Entrepreneur's Roadmap: Mastering the Fundamentals of Inventory Management

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Q&A Transcript

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Center for Business Resilience and Innovation

1. What if as a startup we can't afford to buy everything in bulk?

So there's a couple of different things that we can do here. You can go with vendor financing. That is where you get the vendor to cover the cost, or finance directly through them so that you can get their product into your store. Now, they're going to charge interest for that. Because their business model is not to, you know, lend you inventory or lend you product, they want to sell what they're creating. So they're taking the risk of not receiving that cash payment upfront. So time value of money says if they're going to take that payment over time, they're allowed to charge a little bit of interest. But if that's the only way that you can get the inventory into your store to get started, that might be the way to go. We have to look at what you feel the turnover rate is going to be, how quickly can you sell out, you don't want to just buy in bulk to get the lowest per unit cost, if it's going to take you so long to make those sales that any profitability is eaten up by your carrying costs and your cost of borrowing which is interest.

2. Can you walk through the ratios you mentioned again?

Totally. So your turnover ratio, you will take your cost of goods sold. So whatever it costs to actually create what it is that your retail product is, your cost of goods sold, divided by in dollars, the value of your average inventory, and you can do this for the quarter, you can do it for the year, cost of goods sold divided by average inventory. And if you're using inventory tracking software, you're going to be able to keep track of that. If you're using a clipboard and you check your inventory every single Friday, you just take over the course of 13 weeks for the quarter, the average value of that inventory divided into the quarters cost of goods sold and that will give you some number and the retail sweet spot is between two and four. More than four, again, tends to mean that you're driving revenues, but you might be losing efficiencies. So you might see profitability dip, but those are things that we can look at together. The other one was the quick ratio. The quick ratio is your quick, or your liquid, assets; accounts receivable, cash on hand, marketable securities are included. But we don't often see those divided by current liabilities. Notice that inventory is not included in that because they consider inventory as not being able to be converted to cash quickly enough. So if you've got a bill coming due and you've got tons of inventory but no cash, that's going to be a problem for your business. Another reason to more efficiently manage your inventory and not have so much in inventory that you have dried up the business bank account, allowing you to or not allowing you to make good on your current liabilities. So those are the two that we covered.

3. I own a retail shop and reorder inventory months ahead of when we sell it. What are some resources you recommend for general economic information, so I can do a better job anticipating demand for the year ahead?

Okay, so I know a couple retailers like this, where they do all their Christmas buying back in the spring, so I can totally relate to this. Your public library is a great first stop. Your Public Library has got a resource librarian who right now is bored to tears, because not enough business owners come in to use the resources they have specific to small business database on top of database of information that you can use from the US Census Bureau exporting and importing numbers. All of that is available and most of it available online. You just go in once and they'll show you how to use it. And then you go home and you use your library card number and you log in and do everything from home. Second to that would be us here, I will happily walk you through some different things and resources that we have at the WSBDC. And then finally, check out the SBA website, SBA.gov, they've got some resources there as well. Excellent question.

4. Is there some sort of calculation that is recommended to determine how much inventory you should carry based on your monthly or annual sales?

I wish there was, as I was beginning to fine tune this, get past mayonnaise and really dig deep and get some content developed for everybody, I thought I might be able to develop an algorithm or an equation, have it published in The Wall Street Journal, get famous, Christina, don't worry, I'll be at OneRedmond even after I'm published and famous. But there's not because it's so dynamic. And industries and businesses are so incredibly different. An auto parts store is going to manage inventory very differently than a restaurant who will manage inventory very differently from a salon. It's like baking. My daughter is a freshman at Central studying to be a teacher and she's an avid Baker. And she will tell you that when you change, since everything is based on ratios, when you change the amount of one ingredient that affects everything else. So if we were to go back to the slides, and we looked at all those bullet points, things like capacity, cost effectiveness, scarcity. When one variable changes, it spider webs out and affects the other variables. So it's so dynamic that having a static equation to say these are the exact inventory levels you should have, that doesn't exist. However, comma, the caveat is, we can still help you with your inventory control. And you may not be on that efficient frontier where you're 100% Perfect, but we're going to get you somewhere where you can be more sustainably profitable, and that we will happily help you do.

