Controlling retail inventories made easy

BY DON STALLINGS, CPA

Out of control inventories have probably been the death blow to more small businesses than any other cause. As long as your inventory stays in line with sales the business's cash flow remains manageable; however, inventory purchases far exceeding current sales can eat up cash flow in a hurry. Most banks will loan a certain percentage on inventories, but place a total dollar limit on inventory they will loan.

The first step in controlling inventories is to have a well thought out business plan along with a sales and marketing plan. One of the first steps in coming up with your sales and marketing plan is to know exactly how many times inventory in similar businesses normally turn over in one year. For example, a sporting goods store inventory might be expected to turn over 2 to 5 times per year with the more successful stores turning inventory at 5 times.

If your business plan outlined sales of $1,000,000 with a 33% gross profit margin and turning inventory 3 times, you would need an inventory of approximately $222,222. This is computed as follows: $666,666 cost of sales divided by 3 = $222,222. This inventory might have to be larger if for instance it takes your vendor a long time to deliver the product or if the majority of your sales were confined to two or three months of the year.

Another great tool in managing inventories is the "open to buy" worksheet. This worksheet simply compares how much inventory you have ordered to be delivered each month with the projected cost of inventory sold each month. The trick is to match orders with sales. For example, your business plan may call for sale of $100,000 in September at a margin of 40%. In that case your cost of sales would be $60,000. As your order, you list the dollar amount of each order in the September column until your orders for delivery equals $60,000. Assuming you meet your sales objective you inventory should remain constant. If your sales in September do not meet objectives, you just reduce your orders in subsequent months below expected cost of sales until your inventory is reduces to the desired level.

Managing retail inventories can be made much simpler by using the planning methods outlined in this article. You may need a helping hand from your CPA the first time around, but you will soon get the hang of it. **DBJ**

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