Purchasing and Stock Control

A guide to help you broaden your understanding of the purchasing and stock control functions in the context of a small business

Ensuring that you have the highest quality inputs for your business, at the best prices, is the key starting point not only in the control process, but also in terms of achieving your broader business goals such as customer satisfaction. For example, if defective goods are purchased at the outset then no amount of effective control, or skilful production, at a later stage will change this, and the outcome will be a poor quality end-product and/or increased wastage. The same applies to more expensive items such as furniture and fittings or equipment, and poor purchasing decisions here will result in increased maintenance costs, lower productivity, faster replacement times as well as likely poor customer satisfaction.

Fāilte Ireland

How to Make Sound Financial Decisions:

Purchasing and Stock Control

This short guide has been developed to help broaden your understanding of the purchasing and stock control functions in the context of a small business. The information here is designed to provide you with a general overview of this topic and further tools and resources can be found on the Business Tools web page.

1. Purchasing 3

1.1 Establishing your purchase requirements 3

1.2 Assessing potential suppliers 4

1.3 Choosing suppliers 5

1.4 Supplier relations 6

1.5 Buying at a lower price 7

1.6 Using your creditors to fund your business 8

2. Stock Control and Inventory 9

2.1 The need for stock control 9

2.2 Practical stock control 10

2.3 Stock control administration 12

1. Purchasing

Many small business owners fail to pay enough attention to the purchasing function and as a result may miss opportunities to reduce costs, or raise quality.

Purchasing should be seen as an important activity in your business and never conducted in an ad hoc or haphazard fashion. The key considerations follow.

1.1 Establishing your purchase requirements

The first step in getting the best from your purchasing process is to decide on the specification of your purchases (e.g. what you want your purchase to do and how well it should do it). Agree your specification with the potential supplier including:

Quantity

Quality and appearance

Delivery schedule

However, do not over-specify as unnecessary, or unreasonable, specifications are counterproductive and will add to the cost. Agree your requirements in writing because relationships often break down with suppliers because of misunderstandings; a written specification avoids this risk.

Verbal agreements are binding in law, but may be difficult to prove so detailing your specification in writing will ensure that the supplier will understand the standards that you require.

1.2 Assessing potential suppliers

Whichever supplier you choose, ensure that they possess the following characteristics:

- **Reliability** – if a supplier lets you down, you may be forced to let your customers down. It may be wise to have more than one supplier for any given product.
- **Quality** – of supply and service needs to be consistent. As stated, it is difficult to produce a high quality product if the raw material is not of a high quality in the first instance. Quality needs to be monitored (e.g. is the food delivered to the premises consistent with the agreed food specification, is the laundry service returning clean linen, adequately pressed and free from rips and tears?).
- **Value for money** – is not only concerned with the lowest price. You require consistent levels of quality and reliability and should expect to have to pay more for this (but do not pay excessively for it). Similarly, your customers should also expect to pay more for the quality and consistency you provide.
- **Strong service and clear communication** – you need your suppliers to deliver on time or at least to be honest with you and provide you with sufficient warning if they cannot deliver as agreed. The best suppliers will want to speak with you regularly to monitor your needs and identify opportunities to improve their service to you. Equally you will need to record and inform suppliers of any deliveries that do not conform to specification and established agreements.
- **Financial security** – you need to be assured that your suppliers are financially sound, particularly as you hope to develop a long-standing and mutually beneficial relationship with them. It is always worth credit-checking potential new suppliers.
- **A partnership approach** - a strong relationship will benefit both parties. You need your suppliers to acknowledge how important your custom is to them so that they make every effort to provide the best possible service. Showing your suppliers how important they are to your business is likely to encourage a similar response.
- **Compliance with food safety legislation** - all food businesses (supplier and customer) must be compliant with food safety legislation and are subject to strict control by the relevant authorities. It is important to ensure the supplier is registered and licensed to operate by the relevant authority. Have they HACCP (food safety management system) in place? What recall procedures are there in the event of a food safety crisis? How is food traced throughout the premises?
- **Environmental issues** - do the suppliers demonstrate a commitment to the environment in their policies and practices, can they work with you to maintain your own environmental management policy, are they willing to use your trays/containers/bags etc. for the delivery of products (if not will they take the packaging back) and what is their commitment to recycling?