5. I own a greeting card business. What is the best way to track inventory?

So many questions. How many greeting cards do you sell? How many different types of greeting cards and paper and inks and other things do you work with? How unique is your product? Do you use any sort of special printing method? Do you have the greeting cards that have the little things that use superglue or rubber cement on the front or on the inside? What goes into the greeting card creation process and what different things must do keeping your inventory? A very awesome question but so rooted in the complexity of how dynamic businesses are that I won't be able to answer that here. However, that is something I'll happily work with you one on one. And congrats. That sounds like an awesome business, by the way.

6. I run a restaurant, and we're caught between not being able to anticipate if we'll be able to get the product we need. So we're considering ordering more just to stock up. The other point is that right now, it's hard to predict demand, because people are still concerned about dining in, we can either order more and gamble on demand being there or not, and risk not being able to meet demand. Are you encountering any issues like this? And what do you advise?

Okay, yes. And here's the good news. The good news is in this COVID era, most businesses are being affected the same way. So this is not specific to your business. And that's a good thing, it means your competition is being affected by the exact same thing. So how assertive or how aggressive do you want to be in this? What I mean by that is, do you want to go for broke and be like, hey, you know, we want to grow during this. We don't want to just survive, but we want to grow from this. We want to expand, we strike while the iron is hot. There are some things that we can do to potentially forecast and puts you in a position to grow. Or do you want to be a little bit more, let's wait and see, we've got a good thing going. We don't need to rock the boat too bad. We just want to make sure that we're being flexible and nimble so that when things do turn, we're there to turn right along with it. So these are all questions that must be asked of each business owner to decide what your strategy is going to be for the next quarter, for the next year. Because, and we talked about this yesterday, I met with Renton’s Downtown Partnership, and we talked about this very thing. And the question was asked, well basically, if it's not broke, don't fix it, right. And I politely challenge that, because competition creates the need to continue to innovate. Restaurants two years ago, so much of the survivability was based on who had a drive thru window and who didn't, who already offered some sort of delivery or pickup service, and who didn't, who is able to quickly adapt. And who didn't. And in all honesty that was such a driving force in businesses that made it and didn't, fair or unfair, but that flexibility, largely determined who stayed in business and who didn't. And if you're the ones that stayed in business, I salute you for being resolute. Let's continue to capitalize on that. We don't want to just see you survive, we want to see you thrive. So again, specific to your industry. I can't get into the weeds on that here. But let's work one on one. And there are some resources that I can get you pointed toward, and some questions that we can dig deep on and get you to where you want to be.

7. I work in foodservice or catering and I'm looking at combining inventory orders with a few other companies to drive down costs. Curious if cooperative agreements like this work in other industries.

It can. In fact, this is actually a common practice that falls under this bootstrapping umbrella, which is basically a way to, it may not be the ideal way, because when you're in a cooperative agreement, you've got to rely on some other businesses to hold up you know, they're in the bargains. So when you're doing some sort of bootstrapping technique, there's usually some sort of concession that is being made in flexibility in choice and in frequency of delivery in exactly what you want. In every major city, there's some sort of company and their whole business model is to liquidate the assets of other companies and we see it in restaurants. Seattle's probably got more than one, you can go and buy industrial ranges and ventilation hoods and walk in refrigerators and barstools and glasses and everything else and If you want to open up your restaurant and you're like, hey, I really got my heart set on these blue vinyl barstools. But you go to a restaurant liquidator and you get red vinyl barstools. But they're half off. That is a form of bootstrapping, and so much like your cooperative agreement? Yes, it absolutely exists in all sorts of different industries. But please understand that with anything like that, while it can drive cost down, it also tends to affect things like flexibility and choice. So if you've already decided, hey, we're just we got to get cost down, because we've got to make it through this little short term hiccup here. Great. We can proceed forward with that. If you haven't weighed that yet. Let's talk and decide how much are we giving up? And how much cost savings are we actually realizing? And does that favor me? Or does it not favor me? And what's best for our business moving forward? Great question.

