

# Inventory

---

## Maintaining Enough Inventory

It's very important to make sure you have enough inventory to cover your demands. If you don't have an item in stock, consumers can't purchase it from you. In fact, they will most likely purchase it from one of your competitors.

When ordering items for inventory, keep **lead time** in mind. Lead time is the time between reordering items and actually receiving them. Order processing, order filling, and transportation usually take place during this time. It may be days, weeks, or months, depending on your supplier. Placing the order in advance assures that the products will be there when you actually need them.

To be cautious, you may want to build a **safety margin** into basic inventory figures. Ordering extra goods will decrease your chances of experiencing a shortage. This margin may be arbitrary or based on a percentage of your anticipated inventory needs. A safety margin can also mean ordering your items a few days earlier than you normally would. This is a good idea if your supplier tends to be late on delivery. After you've been in business a while you'll have a better idea of how to calculate your safety margin.

## Avoiding Excess Inventory

While you want to have enough items in inventory to satisfy demands, you don't want to have *too* much. This is especially important for seasonal items that no one wants after the season is over, or perishable products that may lose value or quality by sitting on the shelf. Also, the more inventory you have, the more money you spend on overhead costs, loans, insurance, and other expenses. You may want to consider ordering fewer items at a time, but ordering more often.

## Prioritizing Inventory Needs

If you've ever heard of the 80/20 rule, you probably know that about 20% of the products you sell will provide about 80% of your profit. This 20% consists of things that consumers regularly buy from you, and sometimes, only you. Figuring out what those items are by

analyzing sales records or other documents will help you decide what needs to be in stock and what doesn't. Prioritizing is especially important when you have limited resources and can't keep large inventories of every item.

Don't underestimate the importance of less expensive items! They often have a higher turnover ratio, that is, they move in and out of inventory quickly. Therefore, they need to be replaced more often. They also may contribute more to your company's profit than you realize. When you sell ten \$5 items as often one \$50 item, they've each generated \$50 in sales. Keep these products at the top of your re-ordering list.

## **Inventory Control Programs**

Many inventory control programs used now are software applications for your computer. These programs allow you to do several things, including:

- \* Calculate when you need to reorder
- \* Analyze inventory levels
- \* Monitor changes in unit dollar costs

Another option is to set up your cash register with a point-of-sale software system. POS records each sale as it happens, so inventory counts are always up to date. In addition, it will provide you with more information than other inventory control programs. With a POS system, you can:

- \* Analyze sales data for use in adjusting prices
- \* Maintain a sales history to help adjust buying decisions for seasonal trends
- \* Improve pricing accuracy by using the system's bar-code scanners and credit card authorization ability

## **Inventory Accounting**

When you add or remove items from inventory, you will need to be sure they're accounted for. While you'll probably want an accountant to keep track of the actual numbers, it's still important to understand how the system works.

Different methods can be used for inventory accounting. The last in, first out (LIFO) method assumes you will sell the most recently purchased inventory first. For instance, suppose you purchased five units of a product for \$10 each last month and five more units for \$12

each this month. Using the LIFO method, \$12 would be assigned to each item taken out of inventory until all five recently purchased products are gone. For each item after that, \$10 would be recorded. Keeping less expensive units has its advantages when it comes time to pay taxes on your inventory.

The opposite of LIFO is the FIFO (first in, first out) method. As its name indicates, the goods you receive first are the goods you sell first. Using the example above, the \$10 items would be recorded before the \$12 items. This means the value of your inventory is at its most recent price. FIFO is usually used during periods of relatively low inflation.

Another method used in inventory accounting is the average cost method. Each time new inventory is added, the average cost of the items is recalculated. In the example above, the average cost of the ten items would be \$11 after this month's purchase was made. Now each item taken out of inventory would be recorded as costing \$11.

These are the most commonly used methods in inventory accounting. The method you use should meet your business's individual needs. Ask your accountant what he or she recommends.

## **Buying Inventory**

Your inventory control system will give you a good idea of what you should buy and when you should buy it. **Open-to-buy** is the dollar amount budgeted for inventory purposes for a given period, such as a month. At first you may have to figure this amount by the amount of sales you need to cover your costs and the expected sales volume as stated in your business plan. After about a year, your inventory control system will provide you with more concrete figures.

Typically, your open-to-buy can be figured by using the following formula:

Planned inventory	\$25,000
Planned sales	<u>\$25,000</u>
Equals	\$50,000
Less actual inventory	(\$27,000)
Less stock on order	<u>(\$13,000)</u>
<b>Equals open-to-buy</b>	<b>\$10,000</b>

Remember that this is just an example and that your figures may be very different than those shown. You may want to increase or

decrease the calculated open-to-buy amount based on seasonal fluctuations in demand.

## **Types of Suppliers**

Suppliers may contact you through sales representatives, but when you're just starting out you might need to contact them. Trade shows, wholesale showrooms and conventions, buyers' directories, yellow pages, trade journals, and websites are all good places to look for suppliers.

There are four basic types of suppliers. **Manufacturers** usually have the lowest prices and will assign a regional sales rep to take care of your needs. However, they may require that large quantities be purchased in order to fill the order. **Distributors** buy large quantities of items from manufacturers and warehouse them for sale to retailers. You may want to consider buying from them if you'll be buying in relatively small quantities from a variety of manufacturers. **Independent craftspeople** offer unique and exclusive products through sales reps or at trade shows. They may be a good choice if you own a specialty store or want to sell one-of-a-kind items. **Import sources** include domestic importers who buy foreign goods specifically to resell them to retailers. You may also want to consider traveling abroad to buy foreign goods yourself.

## **Choosing a Supplier**

A supplier's customer orientation is arguably the most important consideration when deciding whom to buy from. A good supplier will not only provide the products you need when you need them, but will also be an advocate for your business. The sales rep should be familiar with your company and industry so that he or she can make reliable recommendations on which products suit you best.

Relationship building is increasing rapidly in buyer-seller affairs. Rather than buying from a different supplier each time, consistent purchases from a single manufacturer will likely be more efficient. The more a sales rep knows about you and your company, the better your needs will be met. Also, reordering products is made much easier when you're already familiar with what is offered.

Once you've made a list of potential suppliers, ask them to submit a sales proposal. This document includes a description of the company, characteristics of the products offered, prices, and other relevant

information. Ask other retailers for supplier references. Getting to know your supplier before committing to an order will help you to make a better choice.