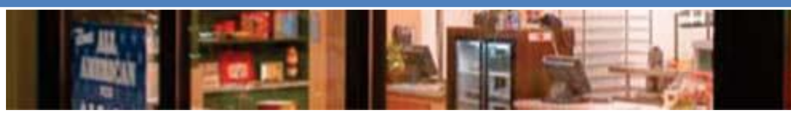
Axis Purchasing – Inventory Control – Basics for Foodservice



White Paper – Inventory Control – Basics for Foodservice

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Inventory Control – Use These Basics to Improve Profitability

Foodservice inventory typically covers inventory stock or consumables/food, beverages, cleaning, and disposable supplies. These products are stored in a designated storage room area or other secure locations of the building.

For the purposes of this paper when we talk about inventory vs. assets – inventory has a use life of one time (consumables/supplies); assets are reusable and must be controlled, but have a longer life (plates/utensils).

In monitoring operating costs in the foodservice industry there is heavy emphasis placed on monitoring and controlling labor. However, labor is relatively easy to control or redeploy, as compared to managing the cost impact of inventory. For example, if work is slow, managers can take steps to cut labor or re-assigned to other areas. Allocation of labor is visual and easily adjusted based on observed criteria. Inventory, once in the building is there till it is used. Inventory control involves numerous costs associated with everything that goes into supporting the operations of a restaurant. Inventory is also a category that may be a low priority, unless it is depleted and results in a disruption of service and / or expediting for replenishment.

The fact is; inventory costs money. These costs include the acquisition cost (price paid) the cost to finance (interest) and control costs (the cost of managing inventory).

Two Basic Types of Costs (outside of acquisition):

There are two basic types of inventory and control costs:

- Soft costs: Receiving, administration, expediting, opportunity costs, service impacts (out of stocks)
- Hard costs: Labor, utilities, warehousing / storage space, equipment, security, carrying/holding costs ("dead stock," loss, spoilage, theft, etc.)

Again, for this paper we will focus on a few of the hard cost areas. Normally, purchasers focus on the acquisition cost (sometimes "stocking up" to get a lower price), but inventory involves a number of sometimes neglected administrative contingencies including:

- Cost to receive and manage inventory
- Cost of invested capital (e.g. The cost of holding the stock)
- Cost of building space, refrigeration, utilities, freezers

- Cost of shortage, i.e., what is lost if the stock is insufficient to meet all demand
- Operations and service impacts (lack of inventory impacts the ability to deliver to customer expectations)

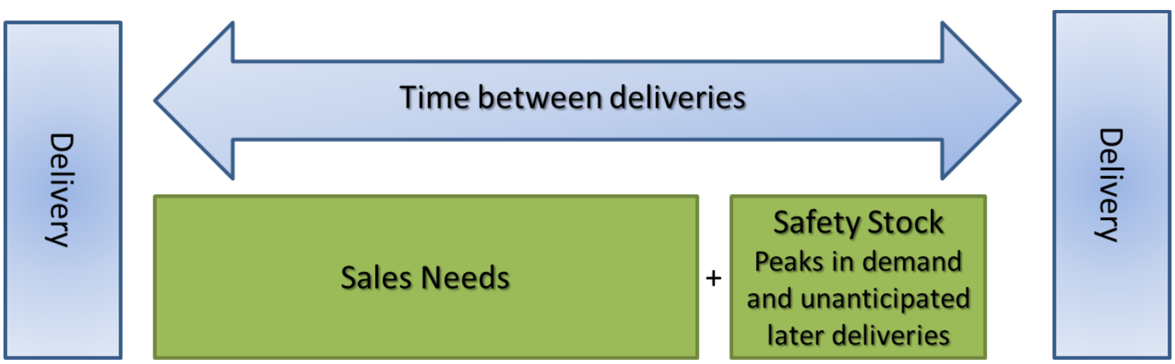
The aggregate of these costs can be significant and impactful on the bottom line. Most companies only look at dollar value of inventory and overlook the Total Cost of inventory ownership and management.

A full-service restaurant may have $20,000 invested in inventory value on hand at any given time. This amount then becomes multiplicative across 50 units and investment can top $1,000,000 or more.

How Much Inventory Do You Need?

Optimum inventory on hand is based on forecasted consumption requirements plus acceptable safety stock until next supplier delivery. Inventory is based on planned needs inclusive of anticipated sales, supplier delivery schedules, any special production restrictions and possible causes for disruption in supply that is the basis for defining requirements of Safety Stock.

Safety stock is required to offset potential spikes in usage or unanticipated disruptions in delivery. Every dollar invested to control results in a dollar in profit.



Keeping the right amount and tracking inventory is therefore paramount to successful restaurant management and a healthier bottom line. If you buy ten (10) steaks and only eight (8) result in sales, with the balance of two (2) being over-cooked, stolen or spoiled, the waste exceeds the cost of just the two steaks lost, as there is additional investment in the storage and preparation of product that did not result in sales. What process and controls are in place to ensure the accountability in the management of the steak? Has the root cause been identified, and if so, are you are aware of the loss, cause, and required avoidance processes?

