HOW TO SETUP AND CONTROL PARTS INVENTORY

THE BEST ODDS & RETURN ON THE DEALER'S CAPITAL INVESTMENT

BY SHAWN LARKIN

The goal of any department in an auto dealership is to take the dealer's initial capital investment and get it to perform. This means utilizing the investment to make additional money and then using the profit along with the original capital and investing it again. Repeating this will create a cycle in which a surplus profit will eventually be produced that can be used to grow the business overall.

Specifically regarding the parts department, finding the best methods to control the parts inventory so the dealer principal's capital is put to good use is job #1. Understanding and setting up a parts inventory that will turn parts over as often as possible while keeping a high off the shelf fill rate is the very root of successful parts inventory management. When it comes to parts inventory control, the key is to bring in fast selling parts inventory and turn over the entire inventory value 6 to 8 times a year.

Since the inception of parts departments, dealers have explored different ways to qualify parts for their incoming stock inventory. This is known as establishing phase-in criteria. The offsetting process of removing parts from their inventory when they lose sales demand is known as phase-out criteria. Most often, we find that parts managers are conservative when it comes to phase-in and to phase-out parts.

Often times, parts managers are slow to phase-in parts since they normally have to work with an inventory dollar value ceiling. To further complicate their phase-in decision, they may not have access to sufficient parts sales history in their market unless they are a high volume parts seller themselves.

Parts managers are also slow to phase-out parts inventory. First of all, they believe that the parts will eventually sell. Secondly, even if a parts manager wanted to return some parts, they may not have enough manufacturer's parts return dollars to do so. The manufacturers prioritize the returns by the age of the part. So, until any phased-out parts become the oldest in their parts inventory, parts managers are forced to retain them.

UNDERSTANDING AND SETTING UP A PARTS INVENTORY THAT WILL TURN PARTS OVER AS OFTEN AS POSSIBLE WHILE KEEPING A HIGH OFF THE SHELF FILL RATE IS THE VERY ROOT OF SUCCESSFUL PARTS INVENTORY MANAGEMENT.

Let's do a deeper dive into the criterion which have known studies and statistics. On the surface it may look like there are countless phase-in and phase-out criteria to review. In reality, many are only in place to satisfy a dealers views on controlling the inventory when sales data and statistics are unknown. Parts managers may opt to look at a part's entire sales performance history ranging from the last 6 months to the last 24 months to determine whether to stock a part or not. Studies show that the most ideal range to base your qualifications on parts inventory sales history is the last 12 months rolling. That is important as the statistics will show this is the optimum value. It will take into consideration any influx of parts sales, like seasonality, and consumer spending habit changes in a year, like Christmas.

Qualify Parts For Stock

Studies recommend a phase-in criteria referred to as "3-in-12" as being the best at qualifying parts inventory that is most likely to sell in a timely manner with the least amount of attrition. These are the parts that have sales demand in at least 3 separate months within the last 12 months rolling and for certain has sold within the last 9 months. Some dealers who are more progressive will cut that 9 month time frame back to 6 months. Keep in mind, we are counting the number of months for which there are sales and not the number of pieces sold. This criteria is considered the best for the dealer and should be the basis for your active parts inventory.

Parts that fall within this phase-in criteria have a 93% chance of selling multiple times per year, leading to dealer profit. Only 7% of these parts may become losers. If managed correctly, this 7% will not need to be written off and will be returned as they reach 10 months-no-sale. This way you never let them age to the point that they are 12 months-no-sale, which is typically the point when parts are written off.

When determining if a part is going to be included within the inventory under this particular phase-in criteria, counting the number of months there are sales demand within the last 12 months rolling is critical. After determining a part is to be included as stock, only then do we count the number of pieces sold, as that will determine how many to stock. The understanding of counting months of sales within the last 12 months rolling is a common theme in the remainder of this article and in inventory control. This is how we add labels to parts based on number of months of sales within the last 12 months, like 3-in-12.

In the example of the label 3-in-12, there are 3 separate months of sales demand within the last 12 months rolling. 2-in-12 would mean the same, except there were only two months of sales within the last 12 months.

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The 7% Of Losers

Since active parts inventory has a 93% chance of selling that means 7% of active parts will become losers on an annual basis and end up falling off. This 7% of parts inventory used to be considered active parts inventory and ordered on a stock order regularly. Now that they have lost sales demand, these 7% are now known as "Phased-Out Parts". At the end of 9 months without sales demand, they are now phased-out parts.

