Analysis

Stock Management and Control

This information sheet was written by SBMS Mentor, Amos Bush, who is a highly experienced retailer. Amos started out with a small auto parts store at Doncaster Shopping Town in Victoria but he grew with the business through a co-operative and then to a franchise which is now known as Autobarn. Amos eventually became the Managing Director and Chairman of the Board of Autobarn which has grown to around 100 stores. Amos says "Poor stock management and control can break a business!"

When I first decided to go into my own business someone said to me, tongue in cheek, that the best way to make a small fortune is to start with a large one. Many a true word is said in jest, but none are truer, than when applied to business. Unfortunately, and it is a sad fact of life, that all too often people go into business investing every last cent they own plus borrowed additional funds in what they hope will be a successful business, and then they fail.

There are many reasons why people wish to go into their own business, but failure, is not one of them. We go into business to succeed, to live our dreams, and to build a better future for our families and ourselves. We may be driven by a vision, or we may simply wish to make money: lots of it we hope. The business of going into business is to do business. And no more so than when we go into a retail business. But all too often people who decide to go into their own business do so without proper preparation and training, lacking some of the basic tools that are required to succeed, and not having a real understanding of what it means to run and manage a retail business.

A basic understanding of the dynamics involved in owning a retail business can make the difference between success and failure; between seeing one's dreams become a reality, or, collapse around their ears. A study by Prof. Allan Williams showed that about 32% of businesses fail in the first year, 16.5% in the second year, 13% in the third year and 7% in the fourth year, and 5% in the fifth year so that after 5 years only 25% are still in business.

Often businesses fail because they are either:
• undercapitalised
• unprepared
• or, in business for the wrong reasons
But the biggest cause is the lack of proper planning. That means that many people have no clear idea as to where they are going, and when they get there, if they get there in the first place, they do not know how to proceed. All too often they are flying by the seat of their pants.
Not a good way to start a business, or, to run one.

A dream, an ambition, or a desire to achieve some form of recognition are not substitutes to proper planning and hard work. Let me hasten and say that many retail businesses do survive, grow and thrive, sometimes in a most competitive environment. And they are clear proof that success is not beyond anyone's reach. The essence of a good retail business is based on the following elements:

- Innovation – having a clear point of difference from one's competitors
- A proper business plan
- A realistic budget
- Sufficient funding, or known sources available, from which additional funds can be obtained
- Trained staff
- Required stock levels
- Proper stock management and stock control systems
- And a clear marketing strategy

The lifeblood of any business is having a positive cash flow. Just as the human body cannot function and survive without a sufficient and healthy blood supply, so it is with business. It cannot survive for long without a positive cash flow, let alone grow and flourish.

There are two generators required to achieving a positive cash flow. These are STOCK and SALES and one can't do without the other. You cannot achieve the required level of sales if you do not have the right level of stock in the first place. Not only that, but it must be stock of the right kind. In other words, proper stock management and control are essential to make it all happen. It is often the lack of a proper understanding of the relationship between the two that is the greatest impediment to run a successful business.

I cannot emphasise enough the importance of managing and controlling stock, and I will give you some ideas as to what one needs to do to ensure that one puts in place the right mechanism to achieve these objectives.

How to keep a balance between sales and stock to achieve and maintain a positive cash flow

Having said this, I must make the point that however important this is to a business, it must not be seen in isolation. It is but a part of a total plan, a business plan. No business, big or small, should be managed without it. It need not be an elaborate document; it can be kept short and simple, but must contain all the necessary elements to make it meaningful. All it needs to do is spell out:

- the reasons you have gone into business
- what you want to achieve in your business
- how you intend to go about doing it
- the costs involved
- the funding required
- a budget
- and a list of the performance indicators necessary to measure the results

It is a road map and one needs to follow it. It tells you whether you are on the right track and if not, why not. You need to regularly review and fine-tune it from time to time in order to achieve the desired results. It highlights any weaknesses and gives a warning of any issues that might arise and need to be taken care of before they become a problem. The whole basis of stock management and stock control is directly linked to the requirements of the business plan to ensure a positive cash flow.

Stock management is the process that one must follow in order to ensure that the business is keeping the right kind of stock at the appropriate levels, at all times, to achieve the levels of sales and GP budgeted. Tracking the stock from the moment it is delivered to the store and following its movement in the store till someone takes it, pays for it, and takes it out of the shop, **is stock control**.

It is the way one follows the system, monitors the results, and acts on it in accordance with the requirements of the business that will determine whether one will be making any money or running out of it. It is surprising to find out how many people think they are running a successful and profitable business, only to be shocked to discover that they are tight on cash, all because they did not keep an eye to what is actually happening to their stock.

Tracking the movement of stock is essential to knowing what is happening in your business. If you have too much stock, it can cost you a great deal of money just keeping it on the shelves. It is said that to keep the stock on the shelves in the store costs about 20% of the cost value of the stock-on-hand.

Just think of it. If your average stock-on-hand level is about $200,000 p.a. the holding costs can amount to $40,000 per annum. If your annual GP is around 50% (i.e. at an average markup of 100%) and your annual sales are about $1,000,000 your GP would be reduced by about 8%.
Of course, the cost of holding stock is part of running a business, but the lower the level of stock sitting in the storeroom, the lower the costs of holding it. In other words, the higher the number of times your can turn over your stock per annum, the lower the stock you need to keep, and the lower the costs of holding it.

