VETERINARY BUSINESS ADVISORS, INC.
Counsel for the Veterinary Profession

Importance of Selective Inventory Control

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Keeping enough inventory is important to a well-run practice. Doing so ensures that you'll have what you need when you need it – and that no patient will suffer because of a lack of a key item. But, inventory represents a large capital investment and cost to your practice, both in getting it on the shelf and then keeping it there. Inventory expense averages 20% of gross revenue, and can become even higher if inventory management is a low priority. Costs include:

- ordering costs
- holding costs
- shrink (loss) costs

The solution? Selective inventory control procedures.

This may not be the most appealing idea to staff, as they generally have little time to manage inventory – and, let's face it – it's less interesting than many/most other things that occur in the practice. However, inventory is the second most valuable asset in most practices, so finding a way to manage it efficiently and effectively makes good business sense – and should result in an increase in your practice's profits.

Here's more.

Benefits of selective inventory control

The more well managed your inventory, the less cost will be associated with it, freeing up more capital to be put towards your retained earnings – and reinvested in your practice. Moreover, selective inventory control allows you to *prioritize*. In other words, this system permits you to spend your limited inventory management resources on the items that will generate the most revenue for your practice. Plus, it creates tight controls to minimize losses on the most valuable items in you inventory. To make those determinations, we recommend ABC inventory analysis.

ABC inventory analysis

ABC analysis helps you to identify which items have a significant impact on overall inventory costs while identifying different categories of stock that will require different levels of management and controls. The four categories are AA items, A items, B items and C items.

AA items

In this list, put any items where it is crucial that you never run out. For these items, you will need to maintain very tight inventory controls, do daily inventory counts, and maintain detailed documentation. Items typically make this list if they are very expensive, if they are frequently used, if they are critical to patient care and/or if they are emergency medications. Examples of AA items include controlled substance such as Fatal-Plus Solution and a commonly used, somewhat expensive item, SNAP® 4Dx® Plus tests.

A items

In this list, you'll put big revenue generators that didn't end up in your list of AA items. These are often expensive and are typically veterinarian-specific mediations. These, like AA items, will require very tight controls as it will be problematic if you run out. You will inventory this list anywhere from daily to weekly. Examples include Rimadyl; Deramaxx/veterinary-specific NSAIDs; Convenia/refrigerated injectable antibiotics; vaccines; and flea and tick medications.

B items

This list will typically contain generic medications, sutures, vaccines, and medicines such as Soloxine, Prednisone and Cephalexin. With items on this list, be vigilant in determining if any should be bumped up to your A list or, conversely, pushed down to your C list. Items on your B list won't need as tightly controlled as those listed above. It may still be problematic if you run out of them but you can probably make substitutions if needed. Quarterly inventory of this list is often enough.

C items

This list may contain some generic medications. They are typically not very expensive and/or are infrequently used. You'll put supplies on this list, plus items that don't expire. Examples of C list items are white goods and shampoos; this category requires the least amount of controls and annual inventory is typically enough.

Advantages of ABC inventory analysis

Dividing up your inventory in this way helps you know where to focus your time and attention in managing your inventory. As is true in many other areas of business, the 80/20 rule applies, with 20% of your inventory generating 80% of your revenue.

Here is a typical breakdown (that, granted, uses a 70/30 breakdown):

- AA / A lists: consists of 10% of inventory with 66.6% of value; will require most of your management time, with close attention paid to minimum and maximum inventory levels. These items will usually have a greater impact on projected investment and purchasing spend.
- B list: consists of 20% of inventory with 23.3% of value.
- C list: consists of 70% of items with 10.1% of value; will require the least amount of management time. When you conduct your periodic obsolescence review (determining what items you will no longer carry) starting with your C list usually makes the most sense.

More inventory tips

The higher your usage of an item, the more likely that inventory count errors will occur. Therefore, to ensure accurate records, higher priority items are counted more frequently. Because AA / A items typically have the most impact on investment, start here when investigating the potential for alternative stocking arrangements that would reduce investment liability and associated carrying costs. These could include next day ordering and/or warehousing. These items will, by definition, have greater turnover ratios. So, when establishing investment and turnover metrics, segregate inventory data by ABC classification, with different targets for each category.