1.3 Choosing suppliers

The most effective suppliers are those that offer products or services that match, or exceed, the needs of your business. It is well worth examining how many suppliers you actually need to enable you to operate your business. Purchasing from a targeted pool of suppliers could have the following benefits:

It will be easier for you to control your suppliers.

Your business will become more important to them.

You may be able to make deals that provide you with an extra competitive advantage.

Example: if you are under pressure to deliver a small celebration meal within a tight timescale and you do not carry the required stock, your supplier is more likely to "pull out the stops" to help you if you spend €2,000 per month with them rather than €500 per month.

" choice "

However, there is also merit is retaining a choice of suppliers. Purchasing from a single supplier only can be risky. If they let you down at short notice, or if they go out of business, you may have difficulty in securing an alternative source of supply in the short-term. Potential suppliers should be easy to locate through:

Existing suppliers or competitors' suppliers.

Trade journals, business databases and trade associations.

Business directory websites.

Prepare a shortlist of suppliers and write to each one, outlining your exact requirements. If you are in the food business, food safety legislation dictates that you use only 'approved suppliers' - give them a food safety questionnaire and follow up with an audit/visit.

" better terms "

Your EHO and/or HACCP consultant if you have one will provide you with more information. Request that each supplier send you product details, price lists and other relevant information, such as MSDS (materials safety data sheets). You may obtain better terms by advising suppliers that they are competing for your order. Identify those suppliers that can offer the quality of product and service that you require. Refine your selection process by comparing each in terms of:

Product suitability and reliability

Reputation, based on references

Quality and flexibility of service

Location and ease of communication

Speed and frequency of delivery

Price, range and order size.

" visit "

For long–term supply contracts, make the effort to visit each potential supplier that meets your quality standards and other requirements.

To assess how they are likely to perform, ask yourself:

Are they professional?

Do they have too much work, or not enough?

How eager are they for your business?

Do they appear to be financially stable?

Are they compliant with the necessary statutory requirements (e.g. health & safety, food safety)?

What is their commitment to staff training and do their employees demonstrate good practices indicating training is successful?

This may be less of an issue with beverage suppliers; however, other suppliers should be assessed on this basis. Ask the potential suppliers for quotes including details of discounts and payment terms for use in your negotiations.

Ask how often prices will rise, what influences will cause them to rise, and how you will be notified.

Once you have narrowed the choice down to a small number of potential suppliers (e.g. two or three) negotiate prices, discounts and levels of service. Remember, every 1% of discount that you can negotiate on your purchase cost improves your profit potential.

1.4 Supplier relations

The foundation of a long and fruitful relationship with your suppliers requires understanding on both sides. Consider the following:

Channel most of your effort towards those suppliers that you will place most business with (five or ten items may account for 90 per cent of the money you spend) and those that provide supplies that are crucial to your business.

Give most of your orders to just a few suppliers.

Request exclusive purchase discounts or cumulative discounts (e.g. if you order over 5,000 units in the next year, you get a five per cent discount on all orders during that period).

Treat suppliers well and they will treat you well.

Keep them up to date with your needs, build a relationship of trust and co-operate to improve the goods and service that you receive.

Agree in advance what will happen if the supplier's goods are not to specification:

Will the supplier replace the goods?

Will replacement supplies be delivered immediately, or will you get a credit note?

Will replacement goods be free? Who will pay for delivery?

Agree on payment terms.

Payments in advance should generally be avoided, especially if you are unsure about the supplier's creditworthiness.

You should ask for a discount for early payment.

Establish what promotional activities your suppliers will undertake on your behalf (especially in the case of your beverage suppliers).

Frequently, brand promotions are undertaken by the major breweries or wholesalers and you need to ensure that you derive maximum benefit from such activity.

1.5 Buying at a lower price

It is almost always possible to pay less – if you are prepared to negotiate purposefully.

Here are some tips to help you improve your purchasing power. Do not automatically accept your potential supplier's first offer and where appropriate, make a lower counter offer. Consider whether, or not, any of the following could lower the purchasing price:

Agreeing a minimum level of periodic purchases (e.g. monthly, annually).

Agreeing retrospective discounts on the basis of volumes purchased.

Discounts for payment by cash on delivery.

