Improve Your Inventory Management, Improve Your Profits

Reducing Your Inventory

Besides your property and buildings, your next largest asset or investment is your inventory holding.

While the value of your inventory asset is generally reflected in a 'Stock Valuation' as discussed below, there is also an added cost of carrying your inventory. The standard 'rule of thumb' for inventory carrying cost is 25% of inventory value on hand.

This means that for every $100 spent on purchasing an item, it will actually cost another $25 in capital, management and storage costs. For this very reason it is important to ensure your inventory asset performs as efficiently as possible.

Remembering that your inventory investment refers to how much you have paid someone else for the privilege of putting their product on your shelf or in your yard. How well this asset performs for you can determine the success or failure of your business.

A key goal of any retail organisation is to maximise store profitability and our experience shows us that most try to do this by raising sales revenues. Advertising more, increasing sales staff, expanding display space, enlarging the store, or running a sale all might increase revenue but will definitely increase costs.

In this issue of the Building Better Business series we will look at a number of key strategies that can be used to deliver increased profitability through the real cost savings of reducing excess inventory and improving stock performance.

To improve the performance of your stock you need to know 3 things;

1. How much is my investment in stock?
2. What products do I have too much of?
3. What are my best & worst performing products?

How Much Of Your $$$ Is Tied Up In Stock?

Stock Valuation

The first measurement to look at is simply the total value of your stockholding, a Stock Valuation. Experience has shown us that many businesses think they know the value of their investment in stock but either do not have the tools or processes in place to report an accurate figure.

At the very least, a business should have an "ideal inventory valuation". You should know what that represents as a percentage of sales, and be able to measure any monthly fluctuation from the average. If an increase in stock valuation is not closely followed by an increase in sales then it is an early indicator of stock related problems.

What Products Do I Have Too Much Of?

Excess Stock

Excess stock can be the silent killer of your inventory performance and subsequently your cash flow. In general this is the result of either out of control or ill informed purchasing.

A simple measure of Excess stock is the quantity of products over and above a set number of days worth of sales.

For example: If sales of Product A for the last six months is 60 and your preferred stock holding is 6 weeks then that equates to a preferred stock = 15 units. If our current stock holding for the product is 20 then your excess stock figure = 5.

What should you do with excess stock?

Return it
Contact the supplier & see if they will take the stock back & credit you for it.

Swap it
If the supplier will not give you a credit then see if they will swap this stock for stock that you need.

Clearance
Set up a clearance section in your store & mark the price down to assist in clearing these goods. You are much better off getting a reduced price for this stock as it puts money back in your pocket & not collecting dust on the shelf.

Move it
If you have other branches that sell these items then move them to the correct branch. Some items sell better depending on the location & customer mix.

Swap it with another Group Member
If you are a member of a national buying group then see if these products are needed by other buying group members in other areas/states.

Once you have identified your excess stock and put in measures to reduce how much you hold it is just as important to put systems in place to ensure the problem does not recur.

Set minimum & maximum levels

Most excess stock situations occur because purchasing is done without the information necessary to make informed decisions on products and quantities. Set minimum and maximum stock levels on all your products and ensure that this information is visible to whoever is raising your purchase orders.

It is important that this information is maintained to suit seasonal trends and any market trends. An easier solution is to have this set up to automate the min & max levels based on sales trends. This automated process should also take into account seasonal trends. For example, you should have fewer heaters in summer, etc.

Supplier deals
Speak with your suppliers and ensure that there are no minimum purchase quantities on the products you order.

Core range
Set up a core range of products that represents what you wish to keep in stock and set controls in place that requires authorisation or validation of purchases outside of that range. Never let staff dictate what they can & cant put into stock. Make staff aware that a purchase order is a blank cheque with the funds coming out of your bank account.

Consignment stock
Consignment stock gives a business the ability to have SOH available for your customers to purchase that you have not had to pay your supplier for. This will hugely assist with cash flow. Also the fact that the supplier will not send you an invoice for the goods until you have sold them means that you have extended your trading terms with your supplier significantly.

Sale or return
If a supplier wants to introduce a new range of products then ask them to do sale or return. This puts the pressure back on the supplier to assist in the selling of these items. Tell the supplier that you are happy for these products to be trialled at your store but you will only pay for goods that are sold.

If the supplier really believes that there is a market for these products then he will agree. If he doesn't then you were going to get stuck with them anyway so why take them in the first place.

Dead Stock

Whilst 'Excess Stock' can be a drain on your cash flow it will eventually sell and produce a return on your investment, 'Dead Stock' on the other hand is unlikely to provide a return. The measurement of 'Dead Stock' is the value of your inventory that has not been sold within a pre-determined period of time.

What should you do with Dead Stock?

Dealing with Dead Stock is much the same as dealing with Excess Stock but as it is unlikely to sell and provide a return a few extra options should be considered.

Auction

Send the goods to an auction house to try to get back as much money as possible.

Write-Off

Writing-Off the stock and simply disposing of it is the absolute last resort & preference should be given to donating these products to charities or offering them as gifts/prizes etc.

Donate

Local Tafe colleges are always on the look out for products that they can use during training. As an example a Tafe student will not care if the Vanity Basin they are installing is apricot instead of white. This also creates a good relationship with future customers as the apprentices of today are the tradesmen of the future.

What Are Your Best/Worst Performing Products?

Gross Margin Return on Inventory (GMROI)

Gross Margin Return on Inventory is an overall measure of the effectiveness of the money you have invested in your inventory holdings. A good GMROI reporting tool enables you to not only measure the performance of your inventory investment but helps to identify stock holdings that could be reduced, products that could be dropped and also stock holdings that should be increased.

The GMROI of a product is calculated by dividing the gross margin made on sales by its average inventory cost over the same period and tells us how profitable a product is.

To give an example of GMROI from an overall business perspective, let's say a business has made a gross margin of $250,000 and had an average inventory valuation of $140,000 for the same period. This means it has a GMROI of 178 % or $1.78. In other words, they are getting back $1.78 for every $1 invested in inventory.

As a guide, a GMROI of between 150 and 200 % is commonly regarded as satisfactory.

When analysisng the GMROI performance of a product there are a number of elements that must be considered before making the decision as to which products to reduce, drop or increase.

Possible causes of a poor GMROI performance could be the argin was too low or the inventory was too high.

Possible causes of the GMROI being too high could be that your inventory was too low which caused frequent out-of-stocks or the product was priced too low – The GP % could be improved without negatively affecting sales.

For this reason, the GMROI performance of a product should be compared with "like for like" products or to the product category as a whole

Summary

The Sterland Group have spent the last 90 years working in and around the building supplies industry. We know that times are tough and now more than ever business owners and managers are expected to do and know more than ever before. Effective inventory management is an important part of helping you increase your profitability whilst improving your cash flow and gaining an overall improvement in your business.

The strategies outlined above are key to achieving that goal.

Contact us

If you would like more information on anything written here or have any general questions relating to how the Sterland group could help your building supplies business please contact us.

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