



RAMA UNIVERSITY

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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: B.COM V SEM..

SUBJECT: FUNDAMENTAL OF FINANCIAL MANAGEMENT

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LECTURE: 38

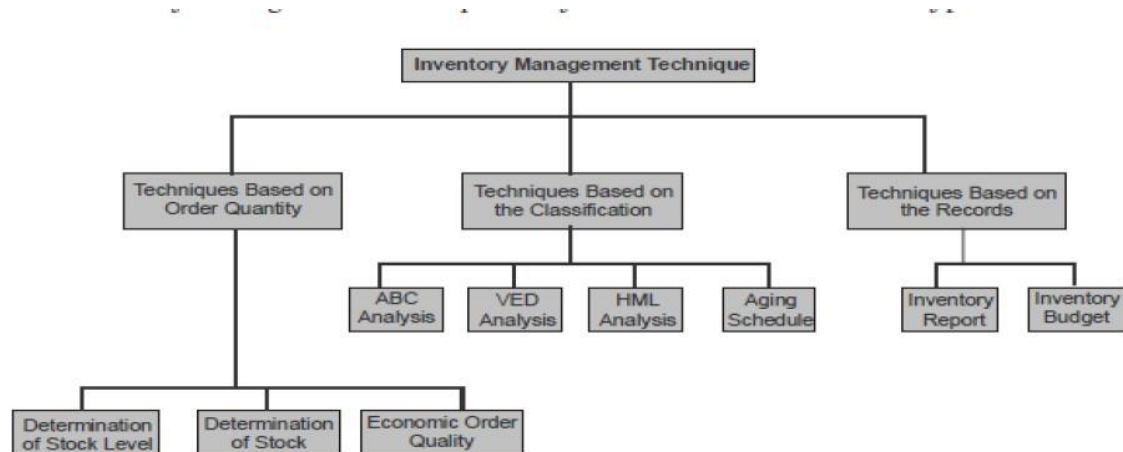
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LECTURE-38



TECHNIQUES OF INVENTORY MANAGEMENT

Inventory management consists of effective control and administration of inventories. Inventory control refers to a system which ensures supply of required quantity and quality of inventories at the required time and at the same time prevents unnecessary investment in inventories. It needs the following important techniques.



Techniques based on the order quantity of Inventories

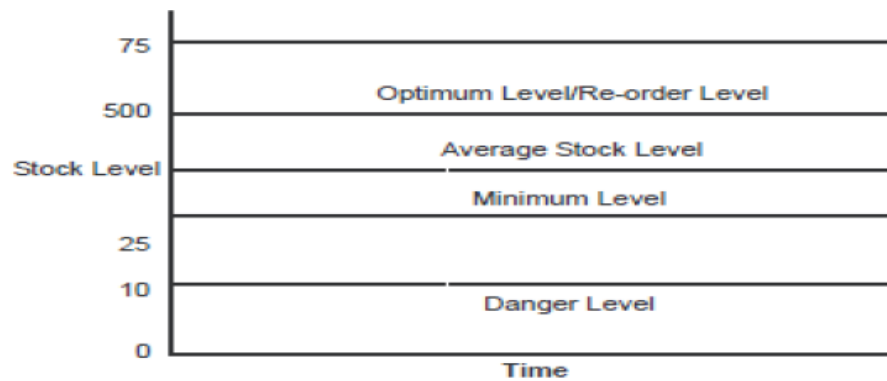
Order quantity of inventories can be determined with the help of the following techniques:

1. Stock Level:

Stock level is the level of stock which is maintained by the business concern at all times. Therefore, the business concern must maintain optimum level of stock to smooth running of the business process. Different level of stock can be determined based on the volume of the stock.

2. Minimum Level:

The business concern must maintain minimum level of stock at all times. If the stocks are less than the minimum level, then the work will stop due to shortage of material.



3. Re-order Level

Re-ordering level is fixed between minimum level and maximum level. Re-order level is the level when the business concern makes fresh order at this level. $\text{Re-order level} = \text{maximum consumption} \times \text{maximum Re-order period}$.

4. Maximum Level

It is the maximum limit of the quantity of inventories, the business concern must maintain. If the quantity exceeds maximum level limit then it will be overstocking. $\text{Maximum level} = \text{Re-order level} + \text{Re-order quantity} - (\text{Minimum consumption} \times \text{Minimum delivery period})$

5. Danger Level

It is the level below the minimum level. It leads to stoppage of the production process. $\text{Danger level} = \text{Average consumption} \times \text{Maximum re-order period for emergency purchase}$

6. Average Stock Level

It is calculated such as, $\text{Average stock level} = \text{Minimum stock level} + \frac{1}{2} \text{ of re- order quantity}$

7. Lead Time

Lead time is the time normally taken in receiving delivery after placing order s with suppliers. The time taken in processing the order and

then executing it is known as lead time.

8. Safety Stock

Safety stock implies extra inventories that can be drawn down when actual lead time and/ or usage rates are greater than expected. Safety stocks are determined by opportunity cost and carrying cost of inventories. If the business concerns maintain low level of safety stock, it will lead to larger opportunity cost and the larger quantity of safety stock involves higher carrying costs.