

Reducing Inventory and improving cash flow

Retail tip sheets by: Rob Golding



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In today's retail environment it is critical that business owners ensure that inventory on hand is in line with projected sales. Overstocking in a tough retail climate is a recipe for cash flow problems and without an inventory plan this is a probable scenario.

By following the simple steps outlined below you will be able to take control of inventory levels and in turn your cash flow which is so critical for retail survival.

Step 1: Establish your current stock turn

This is calculated by establishing your average stock holding over your trading year. This can be calculated as either stock at cost or stock at retail. If we use the at cost method we need to divide our cost of goods sold by our average stock on hand at cost.

For example: A Store has annual sales at retail of \$1,000,000. The Cost of Goods Sold is \$600,000. The average stock held at cost is \$200,000. The store has a stock turn of 3 ($\$600,000 / \$200,000$).

If the business owner aimed for a stock turn of 4 the average stock required would only be \$150,000 thus greatly improving cash flow!

Step 2: Establish your sales budget for the next 4 months

If we are working on a stock turn of 3 we need to have 4 months stock on hand. So using the example above we have estimated that sales for the next 4 months are going to be \$400,000 at retail or \$240,000 at cost so our inventory level over this 4 month period needs to be \$240,000.

Step 3: Determine our opening stock

Again based on the above example our opening stock target is \$240,000. If our stocks are in excess of this figure we need to drive stocks down by holding sales, spiving old stock to ensure we achieve our targeted stock level.

Step 4: Determine our ending stock

We need to establish what inventory will be required at the end of the 4 month period. This will very much depend on our forecasted sales for the next 4 month period. Let us assume that this is a slower period and we have only estimated sales of \$300,000 at retail or \$180,000 at cost. This being the case our closing stock target is \$180,000.

Step 5: Estimate Purchases required

This is now a simple calculation: Sales at cost plus ending stock minus stock at the beginning = purchases. Sales at cost \$240,000 plus ending stock \$180,000 = \$420,000 less stock at beginning \$240,000 = purchases required of \$180,000.

Finally a word of warning. If you anticipate that your margins may be lower than normal, you must increase your cost of goods sold figure. For example the above example is based on a gross profit of 40% if this was to drop to 30% then cost of goods sold would be 70% or \$280,000 with a corresponding stock requirement.

Rob Golding has over 30 years of retail experience and can assist your retail business with:

- Marketing & Promotion Strategies
- Sales Coaching
- Customer Service Strategies & Staff Coaching
- Inventory Management
- Strategic Planning
- Cost Reduction Programs
- Merchandising

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