweighs any possibility of selling the part after 9 months.

This is surely not a hard pill to swallow when you alter the mindset to see your glass half full and if you want to get better and to be amongst the best dealers in the world!

Inventory is a sunk cost. It is not worth what you paid for, it is worth what someone else is willing to pay.