RAMA UNIVERSITY

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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: MBA III SEM..

SUBJECT: WORKING CAPITAL MANAGEMENT

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LECTURE: 20

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LECTURE-20

TECHNIQUES OF INVENTORY MANAGEMENT:

In order to maximize the owner's wealth, the financial manager should aim at the optimum level of inventory on the basis of trade-off between cost and benefit.

There are two techniques which may be advocated for the purpose:

(a) Traditional Techniques to Inventory Management.

(b) Scientific Techniques to Inventory Management.

(a) Traditional Techniques to Inventory Management:

Under this method, comparison may be made between firms belonging to same industry or within the same firm for a particular period or over a period of time for establishing the standard by which efficient inventory management or otherwise may be determined.

For the purpose the following ratios are commonly used :

(i) Materials Turnover:

Average Materials in Stores/Average Daily Consumption

(ii) Work-in-Progress Turnover:

Average W-I-P/Average Factory Cost of Production

(iii) Finished Goods Turnover:

Average F.G. in Stores/Average Cost of Production

The above ratios are used for testing whether the raw materials are over purchased or not, production control is effective or ineffective and finished goods are slow moving or not Therefore, an important indication of efficiency can be noticed with the help of these ratios.

Although, the rapidity of turnover depends on the nature of business, the higher the turnover ratio, the shorter will be the time period. So, the quicker the turnover, the greater will be the profitability and vice-versa. Since, the ratios are not free from snage, the next approach, i.e. Scientific Techniques to Inventory Management may be applied