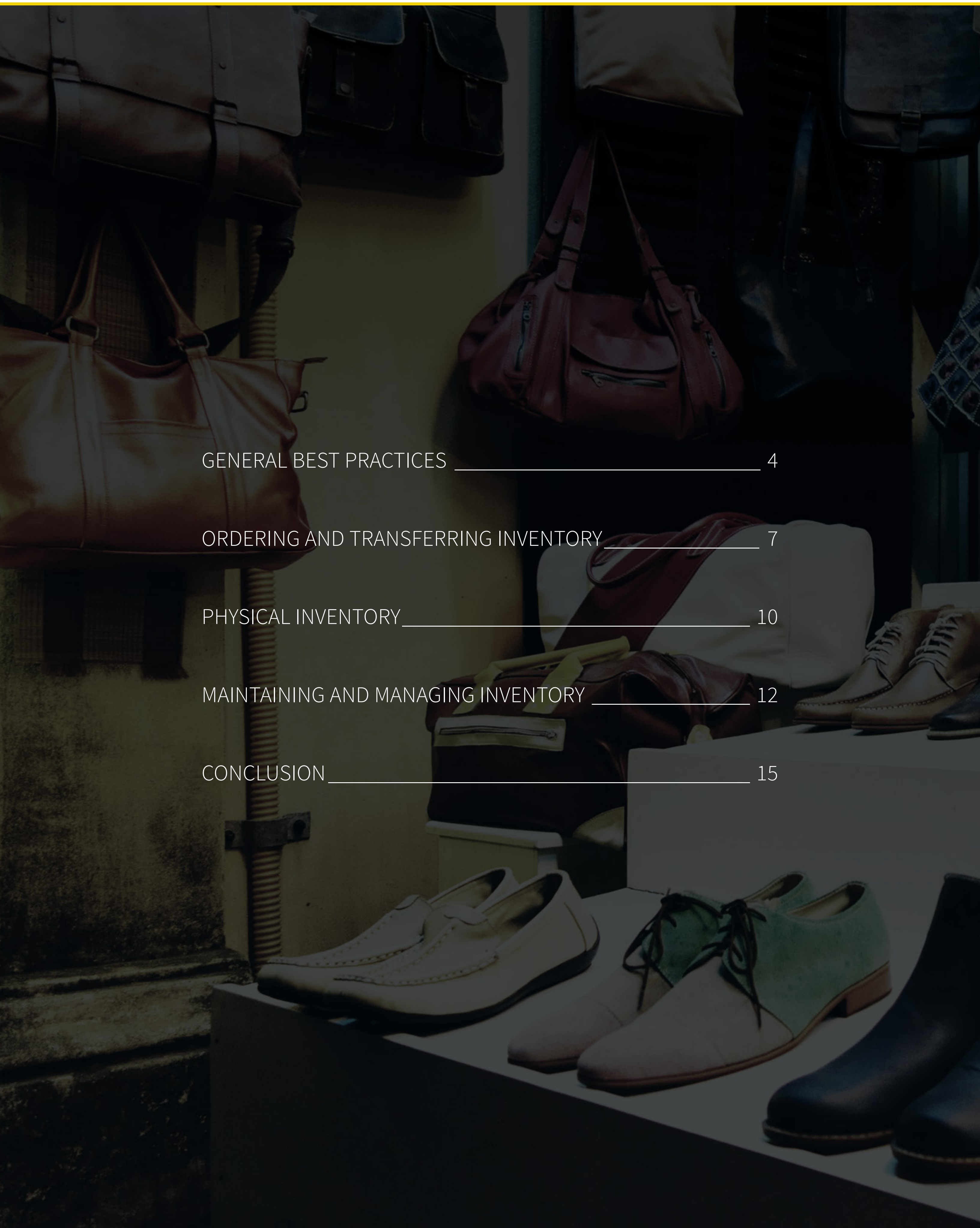
Tactics to Optimize Inventory Management

With an average of 6-12% of inventory-related costs due to a missed opportunity to invest elsewhere and another 6-12% of costs dependent on obsolete inventory, ***almost 25% of inventory management costs could be eliminated or reduced by simply rethinking your strategy.***



Introduction

As a business owner, you deal with lots of numbers and statistics. You calculate daily sales and analyze this data over time to make decisions. You generate equations that display your return on investment to show which products are most profitable. And high profitability makes stocking an item worthwhile, right? Speaking of stock, your more mundane calculations include typing in values for each SKU (Stock Keeping Unit) as you decide what quantities to order, how much of a product you should carry at a time, and when it's time to reorder. Exciting, right?

