

By Chris Quinn and Rex Stewart

Why implement an inventory control system?

For one thing, it can reduce the cost of running your business. Furthermore, it can improve customer service through lower out of stocks. The best reason of all – it makes the job of ordering easier.

Setting up an inventory control system offers other benefits, and the results can be substantial – a fluid inventory, increased margins, and reduced shrinkage. It also enables the operation to prepare for the buyers absence, because records created will enable someone unfamiliar with the task to do the ordering.

Inventory control systems offer a fluid inventory, increased margins, and reduced shrinkage

Ordering

The first key to controlling inventory is to keep accurate ordering records. Order sheets should be set up by vendor, and include all vital information needed to fill out the order. At the top of each order sheet, include the name of the vendor, the phone number, time order is placed, name of contact person, and other information, such as who calls who, minimums, etc. Also put the date at the top of each order sheet and above each ordering column.

List all products and divide ordering responsibilities in logical manner, such as by department and location. Leave room for quantity on hand and ordered. Also indicate out of stocks and items discontinued.

The information gathered will take the guesswork out of ordering. The purchaser will know when to order and will be able to reduce out of stock and over ordering.

Organizing your ordering will also help your suppliers. It will be easier for them to maintain the necessary level of stock if your ordering is consistent.

Keep order sheets to create a historical record, and study seasonal and yearly fluctuation in sales. From this information, you will know which items to discontinue, determine products and shelf allocation and set sales goals for each department.

Set guidelines for dealing with slow movers. Look at the current column, and determine the potential volume. Also evaluate the margin and contribution to departmental margin (see below). Before discontinuing, consider providing promotional support and giving it a more prominent spot on the shelf if the product and potential warrant the support.

Order Point

In order to maintain the optimum level of stock, it is important to determine the lead-time necessary for ordering some items. The lead-time is the amount of time it takes to receive the bulk product once the order has been placed. By determining the lead-time for an order and the average weekly sales of a product, the order point can be determined.

Ideally, the current bulk level of the product should be running out just as the new bulk product arrives.

A good example to use is ordering bulk 10w30 motor oil. Let's assume the lead-time is one week, and we want to determine the order point for 10w30. Average weekly sales for 10w30 motor oil is 100 gallons a week, and the bulk storage tank holds 500 gallons, so our order point is 400 gallons: when our current stock reached that point, we need to place another order.

Your order system needs to reflect seasonal fluctuations. The weekly selling rate is not fixed. Another consideration that needs to be made when determining the order point is the desired amount of safety stock of fast movers to guard against out of stocks or irregular lead times. This may be needed for back stock, etc. The operations desired level of customer service must also be determined. Ideally, your business would never have any out of stocks; a more realistic goal may be to aim for a 95% in stock rate. This goal is weighed against the goals for inventory turns, which should be developed for each department.

Creating a Fluid Inventory

Inventory turns are directly related to product margins and each department's contribution to margin. It costs money to carry an item. The longer the motor oil is sitting in the tank, the more it costs to sell – which is why slower moving items, such as tires, historically have a higher margin than faster moving items, such as spark plugs. Inventory turns and margins may vary within each department also, reflecting the volume of sales for each product category.

Use the following formula to determine inventory turns:

Inventory turnover = Cost of goods sold/average inventory

Determine margin contribution, by department or by item, and setting goals for inventory turns for each margin category are very helpful in evaluating specific items in stock and creating a fluid inventory.

This formula is used for determining the contribution to margin.

Margin x percent of total sales = Margin contribution

To determine the total realized margin, add up the contributions to margin. For margin. For example, if we were examining the margin contribution of each department, our analysis might look something like this:

Buying ahead on specials

A common practice is to buy extra of a product that is on special and sell it at the regular price to make extra margin. As a general rule of thumb, buy no more than a month's worth of inventory and only on high volume items. For example, if you sell 3 cases of bottled motor oil a week normally, buy 12 cases right before the special goes off (including current stock that will be leftover after the sales ends) and sell it at the regular price.

Reduced Back Stock

Order for the shelf. The buyer's goal is to balance between out of stocks and low inventory, and this is possible with proper ordering records.

If you have the choice of holding back stock or ordering more often, the best choice, most likely, is to increase the number of times you order. If you have good control of your inventory, your back stock area will contain only high volume items and products on sales. Organize the back stock area to make ordering and stocking easier. Items can be organized in the same manner as they are stocked on the retail floor.

Take Inventories

Some businesses take monthly inventories, but quarterly inventories are generally stiffest. However, more frequent inventories may be needed for perishables and when establishing new departments.

Record all shrink at retail priced, including product markdowns (difference between original price, and price sold). Calculate shrink monthly to determine the realized margin as compared to ideal gross margin.

Business Security

An important aspect of inventory control is controlling the amount of product that goes out the door unpaid for. Although many of us feel certain that theft is not a problem in our business, others are aware that the least suspected people could be robbing the business blind. That lesson, unfortunately, is often learned through experience. Business is often surprised to find that they have more pilferage problems from employees than they ever could have imagined.

Basic precautions must be taken. Your operation's goal should be to keep the honest people honest. The following check points will help:

- Locate all keys or change the locks. Organize operations to reduce the number of keys issued. Set-up the schedule so that no one is ever working alone at the business
- Provide lockers or a secure area for employees to store personal belongings. Do not let employees ring up their own purchases at the register.
- Set-up a cash register accountability system. All transactions should be track able to a cashier. Set-up systems for paid outs, voids, and refunds. Develop a count out procedure that is verified by a second party.
- When receiving product, check all orders and have the person who checked in the order sign the invoice.
- Do not leave delivery people unattended in unsecured back stock areas.

Improved Security through better design/layout

It is easier to prevent theft than it is to catch a thief. Reduce the risk by designing a business that minimizes the opportunity. Run all departments with a plan in mind that provides greatest visibility of departments to key personnel.

Use lighting and product allocation to deter the prospective thief. Turn dark and dead end areas into bright and noticeable attractions. Employee and Customer traffic is a great deterrent to a thief.

Back stock is most vulnerable to theft. Keep the receiving door closed and locked from the outside when not in use.

Alarm systems are helpful also. Some alarm systems have codes for employees, which they must register in order to enter the building during off hours with out setting off the alarm. This is another way to help keep employees honest.

Check the interior and exterior of the building at each access. Consider extra security measures, such as lighting the back side of the building, a fence around the loading dock, or leaving some lights on inside the business.