8. I'm planning on opening a second location of my retail store. Is there anything I need to know about successfully tracking inventory between two stores?

Okay, so now we are getting past a single location, and really having eyes on our inventory all the time. And my question back to this business owner would be are you going to manage two different inventories at two different locations? Or are you going to centralize your inventory, either off site or at one of the locations? The next thing I would ask is how far away are these two locations from each other? If we're looking at Bellevue and Redmond, that's entirely different than managing two inventories between Seattle and Boise. So let's assume that these two locations are close. I would systematize how you move inventory back and forth, that is have a set day, a set route, a set schedule where you've got one employee, and they're wrapping other things into this trip that goes between the two different locations, and hey, we need extra inventory of A, B and C. And I'm going to pick up some x y & z while I'm there and then bring it back. Keep it standardized, keep it systematized, because the one thing you don't want to do is oh, shoot location number two needs some of this, quick let's run it over before lunch. Keep things on a schedule, and that will help you control that cost part which is one of the bigger ones in your inventory management.

9. If we're launching a new product, should we just guess at how much we're going to sell and buy that much inventory?

Oh, goodness, okay, let's not just take a wild guess at this, there's information out there that can help us get close and here's the thing when it comes to forecasts and projections, if you tell me in month 36, our revenue is going to be this, I guarantee you the one spot you're never going to land on is the one thing you wrote down. So it's not about landing on a spot. But it's about shooting for some sort of range, we think we're going to be between here and here. And if we're above that, great, we're killing it. If we're inside that operating range, that's what we predicted things are going smoothly. If we're below that, we got some things to do, because we're not hitting the minimum that we thought we would. So don't aim for a point. But aim for a range now, specifically. And back to your question. There's a lot of information out there that can help you get close to what that range might be. And a lot of that may not even be stuff that's published already, which is what we call secondary market research. Someone else did it, they published it, you just have to go look it up. That's what the library is going to be able to afford you. But something a little bit closer to primary market research. And that's doing some studies of your customer segment. Doing some soft product launches, doing some, I just completely lost my vocabulary, some product giveaway, some prototypes. That's what I was looking for. I love trade shows when we're launching new things, because a tradeshow allows you to get in front of both your competition and your customer segment at the exact same time. So let's look at how we can get close to what we think we're gonna need for inventory, rather than just take a wild guess. If you take a wild guess, and you're right, fantastic, but that's not replicable. And then you take the next wild guess and we're not right. And we're like, shoot, it didn't work this time. So let's at least understand why we're making a decision that we are.

And if we're not correct, at least we knew what went into it so that when we make the next decision, we can make that adjustment and try and continue to get closer. It's knowing the why behind the what that helps propel our business forward and not just taking wild stabs in the dark. Again, another great question.

10. What are some strategies for reducing storage costs?

Well, that depends on is your storage space inside your retail space? Or is it standalone? Do you have a retail store? And then some separate warehouse or storage facility that's a half mile or a mile or a city away? How long is your lease? When do you have the opportunity to actually change something? What are your needs? And how flexible must you be able to be in the future? So again, let's come back to the baking analogy. Every variable that's changed is going to wind up affecting other variables. That's a really tough question to ask. I apologize. I can't get any further than that. But let's build on that. And there are some things that I can help with, I'm sure.

