A BEGINNER'S GUIDE TO
INVENTORY MANAGEMENT

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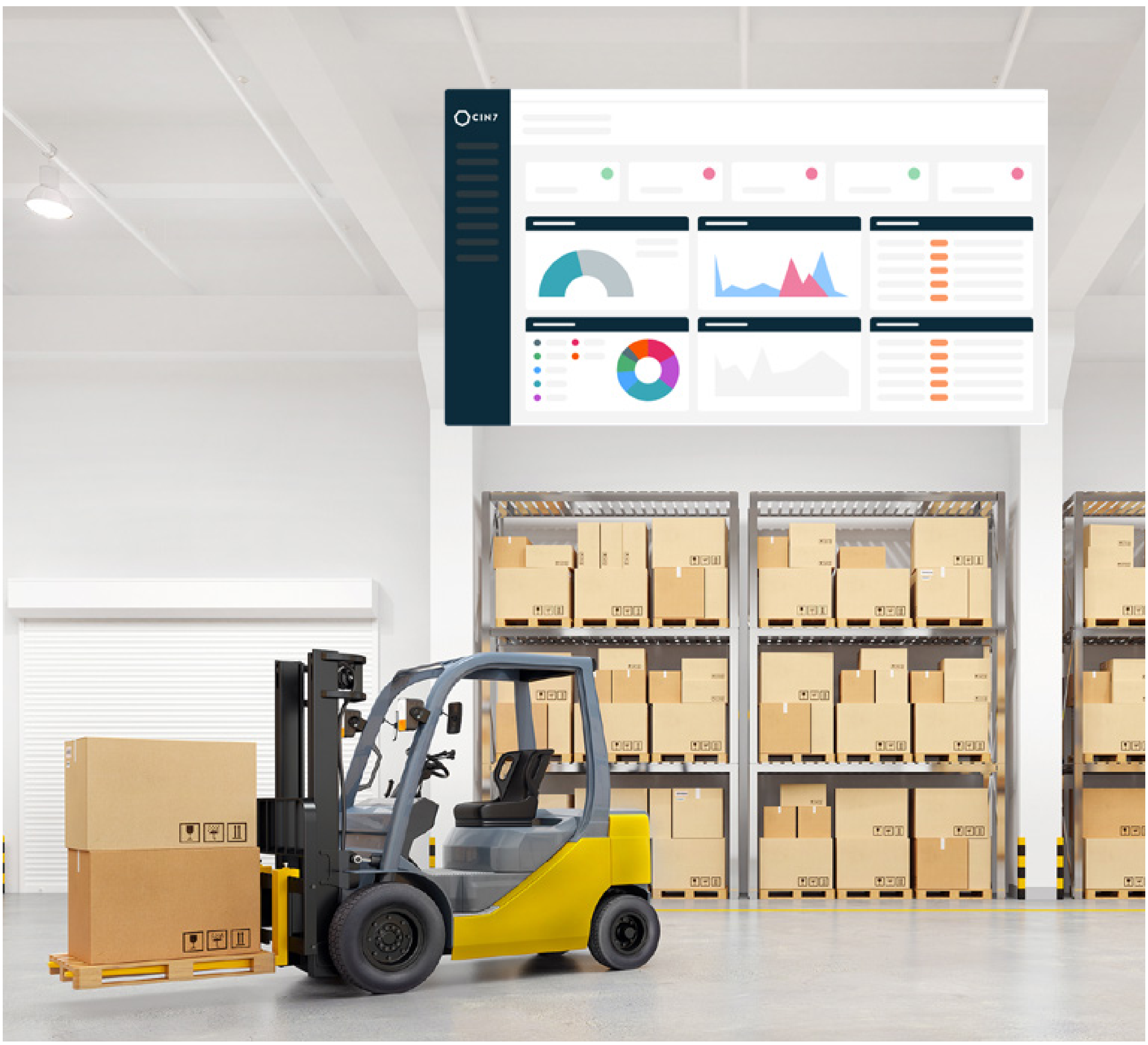


