

Manage your stock effectively

What is stock?

Stock in terms of the normal business, is generally referred to as "trading stock". This includes anything that has been manufactured, produced or bought for the purpose of sale. Trading stock does not include such things as crops or timber or fruit while still growing (that is uncut or unpicked), as well as spare parts for repairs that are not for resale and also livestock with exceptions (see below for details).

Stock, however, has a much wider meaning. Stock also means raw materials, goods in progress, goods in process, as well as finished goods, and all represent various forms of stock encountered in an organisation. Each type represents money tied up until the stock leaves the factory or shop as a purchased product.

Likewise, merchandise stock in a retail store contributes to profits only when their sale puts money into the cash register. In a literal sense, stock refers to stock of anything necessary to do business. This represents a large portion of the business investment and must be well managed in order to maximise profits.

What is trading stock?

Trading stock includes anything produced, manufactured, acquired, or purchased for manufacture, sale or exchange. Things that are commercially regarded as trading stock generally fall within that definition for tax purposes as well. It includes livestock (but excludes standing or growing crops, timber or fruit while attached to the tree) stocks of spare parts for repairs or maintenance purposes and not for resale, manufacture as these become a deduction from your income when they are used, and video cassettes owned by a video lending library because they are used to earn income by hire or rental, not manufacture, sale or exchange.

Keep control of your stock

Businesses have a substantial part of their investment tied up in their stock. In order to be successful your stock must be managed in the best way to provide enough products for customers to be serviced and yet not too much that it causes financial problems in the sense of too much money tied up in stock sitting on the shelves. This management of stock is a skill that needs to be learnt and, if the business owner does not have experience in this area, it would be advisable that their accountant or business advisor be consulted.

The method of stock management also refers to the skills necessary to ensure that there is sufficient product mix to maximise a return to the business. This may mean ensuring that there is the right amount and the right types of product available at the right time in the right place for the right people. Good management therefore determines what to buy, when to buy and how much to buy.



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Control of stock is essential for these reasons:

1. You don't want to have a system where there is no monitoring of stock items. If you do not have the product on the shelf when the customer wants it you will lose a sale. At the same time you don't want to have too much stock sitting on the shelves because stock that is not moving is dead money.
2. There is a lot of money tied up in stock, so a good businessperson should be keeping an eye all the time on stock that moves slowly or is becoming too old to be of interest to customers. In this case the owner of the business must make a decision to quit that stock and turn it into cash, rather than having it sitting there any longer. A good system of control then allows the owner to identify this problem and take action immediately.
3. Information that is obtained from good management of stock will enable the owner to see just how often his stock is turning and then compare the stock turnover rate with the industry averages or with the stock turn rate of competitors (if it is possible to get that information).

Successful stock management requires a proper balance between the costs and the benefits of the stock. Costs, because there is money tied up in stock as well as storage and insurance etc, and the benefits, because you need to have adequate stock on hand in the ranges that are required or demanded by customers. The following points should be kept in mind:

- Financial risk is high if stock levels are high.
- Keep an adequate supply of stock which has a quick turnover.
- If stock is a slow seller, do not increase volumes whatever the price.
- Maintain good stock levels but don't retain obsolete or old stock.

How do you value stock?

1. **Cost price:** This includes all the costs of making the product or bringing the product into a state ready for sale. It involves all manufacturing costs including freight, duties, delivery charges etc.
2. **Market value:** This is the current or normal selling value of the stock. It is the generally accepted value on the market at that time and does not take into account the value if it is necessary to sell quickly for any reason.
3. **Replacement price:** This is the value taken as being the price of replacing that particular product or item on the day the transaction is to take place.

Managing stocks

Uncontrolled stock levels are unreliable, inefficient and costly. In attempting to control stock levels, managers usually lean towards keeping stock levels on the high side. Yet, this greater investment yields a lower return on the dollar invested. This is one of the contradictory demands made upon the manager or business owner with respect to keeping stock. Others include:

- Maintaining a good assortment of products - but not too many.
- Increasing stock turnover - but only at a good profit level.
- Keeping stocks low - but not too low.
- Making volume purchases to obtain lower prices - but not over-buying.
- Getting rid of obsolete items - but not before their replacements have taken hold in the market place.



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Successful stock management involves simultaneously attempting to balance the cost of stocks with the benefits of stocks. Many business owners often fail to appreciate fully the true cost of carrying stock. This includes not only direct costs of storage, insurance, taxes etc., but also the cost of the money tied up in the stock.

