

INVENTORY MANAGEMENT

Introduction

Every enterprise needs inventory for smooth running of its activities. It serves as a link between production and distribution processes. There is, generally, a time lag between the recognition of need and its fulfilment. The greater the time - lag, the higher the requirements for inventory.

The investment in inventories constitutes the most significant part of current assets/working capital in most of the undertakings. Thus, it is very essential to have proper control and management of inventories. The purpose of inventory management is to ensure availability of materials in sufficient quantity as and when required and also to minimise investment in inventories.

Meaning and Nature of inventory

In accounting language it may mean stock of finished goods only. In a manufacturing concern, it may include raw materials, work in process and stores, etc. Inventory includes the following things:

(a) Raw Material: Raw material form a major input into the organisation. They are required to carry out production activities uninterruptedly. The quantity of raw materials required will be determined by the rate of consumption and the time required for replenishing the supplies. The factors like the availability of raw materials and government regulations etc. too affect the stock of raw materials.

(b) Work in Progress: The work-in-progress is that stage of stocks which are in between raw materials and finished goods. The raw materials enter the process of manufacture but they are yet to attain a final shape of finished goods. The quantum of work in progress depends upon the time taken in the manufacturing process. The greater the time taken in manufacturing, the more will be the amount of work in progress.

(c) Consumables: These are the materials which are needed to smoothen the process of production. These materials do not directly enter production but they act as catalysts, etc. Consumables may be classified according to their consumption and criticality.

(d) Finished goods: These are the goods which are ready for the consumers. The stock of finished goods provides a buffer between production and market. The purpose of maintaining inventory is to ensure proper supply of goods to customers.

(e) Spares: Spares also form a part of inventory. The consumption pattern of raw materials, consumables, finished goods are different from that of spares. The stocking policies of spares are different from industry to industry. Some industries like transport will require more spares than the other concerns. The costly spare parts like engines, maintenance spares etc. are not discarded after use, rather they are kept in ready position for further use.

Motives of Holding Inventors

There are three main purposes or motives of holding inventories:

- (i) **The Transaction Motive** which facilitates continuous production and timely execution of sales orders.
- (ii) **The Precautionary Motive** which necessitates the holding of inventories for meeting the unpredictable changes in demand and supplies of materials.
- (iii) **The Speculative Motive** which induces to keep inventories for taking advantage of price fluctuations, saving in re-ordering costs and quantity discounts, etc.

What Is Inventory Management?

Inventory management is the practice of planning the buying, storing and selling of stock—whether it's raw materials, parts or finished goods—to ensure the right type and amount of stock is available without holding excess stock and thereby tying up cash. When done correctly, inventory management saves companies money.

What Is the Main Purpose of Inventory Management?

The primary purpose of inventory management is to ensure there is enough goods or materials to meet demand without creating overstock, or excess inventory.

Risk and Costs of Holding Inventors

The holding of inventories involves blocking of a firm's funds and incurrence of capital and other costs. It also exposes the firm to certain risks. The various costs and risks involved in holding inventories are as below:

- (i) **Capital costs:** Maintaining of inventories results in blocking of the firm's financial resources. The firm has, therefore, to arrange for additional funds to meet the cost of inventories. The funds may be arranged from own resources or from outsiders. But in both cases, the firm incurs a cost. In the former case, there is an opportunity cost of investment while in later case the firm has to pay interest to outsiders.
- (ii) **Cost of Ordering:** The costs of ordering include the cost of acquisition of inventories. It is the cost of preparation and execution of an order, including cost of paper work and communicating with supplier. There is always minimum cost involve whenever an order for replenishment of good is placed. The total annual cost of ordering is equal to cost per order multiplied by the number of order placed in a year.
- (iii) **Cost of Stock-outs:** A stock out is a situation when the firm is not having units of an item in store but there is demand for that either from the customers or the production department. The stock out refer to demand for an item whose inventory level is reduced to zero and insufficient level. There is always a cost of stock out in the sense that the firm faces a situation of lost sales or back orders. Stock out are quite often expensive.
- (iv) **Storage and Handling Costs.** Holding of inventories also involves costs on storage as well as handling of

materials. The storage costs include the rental of the godown, insurance charge etc.

- (v) **Risk of Price Decline.** There is always a risk of reduction in the prices of inventories by the suppliers in holding inventories. This may be due to increased market supplies, competition or general depression in the market.
- (vi) **Risk of Obsolescence.** The inventories may become obsolete due to improved technology, changes in requirements, change in customer's tastes etc.
- (vii) **Risk Deterioration in Quality:** The quality of the materials may also deteriorate while the inventories are kept in stores.

Inventory Management

It is necessary for every management to give proper attention to inventory management. A proper planning of purchasing, handling storing and accounting should form a part of inventory management. An efficient system of inventory management will determine (a) what to purchase (b) how much to purchase (c) from where to purchase (d) where to store, etc.

There are conflicting interests of different departmental heads over the issue of inventory. The finance manager will try to invest less in inventory because for him it is an idle investment, whereas production manager will emphasise to acquire more and more inventory as he does not want any interruption in production due to shortage of inventory. The purpose of inventory management is to keep the stocks in such a way that neither there is over-stocking nor under-stocking. The over-stocking will mean reduction of liquidity and starving of other production processes; under-stocking, on the other hand, will result in stoppage of work. The investments in inventory should be kept in reasonable limits.

Objects of Inventory Management

The main objectives of inventory management are operational and financial. The operational objectives mean that the materials and spares

should be available in sufficient quantity so that work is not disrupted for want of inventory. The financial objective means that investments in inventories should not remain idle and minimum working capital should be locked in it. The following are the objectives of inventory management:

- (1) To ensure continuous supply of materials spares and finished goods so that production should not suffer at any time and the customers demand should also be met.
- (2) To avoid both over-stocking and under-stocking of inventory.
- (3) To keep material cost under control so that they contribute in reducing cost of production and overall costs.
- (4) To minimise losses through deterioration, pilferage, wastages and damages.
- (5) To ensure perpetual inventory control so that materials shown in stock ledgers should be actually lying in the stores.
- (6) To ensure right quality goods at reasonable prices.
- (7) To maintain investments in inventories at the optimum level as required by the operational and sales activities.
- (8) To eliminate duplication in ordering or replenishing stocks. This is possible with help of centralising purchases.
- (9) To facilitate furnishing of data for short term and long term planning and control of inventory.
- (10) To design proper organisation of inventory. A clear cut accountability should be fixed at various levels of management.