Inventory and the Supply Chain: The Battle Is Stressful and Real

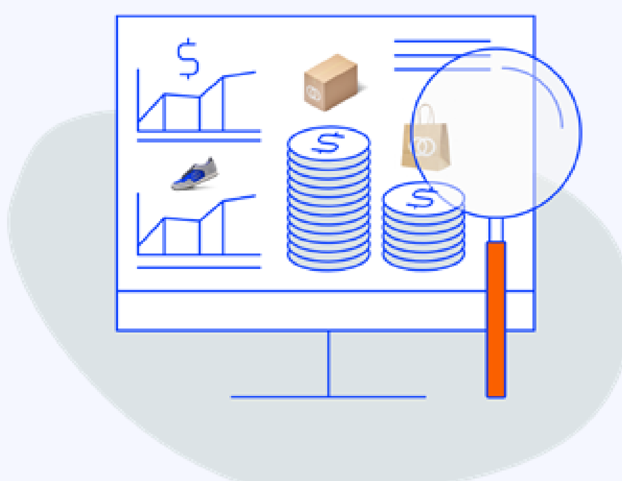
When you bring any product to market, you have a lot to worry about. Are you selling enough? Are your costs out of control? Can you cover your expenses? This guide is for business leaders who struggle with the all-too-real stress and anxiety caused by the battles they wage on a daily basis.

The Battle for Increasing Sales

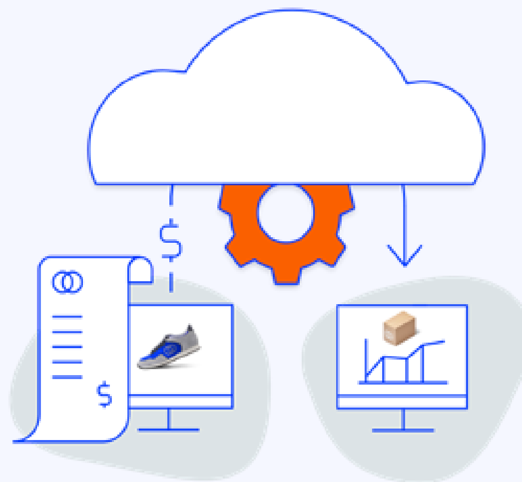
You need to get your products to market fast and sell as many of them as you can. At the same time, however, trends change, so you have to be ready to pivot quickly. How much of a product do you buy from your suppliers? How quickly can you, in turn, sell that product to your customers? How will you monitor sales trends to know when it's time to pivot to a different product that will result in increasing sales?

The Battle for Increasing Margin

You must have a unique value proposition to increase your sales price. You must also lower your costs. For example, you could lower your purchase costs with a volume discount from a supplier. However, that means you'll be carrying a lot of that product. So will you be able to sell quickly enough to capitalize on the volume break? Or will overstock increase your holding costs and erode your margins? And do you buy at a lower price from overseas suppliers or do get your products faster, at a higher price, from local suppliers?



The Battle for Optimized Inventory



You have to decide what to hold and what not to hold in your inventory. This has been the million-dollar question throughout the history of commerce. Holding inventory carries a cost, and the longer a product sits in your inventory, the lower your margins. Selling products that you don't hold in your inventory may increase sales and margins, but it also puts your value proposition at risk. For example, you could dropship from a supplier, but will your supplier be able to guarantee product availability at the time of purchase? Do the pros of lower costs outweigh the cons of lack of control over a product?

The Battle for Fast Cash Flow

Without fast cash flow, you'll constantly worry about funding your working capital. Your bank will be your only option to keep your business afloat. But when you apply for increased overdraft or credit, you will be seen as a growing risk. Your bank will require collateral, such as your house, and the stress of your business will overflow into your home life, amplifying your anxiety exponentially. Can you accelerate cash flow by getting your customers to pay faster while improving payment terms with your supplier to pay them later?

The truth is, all of these battles are interconnected, and the common thread is inventory management. In this guide, we'll show you how inventory management can ease the stress of figuring out how to increase sales, margins, optimal inventory levels and cash flow.

> "It's just having the information at your fingertips that can be immediately understood and without the need for a bunch of spreadsheets. It simplifies your business, makes it a lot easier to run and a lot more transparent."
>
> Gordon Grant, CFO, I Love Ugly

What Is **Inventory Management?**

Inventory management is the methods, data and integrated tools you use to maintain the right amount of goods—in the right place at the right time to meet customer demand at the lowest possible cost to your business—to achieve the highest margin and, in turn, the fastest cash flow.

Inventory management includes:

- ✓ The method you use to keep track of all products in your inventory.
- ✓ The paper/digital recording of your purchases, sales and circumstances affecting inventory.
- ✓ The method you use to report inventory data to your accounting ledgers.
- ✓ Your overall strategy for getting goods in and out of your inventory as quickly as possible.

> “The problem with inventory is that it is a hard process, and sellers don't commit enough to the right tools or commit enough time to implement processes to stay on top of this critical task for inventory-based eCommerce sellers. It is cash in another form, hoping to get a return on investment and a profit. Sellers who don't manage inventory closely are making an inefficient use of capital.”