Reducing unneeded inventory, whether tightening up stocks of essential inventory, or liquidating dead or under-performing inventory, has the benefit of releasing capital for other investment and reducing costs, tied directly to variable inventory levels. Reducing unnecessary investment also provides the opportunity to re-assess both fixed and variable costs, which will lead to identification of other cost savings opportunities. With the reduction of inventory, you free up invested capital, but also create opportunities to reduce expenses, improve profitability, and actually increase cash flow.

Focus - Management Inventory Control

In order to control inventory costs, strong companies have management processes, policies and systems in place. Typical processes need not be excessive or costly. Basic controls are simple yet effective. With management's communication and involvement, the staff becomes an integral part of the organizational process related to controlling the costs of inventory. The top areas to manage are:

Physical Inventories

Count and reconcile inventory stock against expected quantities on a routine basis. The performance of true physical inventories provides a process for tracking waste and shrinkage. The output of counting provides the basis for identifying problems and opportunities. Actual loss and the impact are calculated using standard mathematical formulas.

- (Opening inventory + Purchases – Ending Inventory = Usage)
- (Usage – Sales) = ***Loss***

The frequency of a physical inventory in the food industry is important because of the nature of perishable products with varying life cycles. In typical retail businesses, quarterly audits are common practice. In foodservice, due to temperature and shelf-life considerations, it makes sense to perform physical inventories on a daily or weekly basis on the entire inventory.

Physical inventories are also useful to identify:

- Expired /out of usable life inventory - impacts profit, quality, and poses potential food safety risks.
- Excess inventory – capital investment in product that exceeds shelf life or near term use. Buying in bulk at a lower purchase price carries the risk of spoilage, obsolescence, and shrinkage. Assess the value of bulk purchases to include the query, how long will stock last?
- Optimum inventory levels – stock stored to meet requirement inclusive of safety stock verses how much is stored and for what period of time.

Security

To properly control inventory, access to storerooms must be limited and controlled. This includes securing dock and receiving areas, not allowing unauthorized outside personnel to enter, and keeping in-house production staff from entering secured areas without an approved Requisition.

A Requisition is a “Purchase Order” for inventory to move from the storage area to work in process (WIP) in the operations area. Requisition documents do not have to be elaborate or system generated, it can be as simple as a piece of paper with product requirements, who requested it, and when it moved from storage to WIP. The point is to have a formal evidence chain document that creates accountability.

Requisitions include a list of operational requirements based on planned production. In addition, the document contains what and how much goes out of the storage based on allocated production parameters. This eliminates loss of product through waste and theft. If the Requisition calls for 40 steaks and the planned production is for 20, the Requisition would be overstated. Requisitions must be inclusive of expected production and sales requirements to avoid overstocking the production area. Processes must be in place to ensure Requisition amounts reflect demand; the additional 20 steaks requested should require management approval based on a change in production plans. Requisitions are an essential part of inventory control as the outgoing product has an assigned outlet for sales.

Requisitions also provide support for production planning. The process ensures that all required products are in place and ready for the production staff to work correctly and efficiently. Ordering the right amount and pre-staging upfront provides security measures to avoid theft and mishandling.

Security for inventory control must involve a separation of duties across multiple functions to provide a check and balance system. It is critical to have a specific division of duties between the person that places the order, the receiver, and the party verifying payments. This separation of duties provides protection from theft and fraud.

Inventory and Waste Management

It is critical that all members of the staff from Management through front line workers are aware of and involved to control waste. Track all waste, quantify monetarily and established Key Performance Indicator (KPI) across the organization. Create incentives for personal to stay compliant to these indicators. The impact from poor rotation and lack of shrinkage control measures must be understood and managed at all levels of the organization. The result of theft, breakage or poor handling, shrinkage is the effect of processes that do not manage and measure activities and result in ineffective, inefficient controls that result in waste.

Shrinkage refers to anything that renders inventory unfit for sale or is lost:

- Theft is a common form of shrinkage and impacts inventory because the product has been paid for but does not provide the sales return due. Theft can be from employees or customers.
- Mishandling can come in many forms:
    - Without proper rotation or storage, perishable inventory items can spoil if not sold on time, making it impossible to recover the investments
    - If an item is broken or damaged, it may require disposal and have no financial value
    - Overcooking, improper preparation leads to waste results in product that is unsellable

Often considered part of shrinkage, theft is commonly seen in operations where base product is easily transferable to personal use; this is another reason to perform regular physical inventories. Without regularly scheduled inventories, product will be lost without traceability back to the point in time that the loss occurred. The phrase, "I am not sure where it went" is dangerous to the organization. If theft occurs and there are no consequences, a little theft generally leads to growing amounts. Theft needs to be identified, controlled, and dealt with immediately. Employees need to know it will never be tolerated.