These phased-out parts have only a 15% chance of selling again after 9-months-no-sale, meaning 85% of them will never sell again at your dealership. After they hit 12-months-no-sale, the odds become much worse as only 5% of these parts will ever sell again at your dealership, and 95% will sit forever or until they are written off or returned; provided you can return them at all.

Although these phased-out parts sound bad, they are not the root of an underperforming parts inventory problem. The parts that you really need to look out for are the parts eating most of your return allowance. Those are the unsold and returned special order parts.

Special Order Parts

The phase-in criteria for active parts inventory should never include any parts that lack sales demand – like special order parts. Special order parts are also known as "non-stocking parts" inventory and have a demand of 2-in-12 or as little as 0-in-12. Remember, we are counting the number of months in which there has been sales activity within the last 12 months rolling, and not the number of pieces sold. Be sure not to confuse aged out parts inventory that once was active (the 7%) with these non-stocking special order parts.

Parts managers are often required to keep unsold or returned special order parts for another 10 to 12 months after they were ordered or returned. This is because parts managers typically don't have enough return allowance to return them to the manufacturer. A parts manager will always return the oldest parts in inventory with the small amount of manufacturer return dollars they have. That may leave these unsold or returned special order parts to be shelved, age out, and wait their turn to be returned nearly a year later when they become the oldest parts in inventory. Non-stocking parts are the biggest problem for dealers and parts managers to gain control over, unless they have tight processes and policies to minimize the chance these parts become unsold.

Write-Off Inventory

The worst parts to have in inventory are those that have not sold in the last 12 months or greater. These parts are usually a combination of phased-out parts inventory and unsold or returned special order parts. Typically, the reason dealers still have these parts is because they did not have enough return allowance from the manufacturer to return them before they reached 12-months-old without sales demand. Of the entire parts inventory, parts that carry the highest liability and are the most difficult to move are parts over twelve months no sale, as they have a 95% chance they will never sell again at your dealership.

Setup and Execution

This explains why choosing the phase-in criteria for active parts that requires 3-in-12 or greater with sales demand within the last 9 months is the wise choice. Likewise, the phase-out criteria covers old active parts inventory which lost sales demand and hasn't sold within the last 9 months. It also includes non-stocking parts with a sales demand of 2-in-12 or less.

For ease of implementation, all of these can be set up in your DMS to control and manage your parts inventory automatically. The set up is simple, especially when you have a DMS parts rep with you (or you call your DMS rep to ask how to set it up). You can tell the DMS rep that you want "3-in-12 or greater" as a phase-in criteria and your phase-out criteria setup to phase-out old active parts inventory "after 9-months-no-sale". It is a common configuration. By default, this will mean that any parts which have less than 3-in-12, such as 2-in-12, 1-in-12, or 0-in-12 will be considered "non-stocking" and will never be active until they reach at least 3-in-12.
What you gain from a properly set up DMS is a parts manager with more time to do other managerial tasks and assurance that the inventory that is recommended by the DMS stock order is good inventory with the best probabilities of selling.

Key Points

- Your phase-in criteria includes active parts that have sold in at least 3 separate months within the last 12 months rolling (3-in-12 or greater, ie: 4-in-12), and has sold within the last 9 months.
- Your phase-out criteria includes the 7% of losers that will naturally come from active parts that lost sales demand and haven't sold within the last 9 months.
- Non-stocking parts have 9-months-no-sale are considered special order type parts and have a 2-in-12 or less sales demand.
- Out of the entire parts inventory, parts that carry the most liability and are the hardest to sell are parts over twelve months no sale.
- For peace of mind, dealers want to be sure that their parts department is running with the best odds to selling inventory and reducing risk. A way to do this is to get your DMS representative to implement the above phase-in and phase-out criteria, if you don't know how to do it yourself.
- Even if you are on a manufacturer ordering program, you will still want to implement the above strategy on parts inventory through your DMS because the goal is to make money perform and not bring in inventory just because your manufacturer recommends you do so.

Getting Parts Inventory Under Control

After implementing the above strategy in your DMS, it will take some time for your parts inventory to adjust and get under control. You will find that the parts manager's monthly DMS reports will become more reliable and you will know what the report represents.

Shawn Larkin is the Founder & CEO of North American Dealer Parts Exchange Inc. (NADPE), an online market to help parts managers and dealerships move idle and obsolete parts inventory in bulk without loss. Shawn has spent his entire professional career in the dealer parts business including managing multiple locations as a Director of Fixed Operations.

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