Scott Scharf, Catching Clouds

Your Goods Are Your Inventory (and Inventory Is a Liability)

All the goods you purchase and own for the purpose of selling to your customers are your inventory. From the time you purchase these goods to the time your customer pays for them, that inventory is a financial liability.

For wholesalers and retailers:

Your inventory is the finished goods that you purchase from suppliers that you intend to retail through physical stores, eCommerce, online marketplaces and/or big box retailers.

For light manufacturers and kitters:

Your inventory is the ingredients, components and/or materials you purchase in order to make the finished goods you intend to sell through any of the above-mentioned channels.

Either way, inventory comes with an intrinsic value, including the cost to purchase, make and hold your goods. You don't recover those costs until you sell those goods and receive the cash in your bank account.

Important Terms

Raw Materials

Inventory that can be made into products

Work in Progress (WIP)

Inventory that is in the process of being made into a product

Stock/Finished Goods/ Finished Products

Inventory that is ready for customers to purchase

Inventory Costs and Increasing Margins

Inventory management allows you to place a dollar value on your products for the accurate reporting of costs in your accounting ledger. It takes into account the cost of purchasing the goods as well as the cost of holding them (warehouse, labor, sales force and other costs).

When you know the cost of your goods at the time you sell them, you know both your cash flow and your margin. This helps you make important spending decisions and maintain business operations at a sustainable level for future growth.

Important Terms

Inventory Value

The sum of the costs to make or acquire all your products up until the moment of sale. It includes the cost of purchasing finished products and/or the components you need to make a finished product plus any manufacturing, warehousing or freight costs.

Cost of Goods Sold (COGS)

Similar to inventory value with one important difference: It applies to costs associated with making and producing your products. This is reported as an expense to your accounting ledger.

> "Eighty-five percent of the reasons for failure are deficiencies in the systems and process rather than the employee. The role of management is to change the process rather than badgering individuals to do better."
>
> W. Edwards Deming, Management Consultant

Stock Levels and the Battle for Optimized Inventory

You start to run out of inventory with your very first sale. As new orders come in and more goods go out, how much do you need to replenish your stock to meet demand and in what time frame? These are fundamental questions that inventory management answers.

Too Much Inventory: Holding goods in your inventory costs you (e.g., warehouse rent, interest on holding costs). The longer your goods sit in inventory, the higher their cost. Every good that doesn't sell decreases the cash flow you need to pay the bills and run the business, putting pressure on your banking relationship. Ultimately, excess goods become obsolete and must be sold at markdown to clear space for goods that require higher inventory levels.

Too Little Inventory: Running out of stock represents a different cost. Customers coming to your website or store will not hesitate to shop elsewhere if their order cannot fulfilled. Stockouts don't just cost you a sale. They may cost you a customer.

"Just Right" Inventory: With good inventory management, you'll accumulate data about how much and how well your products are selling with accurate margins, the key to positive cash flow. This information can help you determine how much of your goods you should hold to meet demand at any location.

When you adopt methods and tools to record and monitor inventory, you'll be in a better position to keep costs under control and improve your margins.

Important Terms

Buffer Inventory/ Buffer Stock

Extra inventory you hold to avoid stockouts.

Inventory Ledger

The documents or computer records you'll need to track all transactions that affect the quantity and value of your inventory.

Stock on Hand

The amount of inventory available for sale at any given moment.

Stockout

The depletion of goods from inventory, typically due to an unexpected surge in demand.

Common Methods of Tracking Inventory Value

There are two principle methods you can use to track your inventory value.

Periodic inventory system: Calculate your total inventory value monthly, quarterly or annually (usually at the end of each financial year).

Perpetual inventory system: Calculate and adjust your total inventory value continuously while adjusting for changing circumstances. The perpetual system tracks the value of the purchase and manufacture of goods, adjusting that value for lost, broken or expired goods as well as goods sold. As its name suggests, the perpetual inventory system requires the constant recording of information.

> "We've come from a business that was focused on only one market to one that's focused on five. From Internet to trade to supermarkets, it can be a bit of a nightmare coordinating across all those markets, but Cin7 helps us take the pain out of it."

