

BEWARE THE INVENTORY CREEP

by

John H. Nardoizzi, CPA
Nardoizzi Consulting, LLC

There is danger all around us. Killer bees are swarming northward from the Mexican border. Dutch elm disease has claimed millions of trees across the country. Red tide threatens shellfish beds off the New England coast. And inventory creep is slowly draining profits from oilheat dealers throughout the land.

Unlike natural predators, inventory creep won't sting you, rot your branches or poison your breeding grounds. But it will attack your bottom line with a vengeance.

"Inventory creep" is the phenomenon of "disappearing" inventory that occurs at year end, when physical inventory falls far short of a dealer's on-the-books inventory. The discovery of inventory creep requires a significant write down in the company's annual financial statement, which results in a reduction in profits for that year. It is not unusual for a mid-sized oilheat company to see a loss of \$100,000 or more due to inventory creep.

How does inventory just disappear? There are several factors that contribute to inventory creep. Primary among them are poor inventory management practices, including loose control of access to inventory storage areas, non-reporting of parts use, not accounting for defective parts or supplier shortages. Another major contributor to inventory creep is "shrinkage," more commonly known as theft.

Luckily, there are preventative measures you can take to protect yourself from the ravages of inventory creep. The best defense may be to eliminate your inventory altogether. Instead of stocking parts, some dealers now outsource from supply houses, ordering parts and materials on an "as needed" basis. In some cases, technicians can call the supply house from the customer job site and have parts delivered.

If you prefer to continue to stock your own parts and supplies, it is important that you implement stringent inventory control practices. Parts and equipment should be logged in upon delivery and logged out when used. Access to inventory should be limited and a system of checks installed to prevent parts being misplaced, lost or stolen.

Your inventory system should be computerized. If not, it is time to bite the bullet and join the 20th century, at least before the 21st century arrives. Software packages that track inventory through bar codes makes your job simpler, faster and more accurate.

Will these steps eliminate inventory creep? Not entirely. After all, the world is not perfect and mistakes will be made. But by putting more effort into monitoring and controlling your parts and equipment inventory throughout the year, you can make significant progress toward reducing the difference between actual and paper inventory at year's end. And that means more money will find its way to your bottom line.

John Nardozi of Nardozi Consulting, LLC provides valuation, transaction advice and business management services for fuel oil retailers and distributors. He can be reached at (617) 487-4752, or jnardozi@nardoziconsulting.com.
graymail.com.