

Businesses need to have inventory. However, having excess inventory is expensive. It's important to keep it as lean as possible. Here are some ways to trim the fat from your inventory without compromising revenue and customer service.

Accuracy First

Effective inventory management requires starting with an accurate physical inventory count. That allows you to determine your true cost of goods sold — and to identify and remedy discrepancies between your physical count and perpetual inventory records. We can introduce an element of objectivity to the counting process and help minimize errors.

Next, compare your inventory costs to those of other companies in your industry. Trade associations often publish benchmarks for:

- Gross margin ($[\text{revenue} - \text{cost of sales}] / \text{revenue}$),
- Net profit margin ($\text{net income} / \text{revenue}$), and
- Days in inventory ($\text{annual revenue} / \text{average inventory} \times 365 \text{ days}$).

Your company should strive to meet — or beat — industry standards. For a retailer or wholesaler, inventory is simply purchased from the manufacturer. However, the inventory account is more complicated for manufacturers and construction firms. It's a function of raw materials, labor, and overhead costs.

The composition of your company's cost of goods will guide you on where to cut. In a tight labor market, it's hard to reduce labor costs. But it may be possible to renegotiate prices with suppliers.

Don't forget the carrying costs of inventory, such as storage, insurance, obsolescence, and pilferage. You can also improve margins by negotiating a net lease for your warehouse, installing antitheft devices, or opting for less expensive insurance coverage.

Product Mix

Cutting your days-in-inventory ratio should be done based on individual product margins. Stock more products with high margins and high demand — and less of everything else. Whenever possible, return excessive supplies of slow-moving materials or products to your suppliers.

The product mix should be sufficiently broad and in tune with consumer needs. Before cutting back on inventory, you might need to negotiate speedier delivery from suppliers or give suppliers access to your perpetual inventory system. These precautionary measures can help prevent lost sales due to lean inventory.

Reality Check

It's easy for inventory to get lost in the shuffle when you and your leadership team are facing big-picture issues

such as strategic planning, innovation, and compliance. Managers are often so focused on sales that it becomes easy to lose control. [Contact us](#) for help managing your inventory.