Dan Dear, General Manager, Steens

Methods of Reporting Costs to the Accounting Side

Once you've decided on an inventory system, you'll next need to choose a method of accounting for those same costs once goods are sold and leave your inventory. The most common methods:

First-in, First-out (FIFO) Accounting

FIFO accounts for costs assuming the first goods that enter your inventory are also the first to leave. Let's say your business make shirts and you need 100 shirts to meet demand next month, but your costs go up as you produce them. If it costs $10 to make your first 80 but $15 to make the rest, then your COGS will be:

- First 80 at $10 = $800
- Remaining 20 at $15 = $300
- Total COGS for 100 = $1100

Last-in, First-out (LIFO) Accounting

LIFO assumes that you sell your newest inventory first. Using the same example above, you'll report your COGS this way:

- First 80 at $15 = $1200
- Remaining 20 at $10 = $200
- Total for COGS for 100 = $1400

That $300 difference in COGS underscores why businesses choose one form over another. FIFO is logically suited to accounting for goods that sell at a steady price. LIFO is better suited to industries where prices fluctuate. Generally speaking, FIFO is the more popular and recommended method.

Average Cost

This means that all inventory is calculated by an average unit cost for goods available for sale, during a specific period of time. It's sometimes called the "weighted average method." Average cost is usually used if the accounting system chosen can't handle FIFO or LIFO or if it's hard to assign a specific cost to an individual inventory item.

Setting Up an Inventory Management System

- **Choose your system and method.** You'll need to decide which inventory system (perpetual, periodic) and which accounting method (FIFO, LIFO, average cost) works best for your business.
- **Conduct an initial stock take.** This is a time-consuming but necessary element. An initial stock take gives you a starting point of total stock and value when you start with an inventory management system. You will need to physically count all the goods in your store(s) and warehouse.
- **Schedule regular stock takes.** Stock takes should be done on a consistent basis to maintain inventory accuracy, reduce the risk of undetected theft and shrinkage due to damaged or misplaced goods, and ensure your customers get what they order on time.
- **Record your transactions.** Prepare a ledger or other means to record inventory as well as every transaction that affects stock levels and inventory value (purchase orders, invoices, BOM, etc.). This may be a handwritten ledger, a computer spreadsheet or an inventory management software solution.

WARNING: The more rudimentary your inventory ledger is, the more time and effort you'll spend tracking your inventory. Computer spreadsheets, for example, will require the extensive use of macros to set up value calculations, in addition to repeated copying and pasting to adjust spreadsheet ledgers for each new transaction.

- **Report to your accounts.** Remember, tracking inventory value and cost in a ledger or software program is only part of the story. That information must be transferred to your general ledger at some point. Again, the more rudimentary the system, the more work you'll need your bookkeeper/accountant to do.
- **Mine your data.** Finally, any system will generate data useful for making decisions about your inventory. It will show you your margins, which of your goods sell best, who your biggest buyers are, how long it takes to clear inventory and a lot more. But data buried in ink or spreadsheets are the most difficult (if not impossible) to extract without a LOT of time and effort.

What Your Inventory Management System Should Do for You

✓ **Provide a complete, current view of your inventory.**
Know exactly what stock you have on hand at the moment, what goods are in transit and what goods are in production.

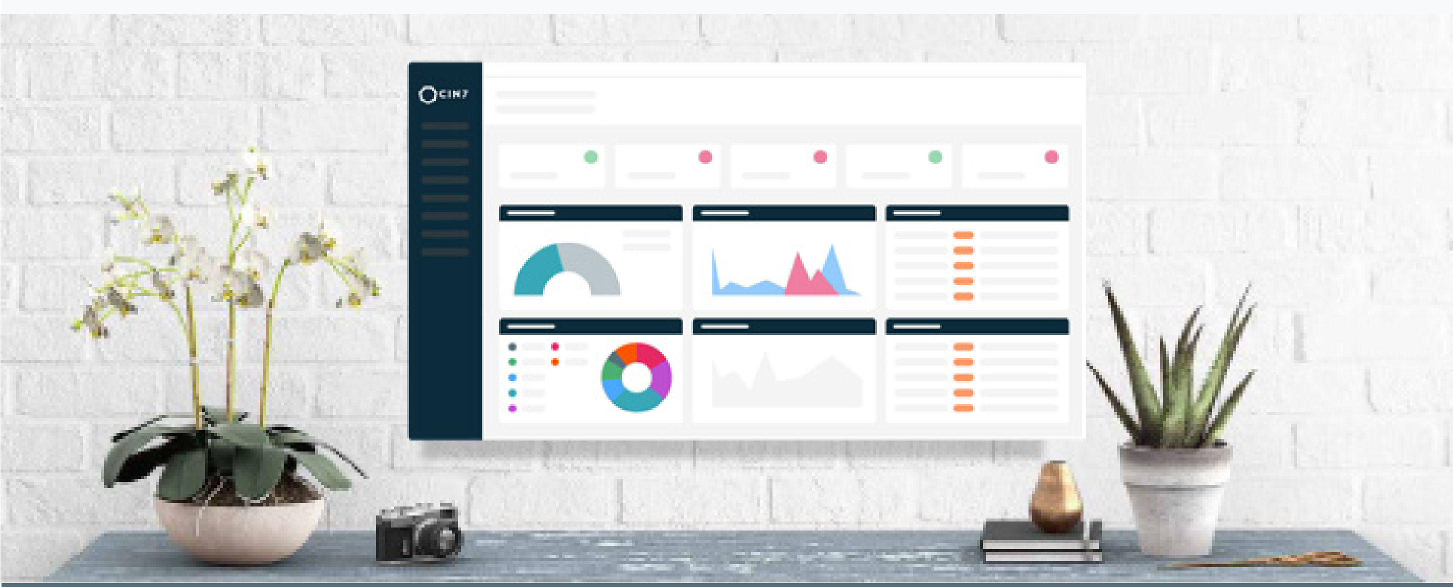
✓ **Give a complete understanding of your actual costs and margins.**
Know what it costs to procure, produce and warehouse goods and what those costs amount to when you sell your goods.

