Purchasing

LESSON 2

Main Idea

Purchasing inventory for a store is an important and complicated job. To be successful, a store must have inventory available for its customers to buy. That inventory must be what customers want to buy and must be available when customers want to buy it. In this unit you will learn the basics of purchasing store inventory, selecting vendors, and managing store inventory. You will also practice some of the mathematics often used in purchasing.

After completing this lesson you will be able to:

- Explain how purchasing impacts sales and profit
- List qualities of a good buyer
- Describe the lifecycle of inventory through a store – from ordering to sale
- Explain the affect of inventory control on sales
- Calculate stock turnover in terms of items and dollars
- List common problems associated with purchasing and inventory control

Key Terms

- Buyer
- Open-to-buy
- Vendor
- Inventory
- Stock
- Invoice
- Inventory Control
- Just-in-time Inventory Control System
- Physical Inventory System
- Perpetual Inventory System
- Stock Turnover

What a Buyer Does

A buyer is the person who is responsible for purchasing the merchandise for a store. Large stores often hire a person whose only job is that of a buyer. In smaller stores, the owner or the manager often does the buying. Regardless of whose responsibility it is, the buyer must be well acquainted with the store's customers. The buyer must also be knowledgeable about the merchandise available for purchase. The buyer's job includes the tasks of planning, timing, and negotiating.

Planning

The buyer must plan which merchandise to buy. Much of a store's purchasing is done weeks or months before product arrives at the store. It is important to know the store's customers to be able to predict what they will want to buy.

The buyer must also plan to make purchases within the budget available for purchasing at any given time. The amount of money available to a buyer for purchasing items for a store is called open-to-buy. Most businesses use a merchandise plan to allocate money available for new merchandise purchases for a specific time period. When calculating open-to-buy for a specific period of time, one must consider merchandise orders that have been placed for the time period and the merchandise that has already been received for the time period.

Timing

Timing is a critical consideration in purchasing. Merchandise must be available when customers want to purchase it. The buyer must decide when merchandise will arrive at the store. If merchandise arrives before customers are ready to buy, the merchandise will sit on store shelves. If merchandise arrives after customers are ready to buy, they will probably have purchased it elsewhere.

Negotiating

The buyer will need to negotiate the terms and discounts of the orders with the vendors or suppliers. This is important because favorable terms and discounts will have an impact on the store's profit margin.

Selecting Vendors

A vendor is a business from which a buyer purchases merchandise. The buyer generally selects vendors. The reputation and reliability of a vendor is of utmost importance. Vendors are expected to deliver the merchandise when it is scheduled to arrive. The buyer must also make sure that the merchandise delivered by the vendor is the same quality and quantity that was ordered.

Inventory Needs

Inventory is the total amount of goods a business has. Inventory may be in a backroom or on the sales floor. Inventory is sometimes referred to as stock. Achieving a balance of inventory that is available for sale and the timely delivery of new merchandise is vital for a store's success. Empty shelves do not encourage sales or repeat business. On the other hand, too much inventory ties up open-to-buy and prohibits the purchase of new items. A buyer can use sales records to establish customer buying patterns and to make important decisions about the amount of inventory available at any given time.

Stock Handling

Once stock is delivered to the store, the process of stock handling begins. Stock handling includes receiving the stock, checking in the stock, price marking the stock, and transferring the stock to the selling floor.

Receiving and Checking in Stock

Most stores will receive and check in stock at the same time. Receiving stock usually entails matching the items and quantities ordered against the vendor's invoice. The invoice is the vendor's bill for stock purchased. It lists the items and quantities being delivered. Checking in stock is done to ensure that the items and quantities ordered and invoiced are the ones received. Checking in stock is also done to make sure that the stock is in good condition and undamaged. The expiration dates of perishable stock should also be reviewed to make sure that they stay fresh for customer purchase.

Price Marking Stock

Once the receiving and checking in processes have been completed, the stock is ready to be marked with its selling price. The store's order form should indicate the selling price of the stock. The stock can then be marked with a price ticket. Many stores use computer scanners to read the stock information from the bar code on each item of stock. The manufacturer can add the selling price to the bar code information. This is an accurate and time-saving way for the store to price mark its stock.