Inventory management isn't glamorous, but you should care about it anyway.

Why? Because while accurate purchase order planning might not exactly thrill you, it's a necessary step towards optimal profit. Remember what we said about the relationship between stock and profitability? Inventory influences sales. Sales drive business. Business creates profit. And that should certainly thrill you.

Having the right product at the right place at the right time is the reason why sales occur, making it absolutely crucial to use all of the information at your disposal to make stock-keeping decisions. When you're not selling merchandise, you're losing money. Period. Whether it's in the form of a missed opportunity, when a customer goes elsewhere to find a product you don't have in stock, or a simple drain on your operating budget, as you pay to store merchandise that isn't moving out the door, you're losing money and potential sales.

In short, proper inventory management allows you to run your business in the most effective and profitable way possible.

In this e-book, we will outline some tips on how best to manage your inventory, putting you in charge of your store's success.

GENERAL BEST PRACTICES

Keep as much product on the sales floor as possible.

You lose money when you're not selling product. By keeping items in the stock room rather than out on the sales floor, you're essentially turning your warehouse or back room, which should be a temporary pit stop between the supplier and the store front, into a very expensive storage facility. Backup inventory is meant to supplement products that are displayed in the showroom, providing sizing options and preventing the store from looking too cluttered or crowded. It is not meant to store items that are not currently for sale in the store; this way of operating drains resources and leads to wasted opportunities. If it's in your store, it should be for sale.

Measure turns and increase turn rate to move product steadily through the purchase cycle.

In order to maximize the profit potential of a product, it is imperative that products are swiftly transferred from the stock room to the sales floor where they can be sold. The rate at which inventory is sold within a certain time frame, inventory turnover (or turn), indicates how efficiently a product is moving through this sales cycle.

The standard equation for calculating inventory turnover is:

$$\text{INVENTORY TURNOVER} = \frac{\text{COST OF GOODS SOLD}}{\text{AVERAGE INVENTORY}}$$

This provides you with data to show which products sell most quickly and make you the most money. On the flip side, you can view which products have slow inventory turnover and lead to lost opportunities. And just like that, you have immediate access to what's making money and what's losing money.

Know your inventory costs.

True or false? Your inventory costs only involve the funds required to buy products that you intend to sell to customers.

False!

The costs of inventory go far beyond what it takes to stock a product, making it even more important to be aware of which products are selling well and which items are simply taking up space and draining your resources.

The typical costs associated with maintaining inventory are:

6-12% — Opportunity
If you didn't have this money tied up in inventory, you'd be able to invest it more efficiently (put it in the bank, use it to grow your business, etc.).

6-12% — Obsolete Inventory
Either you ordered too much of this or demand fell before you could sell it, and now no one wants it. So you're stuck with it.

3-10% — Taxes and Insurance
The fun stuff.

2-5% — Warehouse/Storage
The cost of your warehouse, utilities, and storage.

2-4% — Handling
This includes the time you and your employees spend handling inventory whether you're performing a physical count, keeping inventory clean and organized, or tagging and labeling.

2-4% — Breakage and Theft
Inventory that is broken, damaged, or stolen and thus unable to be sold.

1-4% — Clerical
Purchasing, keeping records, and any other associated work.[1]

ORDERING AND TRANSFERRING INVENTORY

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Plan before you buy.

Use the data at your disposal to plan out your inventory rather than simply reordering using the same quantities you always have for convenience's sake. In the long run, profits trump convenience. Take the time to analyze which items are profitable and use past numbers and other data to forecast future demand. Only after thoughtful data-driven planning should you start buying and stocking products.

Use and analyze past seasonal orders to determine how to price product.