✓ **Empower you to make important product decisions.**
Know how your inventory levels measure against customer demand for every sales channel, and adjust accordingly to avoid carrying too much or too few goods.

✓ **Gather and interpret vital information.**
Collect stock, cost, sales and other data over time and easily access that data to help you make important purchasing and inventory decisions.

✓ **Make inventory management easier and more efficient.**
Avoid rudimentary inventory management systems and spend less time on data entry and administrative tasks. That way, you can focus on making and selling a great product at the highest margin.

> “In the old days, it was all about bricks-and-mortar. Online is incredible, Amazon is incredible, and we can reach so many markets through online purchase.”
>
> Sheryl Steens, Founder, Steens



Inventory Management Software vs. Paper or Spreadsheets

It's possible to set up an inventory management system using handwritten or spreadsheet-based ledgers and journals, but this is far from ideal. Paper ledgers and spreadsheets require constant data entry, copying and pasting, and macro-programming, all of which take more time and effort than businesses can afford.

While you will accumulate vital information to make important decisions, it will take even more time and effort to find that information and present it in any practical way. Lastly, if you sell through multiple channels—and most businesses today do—your administrative and data entry work only multiplies, making it a challenge to maintain control of your inventory, which in turn makes banks even more nervous. Fundamentally, this is what makes Inventory management software far more effective than rudimentary paper or spreadsheet solutions.

The Complexity of Modern Business

These days, most product-driven businesses cannot compete selling through just a single channel. Cin7 works with many companies who:

- ✓ Retail and wholesale
- ✓ Sell through a website, in stores, through online marketplaces and big retail chains
- ✓ Run showrooms and/or use POS in their own stores
- ✓ Use their own warehouses, third-party logistics warehouses or both
- ✓ Use shipping solutions and/or 3PLs for eCommerce, marketplace and direct-from-store order fulfillment

The point is that modern businesses will keep their inventory in many places at any given time, and the more channels they sell through, the more complicated managing inventory becomes without using a comprehensive solution encompassing their entire enterprise.

Cin7: The Inventory Solution for the Omnichannel

Cin7 was built with modern business in mind. It is the inventory management software of your dreams, a cloud-based solution that not only integrates all your channels in a single management platform but also automates the processes you use to get your goods to your customers—in any way they want to buy from you.

Cin7 gives omnichannel businesses:

- ✓ Real-time visibility of inventory levels, from production and supply to warehouse/3PL to any and all sales channels, including brick-and-mortar, eCommerce, marketplaces and big retail trading partners
- ✓ Inventory tracking for components or ingredients used in kitting and simple manufacturing
- ✓ Integration with the most popular accounting solutions for perpetual reporting of actual costs, not average costs
- ✓ A built-in B2B eCommerce module and integration with all popular eCommerce platforms for selling direct to consumers
- ✓ An automated billing managing system for tracking invoices to wholesale customers.
- ✓ Built-in Pick 'n' Pack for simple warehouse management
- ✓ Native POS that works with the most popular payment/PIN pad solution providers in every major market
- ✓ Cost-effective, inventory-integrated EDI for trading with the biggest retailers in every major market, dashboard EDI management, and automated EDI processing
- ✓ Integration with scores of global, national and regional 3PL providers and shipping solutions in every major market
- ✓ Automated fulfillment and dispatch of eCommerce and online marketplace orders

Find out more. Contact sales@cin7.com today.