The costs of holding stock include, but are not limited to the following:
• Interest charges for the funds employed
• Insurance
• Spoilage, damage and obsolescence

The secret of good stock management is knowing what stock to buy, when to buy it, how often, and at what quantities to meet customers' demand. There is a fine line between low stock holding through good management and low stock holding through bad management. This in effect means keeping stocks low because of a tight financial situation or simply, too strong a focus to keep costs down in the mistaken belief that this is the way to make a profit. This could mean not having the right level of stock at the right time to meet customers' demands. Consequently, quite often missing out on sales, and thus, not being able to achieve budgets and possibly alienating one's customers in the process.

Every retail business has two levels of stock requirements. One is to keep a reasonable level of **core stock** on the shelves; the other is to buy bulk, for a specific campaign or special event, in the hope of achieving much larger sales. This can also apply to special purchases of core items meant to be promoted for a specific period of time.

Our knowledge, experience and ability to accurately monitor our sales will determine the level of core product purchases. We know how much product we are likely to sell over a given period, and it depends on the frequency we need to order, and the added costs such as freight, that governs the quantities we need to purchase at any one time. And if we manage this process correctly, we will have sold such products and got the money for it before we have to pay for it. It is important to understand that to buy any of the core products in larger quantities than is necessary to meet demand (except when planning a special promotion), can be unwise unless the additional savings are quite considerable and justify the extra money tied up by such a purchase.

When an opportunity arises to bulk buy the following must be carefully considered:
• The possible quantities one is required to purchase
• The popularity of the items offered
• The quality of the goods
• The full amount of the investment and terms of payment
• The expected period it will take to dispose of the goods
• The net GP that will be generated

If the goods purchased cannot be sold before payment is due, great care must be taken to ensure the goods don’t remain in stock any longer than absolutely necessary, and are promptly disposed of to retrieve the balance of the investment with the minimum of delay. Holding onto such goods could create the opposite of what was intended and could ultimately cause serious cash flow problems. A bargain is not a bargain unless it can deliver the hoped for GP within strict time limits.

It is surprising how often a business lets faulty goods accumulate before returning them for exchange or credit. The cost to the business can be quite amazing. If not managed properly, it can have an adverse effect on the business’s GP and cash flow. When goods arrive in your store you must insist that they have the invoice, or some other document attached, showing the number of units delivered and the prices charged. You cannot accept anything less, because without it, you don’t have the means to check the delivery and the accuracy of the charges. If you have the invoice check it first against your order and then check that the items and quantities supplied correspond with the order. Price the goods and put them on the shelves, always ensuring that the shelves are fully stocked up before you put the balance in the storeroom.

Remember that stock on the storeroom shelves does not sell. It only sells once it is placed on the shelves in the shop. An annual stocktake tells you the total value of the stock you carry and the unit count of each of the items in stock simply as it is at the time of the stock take. This is not enough to maintain a proper control over your stock. You need to carry out weekly random checks of popular and highly priced items to ensure that any goods missing off the shelves have actually been sold and the money received and put through the register. Shoplifting, as we well know, is a plague retailers have to live with, but if not properly monitored it can often mean the difference between making a profit and showing a loss.

Whilst it is difficult to control shoplifting from without, the process of regular random checks could deter it happening from within. That said, it is also a good way of checking the rate of stock movements to ensure sufficient stock is always available to meet demand.

Let us now deal with the issue of stock turns. Say the average stock turnover in your store is four times per year and your average GP is 50%, accepting the 80/20 rule which says that 80% of your sales are generated by 20% of your stock, meaning that some items have a much higher turnover than others. The simple fact is that the more stock turns you achieve the less stock you need to carry and the more gross profit you can make. It is how you manage your stock that can make all the difference.

Based on the above we can say that every item on the shelf in your store should be turned over at least once in every three months. Therefore, anything sitting on the shelf longer than three months and not sold even once during that time should be cleared out and the money used to buy more frequently sold stock.

When you buy stock you are expected to pay for it within 30 days of the month following the delivery of the goods. Have you ever stopped to think that if you have four stock turns a year you are actually only getting paid for your stock around 90 days from the date of purchase. This means that depending on the level of the stock, you have a lot of capital tied up in stock. So when you work out the mark-up on the goods you are selling you need to take this into account. And as already mentioned, the more stock turns you achieve the harder your money will work for you, and the lower the cost of finance. This will help increase your business profitability and give you a better cash flow.

If, despite all that has been said, you do achieve budgets and run a reasonably profitable business, just think of how much better off you could be if you followed the above. For those who are still managing their stock manually, it is strongly suggested that you lash out and get yourself a computer and a suitable software program that can be easily tailored for your business requirements. You would be surprised at the difference this could make to the way you can manage your stock and run your business. And the big difference it can make to your life.

Don’t see it as an expense; **see it as an investment in the future of your business**.

SBMS Mentor Amos Bush
SBMS Mentorss can help you to work on your business rather than just in it and this can maximise your likelihood of success.
If you would like help from a Mentor either call 132 215 or visit the SBMS website www.SBMS.org.au