

Guide to Business Inventory Management

A Step by Step Guide to Managing Your Business Inventory

By BizMove Management Training Institute

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1. Introduction

"Inventory" to many small business owners is one of the more visible and tangible aspects of doing business. Raw materials, goods in process and finished goods all represent various forms of inventory. Each type represents money tied up until the inventory leaves the company as purchased products. Likewise, merchandise stocks in a retail store contribute to profits only when their sale puts money into the cash register.

In a literal sense, inventory refers to stocks of anything necessary to do business. These stocks represent a large portion of the business investment and must be well managed in order to maximize profits. In fact, many small businesses cannot absorb the types of losses arising from poor inventory management. Unless inventories are controlled, they are unreliable, inefficient and costly.

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2. How to Successfully Manage Your Inventory

Successful inventory management involves balancing the costs of inventory with the benefits of inventory. Many small business owners fail to appreciate fully the true costs of carrying inventory, which include not only direct costs of storage,

insurance and taxes, but also the cost of money tied up in inventory. This fine line between keeping too much inventory and not enough is not the manager's only concern. Others include:

- * Maintaining a wide assortment of stock but not spreading the rapidly moving ones too thin;
- * Increasing inventory turnover -- but not sacrificing the service level;
- * Keeping stock low -- but not sacrificing service or performance.
- * Obtaining lower prices by making volume purchases -- but not ending up with slow-moving inventory; and
- * Having an adequate inventory on hand -- but not getting caught with obsolete items.

The degree of success in addressing these concerns is easier to gauge for some than for others. For example, computing the inventory turnover ratio is a simple measure of managerial performance. This value gives a rough guideline by which managers can set goals and evaluate performance, but it must be realized that the turnover rate varies with the function of inventory, the type of business and how the ratio is calculated (whether on sales or cost of goods sold). Average inventory turnover ratios for individual industries can be obtained from trade associations.

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3. How to Develop a Purchasing Plan

One of the most important aspects of inventory control is to have the items in stock at the moment they are needed. This includes going into the market to buy the goods early enough to ensure delivery at the proper time. Thus, buying requires advance planning to determine inventory needs for each time period and then making the commitments without procrastination.

For retailers, planning ahead is very crucial. Since they offer new items for sale months before the actual calendar date for the beginning of the new season, it is imperative that buying plans be formulated early enough to allow for intelligent buying without any last minute panic purchases. The main reason for this early offering for sale of new items is that the retailer regards the calendar date for the beginning of the new season as the merchandise date for the end of the old season. For example, many retailers view March 21 as the end of the spring season, June 21 as the end of summer and December 21 as the end of winter.

Part of your purchasing plan must include accounting for the depletion of the inventory. Before a decision can be made as to the level of inventory to order, you must determine how long the inventory you have in stock will last. For instance, a retail firm must formulate a plan to ensure the sale of the greatest number of units. Likewise, a manufacturing business must formulate a plan to ensure enough inventory is on hand for production of a finished product. In summary, the purchasing plan details:

- * When commitments should be placed;
- * When the first delivery should be received;
- * When the inventory should be peaked;
- * When reorders should no longer be placed; and
- * When the item should no longer be in stock.

Well planned purchases affect the price, delivery and availability of products for sale.

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4. How to Control Your Inventory

To maintain an in-stock position of wanted items and to dispose of unwanted items, it is necessary to establish adequate controls over inventory on order and inventory in stock. There are several proven methods for inventory control. They are listed below, from simplest to most complex.

- * Visual control enables the manager to examine the inventory visually to determine if additional inventory is required. In very small businesses where this method is used, records may not be needed at all or only for slow moving or expensive items.

* Tickler control enables the manager to physically count a small portion of the inventory each day so that each segment of the inventory is counted every so many days on a regular basis.

* Click sheet control enables the manager to record the item as it is used on a sheet of paper. Such information is then used for reorder purposes.

* Stub Control (used by retailers) enables the manager to retain a portion of the price ticket when the item is sold. The manager can then use the stub to record the item that was sold.

