

CLASS 2

REASONS FOR CARRYING INVENTORY:

Inventory is viewed as a necessary evil (non-earning asset) that cannot be eliminated because maintaining inventory increases carrying cost and blocks money that could have been used for alternative productive purposes. However, it is considered a necessary investment to achieve workable system of production, distribution and marketing of physical goods. Some of the important reasons for carrying inventory are as follows:

Improve customer service: An inventory policy is designed to respond to individual customers and/or organizations request for products or services in an instantaneous manner.

Reduce costs: Inventory holding (or carrying) costs are the expenses that are incurred for storage of items. However, holding inventory items in the warehouse can indirectly reduce operating costs such as loss of goodwill and/or loss of potential sale due to shortage of items. It may also encourage economies of production by allowing larger, longer and more production runs.

Maintenance of operational capability: The inventory of raw material and work-in-progress items act as buffer between successive production stages so that downtime in one stage does not affect the entire production process.

Irregular supply and demand: Any unexpected change in production and delivery schedule of a product or a service adversely affects operating costs and customer service level. Hence, an optimum level of inventory and efficient delivery schedules improves customer service level by meeting customer's demand.

Quantity discounts: Large size replenishment orders help to take advantage of price-quantity discount. However, such an advantage must keep a balance between the storage cost and costs due to obsolescence, damage, theft, insurance, etc. Investment on large stock of inventory due to bulk purchase, reduces cash that can be used for other purposes.

Avoiding stock outs (shortages): Under situations like, labour strikes, natural disasters, variations in demand, and delays in supplies, etc., inventories act as buffer and provide protection against reputation of constantly being out of stock as well as loss of goodwill.

CLASSIFICATIONS OF INVENTORY CONTROL:

Inventory control is crucial for managing stock efficiently and ensuring that a business has the right products in the right quantity at the right time. Inventory can be classified based on various criteria, including:

Raw Materials: Raw materials are the basic inputs required for the production of goods. Proper control ensures uninterrupted production and cost efficiency. For example, a car manufacturing company needs to manage its inventory of steel, glass, and rubber to ensure continuous production. If the raw materials are not adequately controlled, the production line can halt, causing delays and increased costs. Effective management of raw materials involves:

- **Forecasting:** Accurate demand forecasting helps in planning the procurement of raw materials.
- **Supplier Management:** Developing strong relationships with reliable suppliers ensures a steady supply of raw materials.
- **Inventory Levels:** Maintaining optimal levels of raw materials prevents production delays and reduces holding costs.

Work-in-Progress (WIP): WIP inventory includes items that are in the production process but not yet finished. Effective control reduces production time and bottlenecks. For example, in a furniture manufacturing company, partially assembled chairs and tables represent WIP inventory. Controlling WIP helps identify and eliminate production bottlenecks, ensuring a smooth flow of production.

Key strategies for managing WIP inventory include:

- ✓ **Process Optimization:** Streamlining production processes to reduce WIP levels and improve efficiency.
- ✓ **Bottleneck Identification:** Identifying and addressing bottlenecks in the production process to ensure a smooth flow of work.
- ✓ **Lean Manufacturing:** Implementing lean manufacturing principles to reduce WIP and increase productivity.

Finished Goods: These are completed products ready for sale. Controlling finished goods inventory helps in meeting customer demand without overproduction. For example, an electronics retailer needs to manage its stock of smart phones and laptops to ensure availability for customers without overstocking, which ties up capital and increases storage costs. Managing finished goods inventory involves:

- ❖ **Demand Forecasting:** Accurate forecasting helps in planning the production and inventory levels of finished goods.
- ❖ **Inventory Turnover:** Monitoring inventory turnover rates to ensure products are sold before they become obsolete.
- ❖ **Customer Demand:** Aligning inventory levels with customer demand to avoid stock outs and overstock situations.

Maintenance, Repair, and Operations (MRO) Goods: MRO goods are items used in the production process but not part of the final product. Proper control ensures operational efficiency and reduces downtime. For example, lubricants, cleaning supplies, and tools in a manufacturing plant are MRO goods. Managing MRO inventory ensures that production equipment is well-maintained and operational, preventing costly breakdowns. Effective MRO inventory management includes:

- ✓ **Regular Audits:** Conduct regular audits to ensure MRO items are available and in good condition.
- ✓ **Vendor Relationships:** Establishing strong relationships with MRO suppliers for timely replenishment.
- ✓ **Stock Levels:** Maintaining optimal stock levels to avoid production delays and equipment downtime.