Is it possible to leverage your purchasing power by 'pooling' your purchasing requirements with similar organisations, or competitors? Such arrangements should enable you to negotiate bulk discounts on the basis of the combined purchasing requirements of all of the participants. You should not be concerned that you may be entering into an arrangement with your competitors. It is likely that they already know as much about your business as they need to. In addition, they may already be using many of the same suppliers that you are.

In circumstances where you do 'pool' your resources with other organisations to improve you purchasing power, you need to ensure that each party enters into a formal agreement with regard to:

The term of the agreement and which suppliers it relates to.

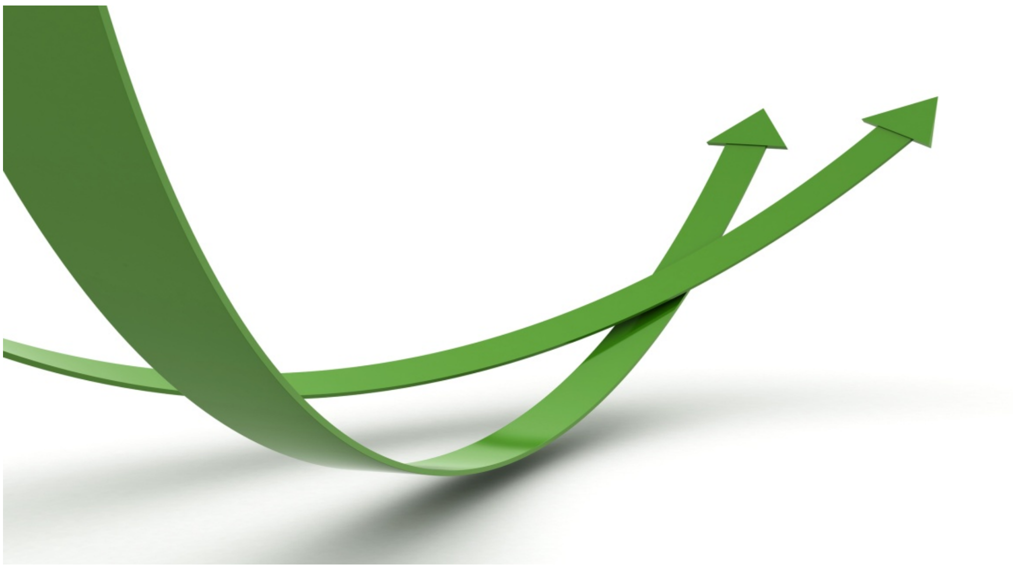
The quality of the goods to be purchased.

The quantity required by each party and any associated discounts.

Invoicing and payment arrangements – preferably each party will pay for its own purchases on an individual basis and each will comply with the payment terms.

Ordering and delivery arrangements.

If supplies are limited and the demand from the 'pool' exceeds the amount that can be supplied, the protocol to be followed by the supplier in terms of the quantities offered to each party.



1.6 Using your creditors to fund your business

It is possible to use your suppliers to part fund your business in the short-term. At the same time, it is important to be aware of legislation pertaining to prompt payment of invoices, which is designed to protect small businesses. Customers that owe you money (known as "debtors"), and do not pay promptly, are using your funds for their own benefit. Although you may receive payment at some stage, until that time your customers may use the funds owed to you to purchase other goods and services. If the amounts that you are owed are such that the amount of cash that is available to your business is limited, you may be required to secure an overdraft (or loan) facility to meet your short-term cash requirements. In these circumstances, there is a cost to your business to fund your debtors.

> *“payment terms”*

The corollary of this situation is that you may use your suppliers to part fund your business in the short-term, by delaying the time when you pay them. Typically, the terms of payment offered by most suppliers is 30 days after the invoice date, or 20 days after the end of the month in which the goods are purchased. You may extend the period between receiving and paying for goods by:

Purchasing your goods at the start of the month rather than during the last few days of the previous month (in circumstances where you are required to pay for all goods delivered during the month by the 20th day of the following month).

Securing agreement with your suppliers to a modification of your existing payment terms (e.g. from 30 days to 60 days).

Renegotiating the terms of your creditor payments, or delaying payment (as long as the supplier does not charge you interest), will have a direct financial benefit to you in terms of interest earned on deposits, or interest saved on an overdraft.

> *“risks”*

However, you should note that there are a number of risks associated with extending your payment terms without the consent of your suppliers:

It may give the impression that your business is facing cash-flow difficulties.