To avoid undue waste, eliminate your garbage disposal as that is a way to "hide" or overlook operational mistakes that result in unaccountable waste. Substitute transparent garbage bags from dark or opaque ones and use a metal frame bag holder. If waste can be seen, there will be more attention in handling and cooking. Additionally, put all food waste into a clear tub and have it reviewed prior to disposal in order to build awareness of root causes and impact. Measure waste disposal quantitatively by amount and dollar impact.

Tracking

With physical inventories comes the process of tracking.

- Does usage equal sales?
- If not, why not?
- How does it work, what do you do?

Tracking involves a simple calculation:

- The Amount Received Used (Actual usage) – Amount Sold (theoretical use) = should be "0"
- Any answer less than zero is a loss. (for the equation to calculate usage see inventory control above)

Mathematically the formula for calculation is simple. Identify the issues with the focus on Total Cost of an item and spend less time to track the life cycle once in inventory. Smart purchasing that saves cents for pound on meat does not provide a financial benefit if the "savings" are lost internally from receipt to sales.

The key to tracking is to discover where and how much of products bought reach the point of sale. Were purchase used properly? Did the amount procured yield the expected amount in sales? Causes of lost product may include:

- Over-portioning – is the production area following established quantities per serving?
- Uncontrolled portioning – is the production area using three ounces of grated cheese when the recipe calls for two?
- Improper receiving and stocking processes – is stock accurately checked and counted upon receipt?
- Uncontrolled payment processes – are invoices cross-checked against actual receipts?
- Product Abuse – is there mishandling in the storeroom or production?
- Product specs – does the expected yield match the actual yield?
- Unmanaged or wrongly calculated Yield – does the received amount provide the expected serving amount based on recipes?
- Theft – is product finding a way to another home and not the front of the house?

Track consistently and in a timely fashion. Daily tracking works best – it is easier to find a loss the closer to the event, as time passes the probability of identifying the gap decreases significantly. By the end of the month, it is too late.

Demand Forecasting

Forecasting demand is an extremely important task for any foodservice establishment. A purchaser may buy more than needed and put inventory "just in case" at needless risk. A recent study conducted by LeanPath estimates that restaurants throw away between 4 percent and 10 percent of the food they buy.

Projecting your stock requirements can make a big difference in bottom line profits as well as customer service and image. Many think about the risks of over stocks. However, customers may not return if their favorite menu item is not available. Understocking has consequences as well. A well-maintained demand forecast system is critical to inventory control. Proper and exacting forecasts help to ensure the control of waste to a minimum and that inventory is always available.

Forecasting should detail items sold as well as the expected amount of waste. It should be current and include all relevant data, sales projections, and marketing promotions. Factors including holidays, weather and day-of-week, all create measurable data points that learning organizations can use. Track consumption and take rates regularly, carefully, and with meaningful KPI's. The tracking will provide a platform to identify new opportunities to limit and reduce exposure. Look for different ways to optimize stock usage. Run Limited Time Offers or special with limited quantities in order to sell out. This reduces inventory risk and creates demand from repeat customers to "buy early".

Buying in bulk may be provide incentive on a per item per buy basis. For example, you may think you save money on a three-month supply of #10 canned peaches. Calculate the Total Cost of product, the actual cost of carrying and loss may exceed the savings at the time of purchase. It is imperative to closely match supply to demand; paying more per case but eliminating the carrying cost, exposure to theft, damage and mishandling.

Proper forecasting helps eliminate unpopular items, reduce the complexity of dishes, and reduce the number of ingredients in use. The goal is to accurately predict what is in on-hand inventory, as well as forecasting the size of the next supply order.

Conclusion

There is a significant amount of investment in Foodservice stock inventory, which, if handled properly, can provide a significant profit. If the controlled processes are followed and communicated to employees, then you are more likely to be successful. Measurement tools must be in place to track and measure performance based on actual and achievable targets.

Focusing only on the product costs at time of purchase will not provide the actual financial impact of the product based on Total Cost of Ownership from receipt through sales. The Total Cost is the actual impact to the bottom line and can only be controlled by managing the process from door to table. Ultimately, solid inventory management processes and systems combine to produce the best form of preventative medicine for a thriving business with excellent cash flow.

At Axis Purchasing, we know that reducing food cost is a blend of supply processes, key partnerships, operations handling and material management. Raise your perception to include all four elements to create consistent, predictable, repeatable food and operating cost controls.

About Us

Much more than a Group Purchasing

Axis Purchasing offers you multi-billion dollar group buying power for food, beverages and supplies without the restrictions of other organizations or the requirement to change distribution partners.

Our programs include manufacturing incentives, low contract pricing and a deep analysis of your purchases so you get more product options. You maintain complete control; keep your current distributor with no out of pocket expense. Best of all we provide a complete satisfaction guarantee.

Our happy customers appreciate our true value, not just cheap prices. That is why we have quickly grown to thousands of foodservice locations across North America.

Give us a call 703-310-7607 or drop us a line at info@axispurchasing.com today.