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The Power of 'Turn and Earn' in Managing Inventory

Getting a handle on inventory is essential to profitable operation. But as every distributor knows, it's tough to strike the right balance between too much and too little.

Being stuck with an oversupply of product in the face of a sudden collapse of demand can take a big bite out of profits, but it's just as bad to turn away customers because you're out of the product they want.

Sometimes the problem won't be as obvious as a glut or a stock-out. A lackluster return on your inventory investment — less than you might earn elsewhere — can also indicate a need to sharpen inventory management tools. The answer may lie in your product mix.

Sort Winners From Losers

Undeniably, fast-selling products seem worthy of a dominant role, but sometimes slower-moving products can be just as profitable if their margin is high. An analytic technique known as "turn and earn" can be a powerful tool to help sort winners from losers.

Turn-and-earn analysis appraises inventory turns in relation to profits, offering an accurate reading of which products in your inventory earn their keep and which ones are freeloading.

Determining Your Index

To determine your turn-and-earn index, start with your annual inventory turn rate, the figure reached by dividing cost of goods sold by the value of inventory. Exclude any transactions not involving the use of stock, such as direct shipments or special purchases.

Cost of goods sold totaling \$1 million and inventory valued at \$250,000, for example, yield an inventory turn of four — meaning that inventory is turning over four times a year.

Next, multiply the turn rate by gross margin percentage — the proportion of revenue left after meeting costs — to get the turn-and-earn rating. For example.

say that a product has a turn rate of six and a gross margin of 20 percent. Its turn-and-earn rating would be 120.

Include Entire Line

Calculated across the entire product line, turn and earn reveals your top — and bottom — performers. For accurate analysis, experts emphasize, the index must be calculated across a product line, rather than for a single item.

In addition to providing product comparisons, turn-and-earn analysis can help pinpoint operational problems. Breaking data into other groupings, such as individual purchasing agents or separate warehouses, for example, may offer insights into internal factors involved in performance variations.

Generally, product line turn-and-earn scores should be around 100 or higher, and usually the higher, the better. But sometimes a very high rate may reflect problems.

You might not be carrying enough stock to meet demand, or your margin may be so high that you are leaving yourself open to opportunistic price-cutting competition.

The logic is straightforward: When competition keeps margins low, the inventory must turn faster. If margins are high, however, a slower turn is acceptable. Calculate turn and earn at least quarterly, to keep operations abreast of changes in demand, competition, and profitability.



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