

Guide to Retail Inventory Management

A strong inventory management strategy helps retailers satisfy customers, lower costs, and increase profits.



The goal of retail inventory management is to carry the specific items shoppers want, meeting demand without running out of stock or carrying too much of it. Making that happen requires careful coordination and planning, and the stakes are high—poor inventory management can leave a lasting mark on a company’s finances.

As a review, here are the basic steps in retail inventory management, which your business is likely already following:



How Much Inventory Should I Buy?

As part of the “combine sales and inventory” step of the process above, you can use the following methods to determine various facets of demand and order the right amount of inventory to maximise profits and minimise costs.

The right inventory management software will automatically make these calculations for you based on the latest information.

Economic Order (EOQ)

The EOQ formula considers demand, ordering costs, and carrying costs to determine the ideal amount to order.

$$EOQ = \sqrt{\left(\frac{2 \times \text{Annual demand in units} \times \text{Ordering costs per order}}{\text{Annual carrying costs per unit}} \right)}$$

Open to Buy (OTB)

Open to buy helps you know how much to spend on merchandise during a fixed period to increase the chances of adequate supply and positive cash flow.

$$OTB = \text{Planned Sales} + \text{Planned markdowns} + \text{Planned end-of-period inventory} - \text{Planned beginning-of-period inventory}$$

Safety Stock

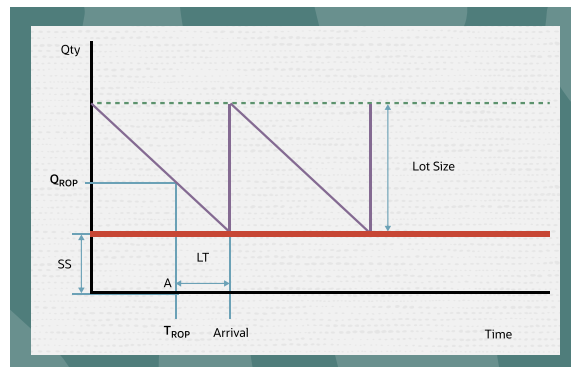
Safety stock is the amount of inventory a retailer should keep as a buffer between expected and actual demand.

$$\text{Safety Stock} = \frac{(\text{Maximum amount of daily unit sales} \times \text{Maximum lead time in days}) - (\text{Average amount of daily unit sales} \times \text{Average lead time in days})}{}$$

Reorder Point

Reorder point uses sales data and lead time to calculate the point at which retailers should reorder a product.

$$\text{Reorder Point} = (\text{Average daily unit sales} \times \text{Average lead time in days}) + \text{Safety stock in units}$$



Key: ROP = Reorder point, SS = Safety stock, Q_{ROP} = Quantity reorder point, T_{ROP} = Time reorder point

Inventory Analysis Methods

After placing your orders for stock and making some sales, it's time to analyse your performance, determine your return on inventory investment, and estimate the value of your current stock. Here are three common ways to do this:

ABC Analysis

In an ABC analysis, inventory is divided into three groups:

- Group A – Products that contribute most to the top or bottom line.
- Group B – Mid-performing products.
- Group C – Products that sell the least or contribute the least to profitability.

Use an ABC analysis to tailor the way you allocate resources to and manage each item according to its specific demand level and better balance your product mix—both of which maximise profitability.

XYZ Analysis

In an XYZ analysis, inventory is divided according to variability in demand:

- Group X – Products with steady demand
- Group Y – Products with high variability in demand
- Group Z – Products with very erratic demand

Retailers often use XYZ analysis to inform more accurate demand forecasts and more precise ordering and stocking processes.

FSN Analysis

In an FSN analysis, inventory is divided according to sales velocity or rate of consumption:

- Group F – Fast-moving items
- Group S – Slow-moving items
- Group N – Non-moving items that barely sell at all

Retailers might use an FSN analysis to shape decisions about price changes, warehouse design and stocking locations, and item discontinuation.

Accounting for Your Inventory

As a retailer, you'll use one of these methods to determine the cost of inventory and goods sold (COGS) for accounting purposes. Regulators expect you to stick with one method in a given year to ensure consistency and accuracy.



First In, First Out (FIFO)

This technique tracks the natural lifecycle of goods, assuming most retailers prefer to sell older products before they spoil, become obsolete, or lose value. FIFO is a popular technique, as it accurately reflects real business conditions.



Last In, First Out (LIFO)

This technique is based on selling newer inventory first, which reduces stated profits and taxes. LIFO is complex and carries a greater risk of manipulation, so it is not as widely used.



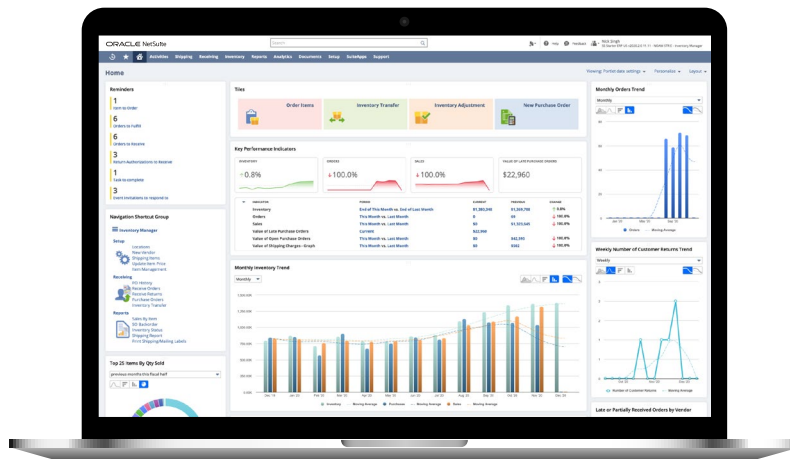
Weighted Average Cost (WAC)

This technique doesn't consider when inventory was acquired, or the cost differences between different batches of items, but rather takes an average of all purchases. WAC is often used when inventory items are practically identical.

Why It's Worth Investing in an Inventory Management System

A retail inventory management system that's part of an [ERP system](#) like NetSuite Inventory Management will help you:

- Confidently make order and fulfilment decisions based on a real-time view of inventory across all locations.
- Automate inventory counts without freezing transactions.
- Harness historical and seasonal data to forecast demand that optimises replenishment orders.
- Optimise inventory levels to increase product availability and provide better customer experiences.



NetSuite simplifies inventory management by highlighting developments that need your attention as well as key purchasing metrics and trends.



Find out how your retail business can benefit from NetSuite Inventory Management