If you're in the process of ordering merchandise for a particular season, use seasonal data from previous years to guide your pricing decisions. Too often, merchants get stuck pricing seasonal or trend-driven products too high and are eventually forced to reduce prices and offer discounts to clear out slow-moving inventory to make way for new shipments.[2] You can reduce the probability of having to cut your profit margins by utilizing the data at your disposal to forecast demand and properly stock your store.

A Word to the Wise

Mother Nature has a way of creating and stifling demand with atypically warm or cold seasons. Be careful to factor this into your analysis by using many years of accumulated data rather than simply relying on last season's numbers.

Generate automatic purchase orders to save time and reduce manual errors.

If you know that you are going to repeatedly purchase the same quantity of an item or items over a certain period of time, save time by using this function. Less wasted time + fewer errors = better business.

Create and configure Model Stocks based on seasonal demand.

To save yourself time, avoid mistakes, and ensure that your store is well stocked, create Model Stocks for products you consistently carry and sell. These quantities, which should be based on past data and forecasted demand, represent the total number of a particular item that you would like to have available at your store at any time.

Demand, however, can be different at various points of the year. (Depending on your region, demand for flip-flops in January probably varies a little from flip-flop demand in July.) Create Seasonal Models based on the trends you see in your store(s) so you always have the right merchandise at the right time. By doing so, you'll miss fewer opportunities, enhance customer service loyalty and increase sales.

Make sure to enter received POs into your inventory management system.

It's important to make sure you account for the product that comes in a shipment through your back door as diligently as you do for the product that walks out the front door in the hands of a happy customer. When you receive a shipment, match the desired order quantity with the actual stock received and account for differences in these numbers in your inventory management software. This keeps your data clean and organized, providing you with accurate reporting to make thoughtful, data-driven decisions.

Buy from yourself first.

When possible, exhaust your own resources before turning to your vendors. Work to equalize inventory in a multi-store environment by generating transfers from stores that are stocked above their Model Stocks to stores that are below model quantity of a particular product. This allows you to balance resources within your organization and prevents you from ordering unnecessary stock from a supplier and ending up stuck with a surplus of inventory.

PHYSICAL INVENTORY

Count inventory regularly.

Even the most elite retail management software can't account for data it doesn't have. Since theft isn't exactly listed as a daily transaction, you have no way of knowing that two pairs of shoes just left the store, hidden in a backpack. You can mitigate the effects of missing inventory by regularly performing a physical count of the merchandise within your store. This ensures that your data is accurate and product is available for customers who want it. Customers walk away satisfied; you don't miss out on a sales opportunity; everyone's happy.

Count inventory regularly…in manageable segments.

Full inventory of an entire store is a daunting task. It's a good practice to perform this comprehensive inventory count on a quarterly or biannual basis, but it isn't necessary to count everything in the store every time you do inventory. Get in the habit of segmenting the store into different product categories and take inventory of these sections frequently. Thoroughly count women's apparel one day, kids' shoes the next, and work through each section of your store using this manageable procedure so you're consistently up-to-date and familiar with your products.

Make sure to refrain from other actions while counting inventory.

Ringing sales, generating reports, entering purchase order information, and any other data-related activities should be put on pause while you're counting inventory in order to avoid mistakes and ensure that your numbers are accurate.

Account for items you can't sell.

In order to represent items that you have accounted for while taking inventory but cannot sell, classify these as non-sellable within your retail management software. This classifies the item as unable to be sold and therefore necessary to replace, even though it was not purchased.

If the item is defective, damaged, or is not in a condition to be put back on the sales floor, the item should be declared non-sellable and either managed back to the vendor or donated. Run reports on your non-sellable inventory to track what merchandise has not been reliable and has caused problems with your customers in order to discuss refunds or marketing dollars back from the suppliers.

MAINTAINING AND MANAGING INVENTORY

Liquidate non-moving items to make space for profitable products.

Sometimes it's better to just cut your losses and move on. "At the end of the day, turning a smaller profit on slow-moving inventory is better than losing money while it takes up space and bottom line."[2] Running "buy one, get one" promotions and offering discounts are good tactics for moving stagnant inventory through the purchasing cycle. Once the last of these items have been cleared out of the storeroom, you can utilize the data and reports at your disposal to accurately gauge demand and make way for profitable merchandise.

Check data and reports frequently.

