Inventory—A Leach…or a Knight in Shining Armor?

The daily business is at hand…taking care of customers…taking care of employees…taking care of vendors…taking care of employees…taking care of investors or the bank…taking care of employees. Little time is left to analyze the health of your business or to read this article!

Therefore, you quickly look at the checking account balance, accounts receivables and accounts payable. You juggle the totals, estimate who will pay, who can wait to be paid and reminisce about the good old days when there was a 3 day float at the bank. Next…move on to the pressing issues at hand.

However, there in the dark corner of the balance sheet, the inventory hides, like a leach, it can literally suck the life out of your current earnings and your future equity. You say…"What is he talking about?" Below you will find discussion that will shed light on the issues.

Problem One: The major problem with businesses, is whether you are a manufacturer, a distributor, or a retail business, you have to make sure that you are getting a proper return on your inventory investment. If you had $500,000 in a mutual fund, you would want to see a typical return.

Unfortunately, I have reviewed businesses where the company profit, measured against inventory, shows that the return is much lower than when the same money is invested in the stock market! Why does this happen? Generally, the Owner does not consider the risk involved with closely held businesses! You should get a much higher return than the stock market when you own a small business due to the high risk one is burdened with this style of ownership…remember when I mentioned banks, customers, vendors, employees…and employees?

By the way, please do not forget the costs of storing inventory, this cost can be significant and can remove what little profit you might have.

When marking up your products, please just take the time to develop an acid test. Mark up your product, then develop your revenue, reduce for costs such as returns, discounts and then apply your cost of goods which should include labor, material costs, storage, freight, overhead, etc. Apply your general administrative costs, including warranty issues…where do you stand?

Look at your return on your inventory investment. If you are not where you want to be, how can you reduce your inventory and still keep your customers happy?

<u>Problem Two:</u> Obsolescence—Has some of your inventory turned into antiques….or junk? If so, take the proper steps quickly. Write off the junk and save on taxes. If it has turned into an antiques, mark it up accordingly and sell it to a different market. This will help your current profit and keep your company clean for when you wish to exit the business. There have been many deals that failed because the Seller thought the Buyer would buy the inventory that was not turning. Generally, the Buyer is not buying a salvage or junk store unless that is the business. Even if you are selling to your kids, don't sell them trash…give them a chance to succeed with good inventory. The stats are against them from the beginning as it is. Please keep this in mind.

<u>Problem Three:</u> Sometimes, business owners take much pride in their volume of inventory. Here is the bottom line…keep your customers happy…but find the fine line where you have just the right mix and though may miss a few sales. When it comes time to sell the business, the bank or investors will not be able to justify too high an inventory for the level of profit that you are obtaining.

Whether you are growing your company…or preparing to sell your company…the "Inventory Leach" can leave you empty handed! Beware! You can't take this too seriously.

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