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Inventory Management System With Respect To Paper Industry in India

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Abstract

Inventory management is generally recognized to be of sufficient importance to warrant the appointment of a person to carry specific responsibility for it .The study investigated the relationship between company performance and inventory management. The researcher used inventory days as a dependent variable and gross profit and net profit as an independent variable. The inventory connotes the value of raw materials, consumables, spares, work –in– progress, finished goods and scrap in which a company's funds have been invested. According to the analysis result in the researcher identified inventory management and gross profit had a positive relationship, inventory management significantly affect to gross profit margin and net profit margin. Hence organizations have to take a correct the decision regarding the inventory management administrative cost and another relevant cost to increase the performance of the organization.

Keywords: Inventory Management, Raw Materials, Costs

Introduction

Inventory Management

'Inventory' generally refers to the stock of some kind of physical commodity but in the accounts it is the stock of finished goods only. Inventories provide a very important line in the production and a sale of a product. In a manufacturing company, a certain amount of inventory known as 'goods in process' is absolutely necessary for the process of production Inventory gives the firm flexibility in its purchasing.

The inventory management aims at

(i) Minimising the firm's investment in inventory, and

(ii) Meeting the demand for the product by efficiently organising the firms' production and sales operations.

On the other hand, an under investment in inventories may hold up production due to its inadequate and erratic supply. The company may not meet its delivery commitments on account of production interruption due to shortage of raw materials.

A manufacturing company must have

(i) Raw material inventory,

(ii) Goods in process inventory, and

(i) Finished goods inventory.

Methods of Inventory Valuation

The methods of inventory valuation evolved overtime may be broadly classified as

- Methods based on actual costs
- Methods based on market price.

Methods Based on Actual Costs

FIFO Methods

This method (First in First out) is based on the sound assumption that the inventories which are received first move out first. Hence, the inventories which remain unsold are those acquired subsequently. This method, however, will not suit the management in times of rising prices.

LIFO Method

In order to eliminate the inventory profit altogether, the alternative is to consider the latest purchases as part of cost of goods sold and treat the earlier purchases as remaining unsold. This is known as the LIFO (Last in First Out) method. In this case, in times of rising prices high cost items would get included in cost of goods sold.

Base Stock Method

Yet another method based on cost is the base stock method. This method is based on the assumption that a mini mum inventory is always carried and the value of such inventory is the cost incurred.

Methods Based on Market Price

Market Value Method

In practices, inventories are valued at figures other than costs also; one popular method is to adopt market value. 'Market Value' has two connotations. One is the value at which the item of inventory could be marketed by the company.

Standard Cost Method

Inventories may also be valued on estimated costs or standard costs. Adoption o f standard costs would mean setting up standard beforehand. Both the consumption and inventory on hand may be valued at standard costs. The actual costs may or may not be different from the standard. The variance between standard and actual cost will have to be adjusted against the profits.

Costs Associated with Inventories

There are five parts of costs:

(i) **Material Costs**

It includes the cost of purchasing the goods plus transportation and handling costs.

(ii) **Order Costs**

The costs associated with procurement is called order cost or buying cost which consists of

(a) cost of processing a purchase order,
(b) transportation costs,
(c) inspection costs, and
(d) general administration and overhead costs.

(iii) **Inventory Carrying Costs**

These are the costs for carrying the inventory which means they will not be incurred if the inventories are not carried. These costs include cost of capital invested in inventory, opportunity costs, storage handling insurance, physical deterioration or cost of preventing its obsolescence.

iv) **Costs of Funds tied up in Inventory**

The most critical cost in inventory situation is the cost of capital tied up in the inventory. This cost is expressed as a percentage of the value of the inventory.

(v) **Cost of Running Out of Goods**

Ratios are highly useful tool for financial analysis assessing the performance of the concern. Ratios can assist management in its basic functions of forecasting, planning, co–ordination, control and communication.

SUMMARY

A good solution to the problem of inventory valuation is to identify the cost of each specific lot and include the same in cost of goods sold or closing inventory as such items are sold or lying unsold. As profit is obtained from net sales less cost of materials and other expenses, thus, for a given sales, the profit returned depends upon cost of materials. While opening stock and purchases cannot be altered, cost of materials can be altered by altering the closing stock value which depends upon the efficient management of inventory and the method of valuation adopted for this and therefore, it is essential to consider the valuation of inventory and its impact on profitability while formulating the profit planning and control programme.

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