Monthly status updates are not frequent enough to provide a relevant snapshot of how your store is performing. With a real-time retail management software system, you have the ability to generate reports whenever you want; take advantage of this tool! The more often you access these numbers, the more quickly you will be made aware of red flags, allowing you to perceive and solve problems before they grow and threaten the success of your business.

Pay attention to availability dates and pricing changes.

As long as we're talking about diligence and staying up-to-date with pertinent business information, it's worth noting the importance of staying aware of vendor changes as well. Your business doesn't operate in a vacuum; not only do you need to consider the inner workings of your own business, but you must be conscious of shifts and alterations with your suppliers.

Create compliance policies to standardize your inventory process.

In order to make sure things are done the right way the first time, it is necessary to establish checkpoints and tasks that must be completed before a product can go on the sales floor. These procedures cover the way products are chosen, shipped, stocked, and counted before they can be sold. The policies should be constructed and instituted based on data, ensuring that there is a reason behind every single inventory-based decision you make, rather than relying on unpredictable "gut" feelings or personal preference.

Utilize drop shipments to avoid too much inventory on hand.

Drop shipping products lets you transfer customer orders directly to the manufacturer, allowing you to keep available space open in your own inventory while still making the sale. You can maximize your inventory space in this way by going straight to the source, keeping your stock room from becoming unnecessarily cluttered.

Conclusion

There are a couple overarching themes that encompass the majority of inventory management best practices.

Gather information frequently and diligently.

Counting your inventory once a year doesn't cut it. Purchasing trends change seasonally and demand can be fickle. Stay up-to-date with your store's inner workings by running reports often and by keeping track of your physical inventory on a regular basis, comparing these numbers to those within your inventory management system in order to have access to accurate statistics.

Use data to make decisions.

Whether you're deciding how much of a certain product to order or determining which items are popular and profitable, utilize the mass amounts of data at your disposal to generate reports to inform your decisions. No matter what your "gut feeling" tells you, data doesn't lie. So use it.

Even though inventory management isn't necessarily the most exciting facet of your business, it is necessary, and when it's done right it can substantially improve your store's profitability.

And increased profit is certainly exciting.

Citations

[1] Yahoo! Voices
http://voices.yahoo.com/9-proven-tips-control-inventory-12111592.html?cat=3

[2] Multi-Channel Merchant
http://multichannelmerchant.com/opsandfulfillment/4-liquidation-tips-for-slow-moving-merchandise-06042012

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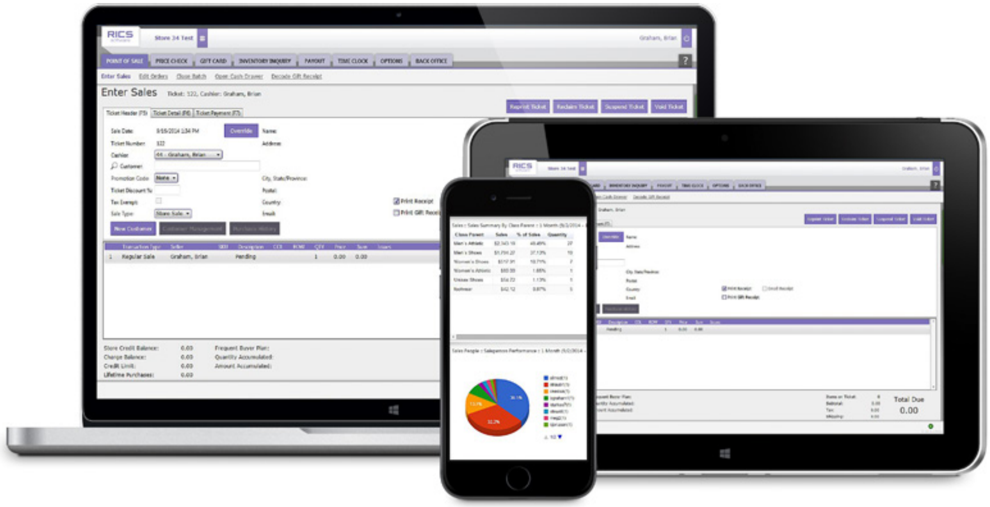

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