It may create cash-flow problems for your suppliers, particularly if you represent a large proportion of their trade.

The level of service offered by your suppliers may diminish and the relationship may be irreparably damaged.

You may be in breach of your supply contract or subject to penalty clauses contained within it.

Future supplies may be made on a cash-on-delivery basis only. This is to be avoided if at all possible as there is a likelihood that all of your suppliers will become aware of this, and they may demand similar payment terms.

2. Stock Control and Inventory

Stock (or inventory) control is concerned with how much stock you have at any given point in time, and how to keep track of it. Efficient control means that funds are not tied up unnecessarily, that the threat of stock losses is reduced and the quality of your products and services is maintained thus ensuring that you have sufficient stock to enable you to meet the demands of your customers. This section of the guide introduces you to:

The need for stock control

Practical stock control measures

Reducing the cost of holding stock

> *consumable stock types*

2.1 The need for stock control

Everything that you use to make your products, provide your services and to run your business is part of your stock. There are four main 'consumable' stock types that you may use in your business:

'Wet goods' (e.g. perishable-dairy, meat/fish, vegetables etc.)

'Dry goods' (e.g. tinned and packet foodstuffs)

Stock ready for sale (e.g. cooked or prepared meals, beverages)

'Other consumables' (e.g. linen, paper, fuel etc.).

In addition you will have items of fixed assets that will be used on a recurring basis (e.g. bedrooms, tables, chairs, buildings etc.). Good practice in any business determines that there is a requirement to control your stocks. The need for stock control arises because:

The cost of holding stock may be expensive.

The production of your goods and the delivery of your services will be compromised in circumstances where stock runs out.

Stock which is not used within its 'shelf-life' will add unnecessary cost to your business.

Low quality stock and purchases will compromise your own standards.

The need to identify, and quantify, the pilferage of stock, stock wastage and obsolete stock.

2.2 Practical stock control

Many small businesses in hospitality and tourism pay too little attention to stock control. The process can be as uncomplicated as you need it to be, however, the key is to check your stock-holding on a frequent basis. This will provide an early warning of problems. There are a number of methods for controlling stock, several of which are appropriate to the small businesses:

Minimum stock level – you identify a minimum stock level and re-order when stock reaches that level.

Stock review – you have a regular review of stock (e.g. weekly) and you place an order to return stocks to a maximum level.

In both cases you will be required to set the minimum, or the maximum, stock level. The key for your business should be to reduce your stock-holding to the amount required to enable you to meet demand in the period until your next delivery. Given that the hospitality and tourism industry can experience significant variations in demand on a daily, weekly and monthly basis, it is recommended that the stock review method be adopted.

The simplest method for recording stock in small businesses with few stock items is to manually maintain a stock book or a stock sheet. The stock book (or stock sheet) will record the quantity in stock of each stock item during each stock count (this is your "closing stock"). This becomes the opening stock of the following period.

The purchases received during the following period (in quantity) are added to the opening stock, and the quantity of goods used from stock during the period (e.g. for food and beverage sales) are deducted from the total. The resulting balance is the closing stock at the end of the period, which should agree with the physical quantity of stock in the stock room, cold room, bar etc. If you do not undertake a physical stock count it is not possible to confirm whether, or not, the closing stock recorded in your stock book is correct.

The value of the stock used in your business can then be determined by multiplying the quantity of each stock item used in the period by its purchase price (e.g. per kilo, bottle, etc.). The value of food and beverage stock, for example, used during the period is your cost of sales, and it is used to calculate your Gross Profit.

In circumstances where the physical stock count is less than the amount recorded in your stock book, one, or a combination, of the following events may have taken place:

- The quantity of purchases recorded in your stock book for the period may be overstated (you need to check that each delivery of stock in the period since the last stock count is correctly recorded).
- The quantity of goods actually received by you during the period may be less than that recorded in the stock book (e.g. the actual deliveries made by your suppliers may be less than the amount recorded on the delivery notes issued by them, to you – it is important that each delivery, and the accompanying delivery note, is consistent).
- The transfer of goods from the stock room to your various departments during the period may be understated (it is good practice to have a stock transfer form, or book, completed each time a transfer is made from your stock room).
- Stock may have been pilfered, damaged or be out of date and have been disposed of without any record of this in your stock book (in the case of damaged or out of date stock).

