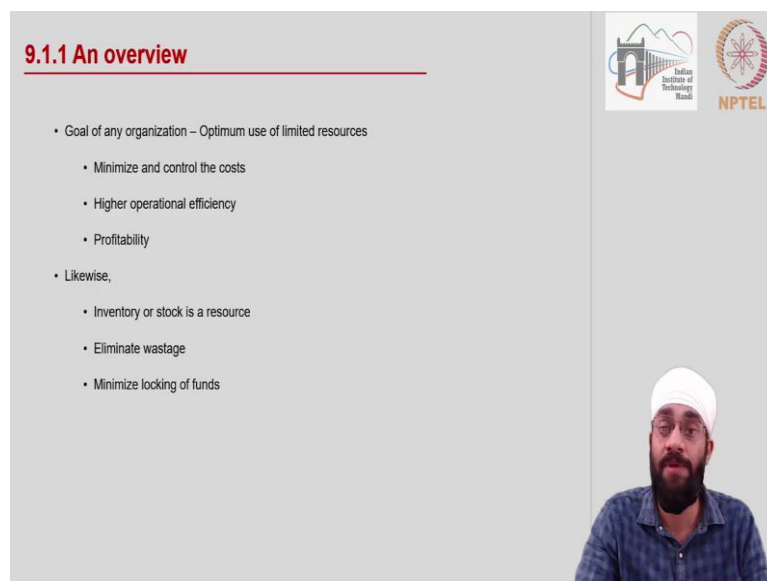


Financial Accounting
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Lecture – 117
9.1 Introduction to Inventory Management

Hi. Welcome to topic 9 of the course on Financial Accounting. In this topic, I am going to introduce you to some techniques, some methods of inventory analysis and control.

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9.1.1 An overview

- Goal of any organization – Optimum use of limited resources
 - Minimize and control the costs
 - Higher operational efficiency
 - Profitability
- Likewise,
 - Inventory or stock is a resource
 - Eliminate wastage
 - Minimize locking of funds

The slide also features the logos of the Indian Institute of Technology Mandi and NPTEL in the top right corner, and a video inset of the lecturer, Dr. Puran Singh, in the bottom right corner.

Understand that for any organization making full utilization of resources, and also the efficient utilization of resources, is highly important. For any organization, the resources can range from monetary resources to non-monetary resources. Stock is such a resource and it becomes very important for a business, be it manufacturing business or a trading business, to take care of its stock, to manage its stock well, so that the stock can be utilized fully to generate maximum amount of profit.

On these lines, in this topic we are going to talk about inventory as a resource and how the waste of inventory can be minimized, how the cost of managing the inventory should be minimized, so that the business can earn the profit to its potential.

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9.1.2 What is inventory?

- **Trading Business**
 - Finished goods
- **Manufacturing Business**
 - Raw Material
 - Work in Progress
 - Finished Goods

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The stock, the inventory, can be defined in various different ways depending upon what is the nature of the business. For example, for a manufacturing business, inventory could be raw materials. On the other hand, for a retailer the stock can be the stock of finished goods that he or she sells. Also, there can be work in progress. All I am saying is that the notion, the concept, of inventory basically represents a collection of items which are used either in the production process or to be sold further, but the basic concept is that you use this stock of goods to further sell and make profit.

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9.1.3 Nature of inventory

- 'Inventory is a necessary evil'
 - To protect against uncertainty
 - Transaction motives
 - Precautionary motives
 - Speculative motives
 - But it blocks cash

The slide features a header with the title '9.1.3 Nature of inventory' and a red underline. It discusses the nature of inventory as a 'necessary evil' and lists motives for holding it. Logos for the Indian Institute of Technology Mandi and NPTEL are in the top right. A video feed of a man in a white cap is in the bottom right.

A manufacturing business, for example, has to maintain sufficient quantities of various kinds of raw materials in the business, so that the production process is not halted, and is not stopped, because of lack of one of the many raw materials which are required to produce the end product. Therefore, the business has to protect against this uncertainty. There are not only the uncertainties of availability of stock, but there can be a large number of other factors which may influence the production process as well. Therefore, the inventory is said to be a necessary evil. Why is it necessary? Of course, we need stock of goods to create the final product for a manufacturing business. But also, why is it evil? It is evil in the sense that it incurs cost for a business. In order for a business to maintain a certain level of stock, you have to invest, you have to purchase that stock from the supplier, or from various suppliers. And, when you purchase the stock, it is not yet sold. There is a long production process that has to take place in order for raw material to be converted into finished product. During all this time the business has invested, has blocked the money into the stock of raw material which is being processed. Therefore, in that sense it is called evil. Of course, you are going to sell off this stock by converting it into a finished product and then you are going to make profit.

But the question is how much stock should you maintain? Maintaining too much stock would incur a lot of cost as you have to block money, and after you have blocked money there are other costs that are involved. You have to look after this stock, you have to make sure the stock is insured, it is protected, put in a godown, there is security, it should not catch fire and so on.

So, you have to take care of this stock as well. Plus, there are precautionary motives: what if there is a lockdown, for example, the goods are not allowed to move from place a to place b and you do not want to halt the production process. You have to make sure the necessary level of stock is available within the premises for example. So, some precautionary motives for which you might want to maintain a certain level of stock.

So, you have to learn some techniques of stock management, inventory management and control. Also, there could be some speculative motives to take advantage of rising prices. Of course, within the given regulations and laws, but there could be cases where you would want to benefit monetarily from various circumstances in the economy. So, given this whole discussion on how stock maintenance is necessary but also it incurs some cost, how do we balance the two to make sure that the cash that is being blocked in the inventory is actually yielding good benefits for the business? And that is where the inventory management techniques come in handy.

Although inventory management can be a larger topic and can be discussed in great detail, in this course we only scratch the surface. I introduce you to three, four different techniques of understanding how stock should be managed, should be ordered, should be maintained and should be valued. But there could be a larger discussion on this topic as well.

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The slide is titled "9.1.4 Inventory Management" in red text. Below the title is a bulleted list of inventory processes:

- Planning and controlling
 - Acquisition
 - Storage
 - Sale

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So, the planning of the stock, the management of the stock, what does it involve? We are essentially talking about procuring the stock via acquisition, and then storing the stocks, the storage of the inventory and then of course, selling it off. So, that is a typical process or various aspects that are involved in the inventory management and we are going to address that as we move forward in this series of videos.

So, I will see you in the next video, where we talk more specifically about one of the few techniques that we are going to discuss.