Take a look at your ABC inventory system at least annually. You may discover a need to reclassify seasonally as some items may change categories based on seasonal demand (such as flea medications).

Who should complete ABC analysis?

Ideally, the practice manager should be responsible for the analysis. He or she would then communicate results to the inventory manager, who would use the information to identify necessary time resources for managing key inventory items.

Nuts and bolts

To begin managing inventory in this way:

- Use practice management software to import all inventory items into an Excel spreadsheet
- For each item, determine the number of units sold annually.
- Calculate the annual usage value (AUV) by multiplying the number of units sold by the cost per unit. This can also be considered the gross annual sales per item.
- Arrange the info in a spreadsheet, as shown on the next page:

Item Name	Annual Units Sold	Average Annual Cost per Unit	Annual Usage Value
Amoxidrops 50 mg/ml (50 ml)	30	$14.27	$428.00
Amoxidrops 50mg/ml (30ml)	120	$27.02	$3,242.40
Clavamox 62.5 mg (1 tab)	2943	$1.19	$ 3,503.57

Cavamox 125mg (1 tab)	982	$2.28	$ 2,238.96
Clavamox 250mg (1 tab)	561	$3.76	$ 2,109.36
Doxytabs 50mg (1 cap)	169	$0.41	$ 69.08

Next, sort the items based on AUV from greatest to least.

Item Name	Annual Units Sold	Average Annual Cost per Unit	Annual Usage Value
Clavamox 62.5 mg (1 tab)	2943	$ 1.19	$ 3,503.57
Amoxidrops 50mg/ml (30ml)	120	$ 27.02	$ 3,242.40
Cavamox 125mg (1 tab)	982	$ 2.28	$ 2,238.96
Clavamox 250mg (1 tab)	561	$ 3.76	$ 2,109.36
Amoxidrops 50 mg/ml (50 ml)	30	$ 14.27	$ 428.00
Doxytabs 50mg (1 cap)	169	$ 0.41	$ 69.08

Calculate cumulative AUV, as shown:

Item Name	Annual Usage Value	Cumulative AUV
Clavamox 62.5 mg (1 tab)	$ 3,503.57	$3,503.57
Amoxidrops 50mg/ml (30ml)	$ 3,242.40	3503.57 + 3242.40 = $6,745.47
Cavamox 125mg (1 tab)	$ 2,238.96	$6745.47 + 2238.96 = $8,984.43
Clavamox 250mg (1 tab)	$ 2,109.36	$11,904.29
Amoxidrops 50 mg/ml (50 ml)	$ 428.00	$11,522.29
Doxytabs 50mg (1 cap)	$ 69.08	$11,591.37

Finally, calculate the number of items and their cumulative percentages.

Using the total AUV, you can determine the percentage of the total AUV that each item represents. You can then cumulate those percentages to determine your top 80%.

Item Name	**Annual Usage Value**	**% of Total AUV**	**Cumulative % of Total AUV**
Clavamox 62.5 mg (1 tab)	$ 3,503.57	30%	30%
Amoxidrops 50mg/ml (30ml)	$ 3,242.40	28%	58%
Cavamox 125mg (1 tab)	$ 2,238.96	19%	78%
Clavamox 250mg (1 tab)	$ 2,109.36	18%	96%
Amoxidrops 50 mg/ml (50 ml)	$ 428.00	4%	99%
Doxytabs 50mg (1 cap)	$ 69.08	1%	100%
Total AUV	$ 11,591.37		

In this case, the top three items constitute 78% of your revenue. These items are the products that move off of the shelves quickly and are most valuable. They should be counted frequently to minimize shrinkage and theft losses.

Designing an inventory management scheme that fits your practice to account for your most valuable products more frequently will help to decrease your inventory expense and losses. Since inventory can occupy greater than 20% of your revenue, tighter inventory management will increase your practice's profitability.