Lean and Mean: Inventory Management Strategies That Work

Fritz Wood, CPA, CFP
H.F. Wood Consulting
Lake Quivira, KS

inventory \’in-ven-tor-e\ n
1: the quantity of goods or materials on hand :STOCK 2: a list of goods on hand 3: the act or process of taking an inventory
Merriam’s New Collegiate Dictionary, 1975 edition, G. & C. Merriam Company, Springfield, MA

One of the basic needs in a veterinary practice is an adequate inventory of drugs and supplies. Also, drugs and supplies represent the second largest expense item for most practices (after salaries and wages).

Anyone in the practice – veterinarian, hospital manager, veterinary technician, veterinary assistant, or receptionist – can manage inventory. Having a single individual in charge of inventory is critical to ensure accuracy, consistency, and efficiency. At least one health care team member should be trained as a backup.

The inventory manager’s duties should include

- Maintaining an adequate stock of all products used, dispensed, and sold.
- Organizing inventory so items are easy to locate.
- Identifying products that need to be reordered.
- Maintaining accurate purchasing and inventory records.
- Ordering.
- Receiving and inspecting shipments.
- Establishing and updating pricing for all inventory items.
- Rotating stock and monitoring expiration dates.
- Evaluating new or updated products and considering specials offered by suppliers (this responsibility will most likely be shared between the veterinarian(s) and the inventory manager.).

Basic inventory goals

Two objectives are most important: ensure that items are on hand when needed, and minimize the expense of keeping supplies in stock. These two goals hang in a delicate balance; overstocking assures never running out but uses up too much capital, a lean inventory reduces the expense but increases the risk of being out of something in an emergency.

Even though inventory is considered an asset, it is unproductive until it is used or sold. Products sitting on a shelf too long may expire, become damaged or stolen, become obsolete with the introduction of better products, or become shopworn. The effect of time is especially evident with pet health care products displayed in the reception area. Products that sit in a display for too long collect dust and labels become smudged and tattered. Clients shun shopworn packages as undesirable, even though their contents may be unaffected.

Therefore, another important goal of inventory management is to increase turnover. The rate of inventory turnover is defined as the number of times inventory is used up (“turned over”) and replenished each year. For example, assume a practice spent $80,000 on supplies during the year. At the beginning of the year, the cost (wholesale value) of inventory on hand was $22,000, and $18,000 at the end of the year. The turnover rate would therefore be 4 ($22,000 + $18,000 = $40,000; $40,000/2 = $20,000; $80,000/$20,000 = 4). That means the average inventory item is replaced 4 times in a year, or every three months. The higher the turnover, the better. The turnover rate should be used as a benchmark for monitoring inventory management. Note that if your turnover rate is near 12, it should be possible to operate without investing capital in inventory. In essence, the products are sold before they are bought (paid for). If you can’t take the time to evaluate your entire inventory, concentrate on items you spend the most on (usually flea/tick control, heartworm preventives, and pet food). Pareto’s Law, or the “80/20” rule states that 20% of items stocked account for 80% of expenditures.

Turnover Rate = Yearly Inventory Expense/Average Cost of Inventory on Hand

Average Cost of Inventory on Hand = Year’s Beginning Inventory + Year’s Ending Inventory/2

Effective inventory management is a huge opportunity in veterinary medicine today. For example, according to the AVMA Report on Veterinary Practice Business Matters (2011 Edition), small animal practices turn over their inventory only 4.39 times per year – so they hold 83 days of inventory on hand (365/4.39). Most practices can and do receive shipments from suppliers at least weekly. So having almost three months inventory on hand is clearly excessive. Chances are, tens of thousands of dollars are sitting idly on your shelves instead of comfortably in your bank account.

Inventory control

An inventory control system should:

- Be easy to use.
- Improve efficiency.
- Minimize stockouts and emergency shipments.
- Increase inventory turnover
- Signal when an item needs to be reordered.
- Track past and present costs and indicate appropriate pricing.
- Ensure ordered items are received and back-ordered items are tracked.
- Identify expired or outdated items for removal (in some cases, for return to suppliers for credit).
- Help reduce the risks of employee theft and malpractice liability.
- Fulfill certain accounting, tax, and insurance requirements for reporting value of inventory on hand.