It is often not realised that small reductions in stock investment may result in large percentage changes in the company's total cash position. For example, one reward of improved stock management may be an increase in working capital, without the necessity of having to go out to borrow money elsewhere.

Stock turnover rate

One commonly used simple measure of performance by managers is the stock turnover rate. This value gives a rough guide by which managers can set goals and measure performance. It must be realised that the turnover rate varies with the function of stock, the type of business and how the ratio is calculated, for example, whether on sales or on cost of sales. On a cost of sales basis, the average stock turnover rate for manufacturers may range from 4 to 21. Various associations and professional organisations publish these types of values periodically, so they can be a useful guideline for matching up one's own business performance.

Stock turn ratio

This ratio indicates the number of times the stock in the business has turned over. The lower the rate the longer the stock is taking to turnover so funds are invested in inventory for longer periods which has an adverse effect on liquidity.

$$\begin{aligned}
 \text{Stock turnover} &= \frac{\text{Cost of goods sold}}{0.5 \times (\text{opening} + \text{closing stock})} \\
 &= \frac{\$425,000}{0.5 \times (\$40,000 + \$26,000)} \\
 &= 12.9 \text{ times}
 \end{aligned}$$

In this case stock is turning over almost thirteen times per year or approximately every four weeks.

Why do you have to stocktake?

If you operate a business the tax law says that you must record the value of all trading stocks you have on hand at the beginning of your income year, usually 1 July, and at the end of your income year, usually 30 June. This is so that you can work out whether or not you have a taxable income for the year. The best way to work out the value of your stock on hand is to count it.

Except for the first year you are in business, the value of your stock at the end of the financial year will be the same as its value at the start of the next financial year. If the value of the stock at the end of the financial year is more than at the beginning of the year, you must include the difference as part of your assessable income when you lodge a tax return. If the value of stock at the end of the year is less than at the beginning of the year, your assessable income will be reduced by that difference.

Manual stock control methods

At a very basic level, business stock records provide the information needed to make decisions about stock management. The number and kinds of records maintained, as well as the type of control system needed, depend upon the type and size of stock.

In a very small business where visual control is used, records may not be needed at all, or only for slowly moving or expensive items. In a larger organisation, where many items from various suppliers are involved, more formal stock records, such as cardex type files, are appropriate. In such a case, regardless of the type of records maintained, the accuracy and discipline of the recording system is critical.

Many small manufacturers, wholesalers and retailers with relatively few items in stock, use a manual stock control system. They use card records, stock tags and accounting data to capture the information necessary to establish economic order quantities, order points, and other parameters for effective stock control. However, as the number of items, supplies and general importance of stock increases, it is often desirable to consider the use of computerised systems for stock control.

Using computers in stock management

Today the use of computer systems to control stocks is far more feasible for small business than ever before, both through the widespread existence of computer service organisations, as well as the availability of easy, user-friendly software and cost.

Most computer manufacturers offer free, written information on the stock management systems available for their computers. In addition, computer companies have material readily available describing the use of their particular software programs for stock management. These companies provide a good source of information on general descriptions of particular stock management techniques, as well as help on specific stock management problems.

The hidden costs in stock

When planning stock levels, you need to consider the hidden costs involved in keeping too much stock on hand. These will include the following:

1. Financing costs - this is the interest expense associated with purchases and holding of stock on the shelves.
2. Opportunity costs - this is the cost of the alternative income producing value of the money that is tied up in stocks when it could be used for other purposes.
3. Storage costs - when the space to store stocks need to be leased or purchased, there is a cost involved.
4. Insurance costs - the more stock that is carried, the greater the cost of insurance.
5. Obsolescence costs - the lost sales that occur when new and improved products come on the market and consumers no longer want the old items that you are still carrying.
6. Shrinkage costs - these are losses which are due to damage, spoilage, breakage, or theft and increase the longer the item sits on the shelves or in the warehouse.



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In fact, high stock levels as well as low stock levels can cost the business money. High stock levels may cause an increase in all the above costs, but lower than sensible stock levels can mean lost sales because customers will be dissatisfied that they cannot obtain what they want, when they want. The trick is to balance off the two to arrive at a stock level that is economic for the business and keeps the customers happy.

Further information

The following fact sheet provides further information on these issues:

- Control your stocks