11. Back to the greeting card business. I have a greeting card sales rep He is insisting that I have UPC barcodes on all my printed cards. Getting one would cost me at least $750 to add these; however, I am taking classes with a big greeting card group of people called proof to product. They say most card companies do not put UPC on their cards. And if they do, they said the store that is requesting them should supply the UPC. Should I not work with the sales rep? Or how do I get to the store to supply these?

Extremely specific. Alright, so again, there are usually more variables that are in play then than we uncover initially. My initial reaction is any person who is trying to get you to do something that is outside of norms, outside of standard practices, probably not someone that you are going to continue to work with, not because this person is malicious, or anything else. But for a simple business decision of the shortest distance being between two points is a straight line. Why would we incur these extra costs, this extra effort, when there's another way of doing things? Now the caveat, the asterisk to that might be, can working with this rep’s company to do more for my business? I don't know the answer to that question.

The second part, saying that most card companies do not put UPCs on their cards? And if they do, they said the store that is requesting them should supply those UPCs?

Should I not work with the sales rep? Or how do I get the store to supply these UPCs? Okay, so specific to how you get the store to supply them. I don't know, that's just a little bit outside of my wheelhouse. But if that's an industry standard, then that should not be a super tough challenge. And we've got some advisors who specialize in retail, and I bet you we can find that answer if that's something specific that we're looking for.

12. What are some important things to track when counting inventory? For example, I'm opening a cafe that sells coffee and sandwiches. Do I need to track every single ingredient for both products?

You need to track the things, well, you need to track everything to make sure that you're receiving what you ordered, receiving what you paid for, to keep track of spoilage. But the main thing is to keep track of the things that are most pertinent to your deliverables. And the things that are more challenging to replace, on a short fuse. So if you're dealing with sandwiches, bread is not going to keep for a long time. If you're specializing in tuna sandwiches, that tuna is going to be a heck of a lot easier to track because you can just store it and kind of forget about it. You can buy as much as you want, as much as you can afford. And it's got a long shelf life. But those things that are going to turnover more frequently are the things that you're going to have to track. More specifically, the little one-off ingredients. Someone says, hey, put a little basil on my sandwich, or whatever it is, or this special mustard that you'd have in the back, but you only have one. It's like Worcestershire, stop laughing at me, long enough to buy a second bottle of that, right. So for things like that, you're not paying as much attention to those specialty things that last forever and you don't use very often. As opposed to the things that you know you're going to turn over, like the luncheon meat and the cheese and bread. Also keep in mind the non-consumable things like cups and lids and plates and liners and all those other things. So the things you use the most of and most pertinent to your deliverables.

13. Do you recommend any particular inventory management software? We have exceeded the capacity of our accounting software to properly track and report on our inventory.

I don't, that is a question I would be able to pull out to the network of WSBDC Advisors and ask those who work a little bit more closely more often to see if their clients recommend anything. But what a great problem to have, you have outgrown your old software. Bravo

14. What is any last-minute advice or parting thoughts you'd like to give to the group?

I would say there's always room for improvement. And like the quote you read from, it was John Baker, am I remembering the person? Okay. Absolutely correct. We can't improve what we don't track, and I will share from personal experience that when I first had my first business, I was a financial advisor and spent the better part of 17 years doing that. I didn't track those things. And I just said to myself if I'm doing the right thing and I'm doing a lot of things, things are going to work out. And it didn't take long. Actually, it did take long because I was stubborn about it. But I realized that the less I was paying attention and the more I was losing track of all those ratios and numbers and thresholds and parameters, all those things I wasn't paying attention to were costing me because I wasn't able to drive the decisions based on analytics and metrics in real numbers. It was, I think this is right, it was one of the biggest mistakes I've made as an entrepreneur is not knowing the hard and fast numbers to my business. So we start with your financials, we start with your balance sheet, we start with your income statements. And understanding that will give you a great bird's eye view on what you're doing great. And then some of the areas for improvement. So really understanding the numbers for your industry, what your competition is doing and how you rank and how you grade out against your competition. And then just the overall health of your business.