Elements of the system

Reorder log ("Want list")

The entire clinic staff must be trained to identify items that need to be reordered. The inventory control manager should not have to check inventory more than once a week. Day-to-day depletion of supplies must be monitored by everyone. The "Want List" can take the form of a web page, white board, notebook, clipboard, or basket.

Over time, the inventory manager should be able to set a stock minimum; or the minimum quantity of an item that should be kept on hand. The minimum depends on ordering frequency and sets the reorder point.

Reorder point

The reorder point is defined as the level to allow a product supply to deplete before reordering. Once the reorder point is set, the reorder quantity must be determined.

Reorder quantity

The reorder quantity is the amount that should be ordered once the reorder point is reached. A basic rule of thumb is to order a one-month supply. You will fine-tune these amounts as you become more comfortable with your system. The inventory manager should continuously look for opportunities to reduce both the reorder point and reorder quantity.

Several methods can be used to signal the reorder point:

Manual methods

The simplest method - when someone sees that an item is getting low they simply write it on the "Want List."

Some clinics use a system where the last item is marked with a sticker to indicate that the reorder point has been reached. The inventory manager can clearly see by looking at the shelf what needs to be reordered.

Other clinics use a reorder tag (sometimes called a "Red Tag Inventory System") which is placed directly in front on the last unit of the minimum quantity. When the first unit is taken from the bundle for use, the tag should be removed and placed in a nearby box or basket.

An order book shows when, what and from whom you ordered. It typically lists order date, quantity ordered, size ordered, item name, vendor, unit cost, total cost, date received, quantity received, and discount (if applicable). A vendor list (complete with names, telephone numbers, account numbers, fax numbers, email addresses, etc.) is often stored in the front of this book. Anyone at any time should be able to quickly see what was ordered and when. This book is a great reference when the inventory manager is out of the clinic.

Computerized inventory control

While the initial set-up of a computerized inventory system is labor intensive, the efficiencies gained can be significant. Each item (that goes through the receipting process) must be counted and entered into the computer. The next task is to set a minimum number of items that must be on hand (the reorder point). Next, enter the reorder quantity (a one month supply might be a good starting point). Finally, enter the vendor information for each product.

Each time a client is invoiced for an item it is automatically taken out of inventory. When the quantity dips below the required minimum, the computer will indicate that the product needs to be reordered. It will tell you what to order, who to order from, when you last ordered, how many you ordered, and how much it cost. Each time you receive a shipment you will need to add each item (that goes through the receipting process) into the computer.

Many veterinary practice management consultants recommend two inventory control systems – the computer is used to track items that go through the receipting process, and for everything else one of the manual systems is used (e.g. suture material, gauze pads, bandages, syringes, and so on).

Your shipment arrived

When an order is received, there should be an out-of-the-way place where it can be stored until you have a chance to unpack it. All shipments should be untouched until the inventory manager can answer the following questions:

- Did we get exactly the same amount as we ordered?
- Did we receive the right form (capsules, tablets, or powder)?
- Did we receive the right size (50 mg, 100 mg, or 500 mg)?
- Is the product "short-dated" (will it expire before it's used or sold)?
- Does the invoice list the price quoted and recorded in the order book?
- Does it cost more than the last order (if so, the sale price should be adjusted upward)?
- Was anything backordered (if so, immediately note in the order book)?
- Is anything damaged or missing?
- Can we go ahead and pay the bill?

Other considerations

Establish a good relationship with sales representatives. Sales representatives can and should add value each and every time they visit your practice, so make time to see them. View them as a member of your health care team. They can be very helpful in myriad ways including

- Giving you an "outsider's perspective" of the look, feel, and smell of your clinic. Remember, they probably visit more than 100 clinics with some frequency, so they see The Good, The Bad, and The Ugly
- Resolve problems with your order or your account
- Continuing education (in-service meetings)
- How other practices achieve success
- Identify potential new-hires
- Merchandising
- Selling skills
- Making you aware of new product advances and offerings
- Source of new technical, medical, and marketing information

Price is never the only determinant of value; you want to deal with reputable companies and representatives that respect you and your practice. The fewer suppliers dealt with, the less time spent with sales representatives and the purchasing process. The time spent bargain hunting may not be worth the small savings you gain. Also, since most products are sold to clients at a mark-up, higher prices are ultimately passed through to clients (and therefore not borne by the clinic).