Transferring Stock to the Selling Floor

The new stock is now ready to be moved to the selling floor. The new stock should be transferred to the selling floor as quickly and as carefully as possible. New stock should be displayed in an area of the store that gets a good amount of customer traffic.

Stock Storage

There will be times when the entire amount of stock purchased cannot be placed on the selling floor. In those cases, the extra stock should be stored according to its type and requirements. For instance, milk products need to be refrigerated. Extra quantities should be placed in a refrigerated case until there is space for them in the refrigerated section of the store. Other stock, such as nonperishable packages of food, can be stored on shelves in a backroom until needed. Each item of stock should be evaluated according to its storage requirements and should be stored accordingly. It is important to keep shelves stocked on the selling floor.

Inventory Control

Inventory control is the management of the merchandise a store has for sale. This includes assuring that the store has sufficient stock to maintain sales goals. This also means avoiding too much stock at any given time. Inventory control also involves managing the stock on the selling floor and in the back room. There are several methods of inventory control, such as the just-in-time inventory control system. This method is usually computerized. A store is linked to suppliers through a computer system that purchases new inventory automatically as sales are made. Just-in-time inventory systems reduce the total amount of inventory a store must carry.

Inventory Systems

It is important to keep track of the merchandise a store has in its inventory. There are two systems that stores use to do this—the physical inventory system and the perpetual inventory system.

Physical Inventory System

The physical inventory system makes use of periodic counts of stock to ascertain stock levels. This inventory system requires that each item of stock be counted and recorded. To save the time and expense of counting all stock items in each inventory count, many storeowners will rotate the items that are counted at any given time.

Perpetual Inventory System

The perpetual inventory system keeps track of stock items on a continual basis. This inventory system can use either manual or computerized methods. The manual method requires keeping track of items received and sold by hand. The computerized method uses a scanner to record items received and sold. The information from the scanner is then sent to the store's computer, where the inventory is updated.

Stock Turnover

Stock turnover is an important tool that tells how well the store's inventory is being managed. Stock turnover measures how often stock is sold during a given time period. Stock turnover can be measured in items of stock or in dollars invested.

Summary

This unit covered the topic of purchasing and the jobs of the buyer. We have learned about the importance of selecting the right vendors. We have also learned about the importance of inventory to a store and how to handle items of inventory as they arrive at the store. Lastly, we have learned about inventory control, inventory systems, and how to compute stock turnover in both items of stock and in dollars invested.

Key Math Concepts

CALCULATING OPEN-TO-BUY

Use the formula below to calculate open-to-buy:

Open-to-buy = Planned Purchases – (Orders Received + Merchandise Ordered)

EXAMPLE

You have planned purchases of $1,000.

You have received orders that total $400 and you have ordered merchandise that totals $200.

Open-to-buy = $1,000 – ($400 + $200)

Open-to-buy = $400

COMPUTING STOCK TURNOVER

To compute stock turnover in items of stock, use this formula:

Stock Turnover in Items = Number of Items Sold ÷ Average Number of Stock Items in Inventory

To compute stock turnover in dollars invested, use this formula:

Stock Turnover in Dollars = Dollar Sales of Inventory Items ÷ Average Dollar Value of Inventory Investment

Key Terms

Buyer
The person who is responsible for purchasing the merchandise for a store.

Open-to-Buy
The amount of money available to a buyer for purchasing items for a store.

Vendor
A business from which a buyer purchases merchandise.

Inventory
The total amount of goods a business has, including goods in the backroom and on the sales floor.

Stock
Another term for inventory.

Invoice
The vendor's bill for stock purchased.

Inventory Control
The management of the merchandise a store has for sale.

Just-in-Time Inventory Control System
A usually computerized method of inventory control that involves linking a store to its suppliers through a computer system that purchases new inventory automatically as sales are made.

Physical Inventory System
An inventory system that makes use of periodic counts of stock to ascertain stock levels.

Perpetual Inventory System
An inventory system that keeps track of stock items on a continual basis.

Stock Turnover
A tool that measures how often stock is sold during a given time period.