The key point is that you will have to pay for the purchases you make (and which are recorded on the delivery notes - whether they arrive into your stock or not). In circumstances where your actual stock level is below the stock level shown in your records, your cost of sales will be increased and your profitability will be reduced. Without a regular stock count, it is impossible to establish if you have a stock problem and when the problem arose. While the stock counting process may not pinpoint the nature of the problem, if a problem does exist, regular stock counts will provide sufficient warning to you to investigate the matter further.

Third party stock control

Many small businesses leave the stock taking process to their auditors. However, this is likely to be undertaken on an annual basis only and may give rise to a number of problems:

- If your Gross Profit Margin for the year is less than anticipated, and the deficiency in the Gross Profit Margin is caused by an increase in your cost of sales (and you have not lowered your selling prices), it will be difficult to identify when the profit margin began to deteriorate in the absence of monthly stock count records. It may also be difficult to identify those stock items that are giving rise to the deterioration in profit margin.
- The risk of theft (e.g. pilferage) may be increased as stock will not be checked on a frequent basis.
- Stock may not be utilised before its 'use-by' date (in particular, fresh food) as it will not be physically checked on a regular basis. Ideally, stock should be used on a 'first in, first out' (FIFO) basis.

An alternative to undertaking the stock-control process yourself is to use the services of a professional stock counter. A professional stock counter will provide an independent validation of your stocks, your profit margin (normally on a product by product basis), and will assist you in identifying weaknesses in your stock control process. The stock counter should be able to pinpoint those products that have not provided the expected level of profit margin.

2.3 Stock control administration

As outlined above, there are many administrative tasks associated with the stock control process. Dependent upon the size and the complexity of your business, these may be undertaken as part of the administrator's duties, or, by a dedicated stock controller. For security reasons, stock rooms should be locked when not in use. To maintain staff accountability, each department should be responsible for its own stock control. Documentation must be signed off and collated by the Owner/GM/stock controller. Typical paperwork to be processed includes:

- Delivery and supplier notes for incoming goods.
- Purchase orders, receipts and credit notes.
- Goods returned notes.
- Requisitions and issue notes for outgoing goods.

Points to remember when counting stock:

- Good preparation is the key to successful stock counting procedures - keep the premises tidy, have updated stock sheets ready, ensure stock amounts are low, ensure the team is briefed beforehand.
- The stock count should be taken by two people, one to call stock and the other to write it down.
- Count stock after the close of business. Stock taking should not occur during business hours.
- Stock sheets should be updated regularly with new products and, more importantly, prices should be updated constantly.
- Clearly segregate stock to ensure ease of counting. Ideally stock sheets should mirror the layout of stock in the stores. This will ensure little time is wasted tracking down items.
- Only current re-usable stock should be counted. Out of date, end of line products should be returned or discarded. If these items are included in the stock count then the stock value will be incorrect.
- A procedure should be established to identify excessive amounts of any particular product and these should be returned to the supplier or used by staff before they go out of date.
- Staff should be fully trained in stock control procedures.
- Control measures should be established to prevent/reduce waste.
- Always have a closing stock meeting with all of the stock counters to ensure that all areas on the premises that contain stock have been included in the stock count.

Stock can tie up a large slice of your working capital (funds required for the day to day operation of your business) if not controlled. It can also add substantially to the costs of operating your business. Applying the basic stock control procedures outlined above can assist you in managing stock purchases and stock holding. However, stock costs money and the more of it that you have, or the longer you hold on to it, the more costly it is. If your cash is tied up in stock unnecessarily, this will incur an interest cost. Therefore, it is important to reduce your levels of stock and to turn the stock into a sale as soon as possible.

This guide has been provided to you as part of Fáilte Ireland's suite of guides and templates in the Business Tools resource.

Please note that these resources are designed to provide guidance only. No responsibility for loss occasioned to any person acting, or refraining from action, as a result of the material in this publication can be accepted by Fáilte Ireland.

The user shall not market, resell, distribute, retransmit, publish or otherwise transfer or commercially exploit in any form any of the content of this guide. For a full version of the disclaimer, go to the Fáilte Ireland website.

Fáilte Ireland
88-95 Amiens Street
Dublin 1

www.failteireland.ie

BT-PSC-C6-0913-4