As a business grows, it may find a need for a more sophisticated and technical form of inventory control. Today, the use of computer systems to control inventory is far more feasible for small business than ever before, both through the widespread existence of computer service organizations and the decreasing cost of small-sized computers. Often the justification for such a computer-based system is enhanced by the fact that company accounting and billing procedures can also be handled on the computer.

* Point-of-sale terminals relay information on each item used or sold. The manager receives information printouts at regular intervals for review and action.

* Off-line point-of-sale terminals relay information directly to the supplier's computer who uses the information to ship additional items automatically to the buyer/inventory manager.

The final method for inventory control is done by an outside agency. A manufacturer's representative visits the large retailer on a scheduled basis, takes the stock count and writes the reorder.

Unwanted merchandise is removed from stock and returned to the manufacturer through a predetermined, authorized procedure.

A principal goal for many of the methods described above is to determine the minimum possible annual cost of ordering and stocking each item. Two major control values are used: 1) the order quantity, that is, the size and frequency of orders; and 2) the reorder point, that is, the minimum stock level at which additional quantities are ordered.

The Economic Order Quantity (EOQ) formula is one widely used method of computing the minimum annual cost for ordering and stocking each item. The EOQ computation takes into account the cost of placing an order, the annual sales rate, the unit cost, and the cost of carrying inventory. Many books on management practices describe the EOQ model in detail.

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5. Advanced Inventory Management Strategies

In recent years, two approaches have had a major impact on inventory management: Material Requirements Planning (MRP) and Just-In-Time (JIT and Kanban). Their application is primarily within manufacturing but suppliers might find new requirements placed on them and sometimes buyers of manufactured items will experience a difference in delivery.

Material Requirements Planning is basically an information system in which sales are converted directly into loads on the facility by sub-unit and time period. Materials are scheduled more closely, thereby reducing inventories, and delivery times become shorter and more predictable. Its primary use is with products composed of many components. MRP systems are practical for smaller firms. The computer system is only one part of the total project which is usually long-term, taking one to three years to develop.

Just-In-Time inventory management is an approach which works to eliminate inventories rather than optimize them. The inventory of raw materials and work-in-process falls to that needed in a single day. This is accomplished by reducing set-up times and lead times so that small lots may be ordered. Suppliers may have to make several deliveries a day or move close to the user plants to support this plan.

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6. How to Improve Your Inventory Management System

What to do at time of delivery:

- * Verify count - Make sure you are receiving as many cartons as are listed on the delivery receipt.
- * Carefully examine each carton for visible damage. If damage is visible, note it on the delivery receipt and have the driver sign your copy.
- * After delivery, immediately open all cartons and inspect for merchandise damage.

Steps to take when damage is discovered:

- * Retain damaged items - All damaged materials must be held at the point received.
- * Call carrier to report damage and request inspection.
- * Confirm call in writing--This is not mandatory but it is one way to protect yourself.

Steps to take when carrier makes inspection of damaged items:

- * Have all damaged items in the receiving area - Make certain the damaged items have not moved from the receiving area prior to inspection by carrier.
- * After carrier/inspector prepares damage report, carefully read before signing.

Steps to be taken after inspection has been made:

- * Retain damaged materials -- Damaged materials should not be used or disposed of without permission by the carrier.
- * Do not return damaged items to shipper without written authorization from shipper/supplier.

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7. Inventory Tips for Manufacturers

If you are in the business of bidding, specifications play a very important role. In writing specifications, the following elements should be considered.

- * Do not request features or quality that are not necessary for the items' intended use.
- * Include full descriptions of any testing to be performed.
- * Include procedures for adding optional items.
- * Describe the quality of the items in clear terms.

The following actions can help save money when you are stocking inventory:

- * Substitution of less costly materials without impairing required quality;
- * Improvement in quality or changes in specifications that would lead to savings in process time or other operating savings;
- * Developing new sources of supply;
- * Greater use of bulk shipments;
- * Quantity savings due to large volume, through consideration of economic order quantity;
- * A reduction in unit prices due to negotiations;
- * Initiating make-or-buy studies;
- * Application of new purchasing techniques;
- * Using competition along with price, service and delivery when making the purchase selection decision.

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