MATH EXERCISES **LESSON 2**

Purchasing

1. Compute the open-to-buy for a store with planned purchases of $3,500. Orders received total $975 and merchandise ordered totals $1,200.

2. Compute the stock turnover in items for a product that has sales of 350 units and an average of 70 items in inventory.

3. Compute the stock turnover in dollars for a product that has sales of $6,000 and an average value of inventory investment of $1,500.

4. A store's buyer places an order for three dozen coffee mugs at a cost of $3.75 each, four dozen plastic glasses at a cost of $1.00 each, and two dozen insulated soft drink holders at a cost of $0.50 each. The delivery charge for this order is $7.50. There are no applicable discounts. What is the total cost of the order?

Purchasing

1. You are selecting a vendor for a new product for your store. Vendor A is a new vendor without an established reputation who is willing to offer attractive discounts on the product. Vendor B is an established vendor with an outstanding reputation for reliability and honesty, but this vendor's price on the product is higher than it is at other vendors. Vendor C is an established vendor with a reputation that has recently suffered because of slow or incomplete deliveries. The price for vendor C's product is between the prices of vendors A and B. Choose one of these three vendors and provide the rationale for your decision.

2. You are responsible for receiving and checking in stock orders that have just arrived at the store. The stock that has arrived includes milk, ice cream bars, packaged dog food, canned soup, and hot dogs. Describe the order in which you would receive, check in, and route each item to the sales floor.

3. Explain why a storeowner might choose to use a combination of perpetual and physical inventory systems to keep track of store inventory.

4. The stock turnover rate for your store is calculated on a monthly basis and has been falling for the past three months. Is this a cause for concern? If so, why?

Purchasing

GOAL: Your goal is to find the best purchasing policies for your store. You want to buy enough to satisfy customers, but not so much that products expire. Specifically, you want to generate $35,000 sales with $0 of expired goods.

YOUR SITUATION: In this lesson, you control Purchasing. All other actions are controlled for you.

1. Run the **Purchasing**, **Run To**, **Comment Log**, **Products**, and **Product Aging** sections of the **Tutorial.**
2. Open the **Purchasing** lesson.
3. Using **Purchasing** under the Actions menu,
   a. Set the **Target Inventory Level** to 100 Units. This amount is purposely set too low, so you can see the effect of purchasing too little.
   b. Use **Options->Run To** to run the simulation to January 15. Use the Faster button to speed up time, if desired. Observe the store floor and your message window. Click **Reports->Comment Log**.

QUESTION 1: What problems are you having with inventory?

   c. Click the **Products** button on the main toolbar. Check **Expired Goods** as well as **Sales.** Click **Table** under **Show As.** For the final week shown, enter the level of sales and expired goods on line 1 of **Worksheet 1**.
4. Again using **Purchasing** under the **Actions** menu,
   a) Set the **Target Inventory Level** to 2000 Units. This amount is purposely set too high, so you can see the effect of purchasing too much.
   b) Use **Options->Run To** and run the simulation to January 29. Click **Reports->Product Aging**.

QUESTION 2: What problem do you see with your inventory?

   c) Click the **Products** button on the main toolbar. Check **Expired Goods** as well as **Sales**. Click **Table** under **Show As**. For the final week shown, enter the level of sales and expired goods on line 2 of the worksheet below.
   d) On the **Products** report, uncheck the **Total** and **Sales** boxes and check **Products 1-12**.

QUESTION 3: Which products are expiring?

   e) Uncheck **Products 1-12** and check **Products 13-25**.

Continued

QUESTION 4: Which additional products are expiring?

5. Re-open the lesson and try several different settings for **Target Inventory Level.** Try to keep sales above $35,000 per week and expired goods at zero. You can use the More button on the **Purchasing** screen to set custom policies for the products that you found were expiring. Each time, run the simulation forward at least two weeks. Record your results on lines 3-5 of **Worksheet 1.**

QUESTION 5: What purchasing policy enabled you to meet the above goals?

WORKSHEET 1

Target Inventory Level	Sales	Expired Goods
Global Level: 100 Units		
Global Level: 2000 Units		
Global Level: Product Specific Levels:		
Global Level: Product Specific Levels:		
Global Level: Product Specific Levels:		