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Inventory Management in Sugar Mills - A Comparative Study

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INTRODUCTION:

The term "inventory" is originated from French word 'Inventaire' and the Latin 'Inventarium' which implies a list of things found. The term inventory has been defined by the American Institute of Accountants as the aggregate of those items of tangible personal property which are (a) held for sale in the ordinary course of business, (b) are in process of production for such sales, or (c) are to be currently consumed in the production of goods or services to be available for sale.

The term inventory includes – raw materials work in process, finished goods packaging, spares and other stocked in order to meet an unexpected demand or distribution in future.

INVENTORY MANAGEMENT:

Inventory management is a process which includes determining the size of inventory to be carried out establishing time schedules, procedure and lots size for new orders, coordinating sales, production and inventory policies, providing proper storage facilities among the receipt and disbursement and procurement of materials, developing proper record system for the same and assigning responsibility for executing inventory control system.

OBJECTIVES OF INVENTORY MANAGEMENT:

The objective of inventory management may be viewed in two aspects:

- 1) Operational
- 2) Financial

1. OPERATIONAL:

The operational objective is to maintain sufficient inventory to meet demand for product by efficiently organizing the firm's production and sales operations.

2. FINANCIAL VIEW:

According to the financial view is to minimize inefficient inventory and reduce inventory carrying costs.

TECHNIQUES OF INVENTORY MANAGEMENT:

1) ABC ANALYSIS:

This is one of the widely used techniques to identify various items of inventory for the purpose of inventory control. In other words it is very effective and useful tool for classifying, monitoring and control of inventories. The firm should not keep same degree of control on all the items of inventory. It is based on Pareto's Law. The firm should put maximum control on those items whose value is the highest, with the comparison of the other two items. This technique concentrates on important items and is also known as control by importance and exception (CIE).

2) ECONOMIC ORDER QUANTITY (EOQ):

Economic order quantity refers to that level of inventory at which the total cost of inventory is minimal. The total inventory cost comprising of ordering and carrying costs. EOQ is also known as Economic Lot Size (ELS).

The formula is $EOQ = \sqrt{2VAO}$

\sqrt{CC}

Where A = Annual usage

O = ordering cost per order

CC = price per unit x carrying cost per unit in percentage

3) ORDER POINT PROBLEM:

After determination of EOQ, then at what level of inventory should the order be placed? If the inventory level is too high it will unnecessarily block the capital and if the level is too low it will disturb production by frequent stock out and also involves high ordering cost. Hence an efficient management of inventory needs to be maintained for optimum inventory level, where there is no stock out and costs are minimum. The different stock levels are (a) Minimum level (b) Reorder level (c) Maximum level (d) Average Stock level (e) Dangerous level.

4) TWO BIN TECHNIQUE:

It is one of the oldest techniques of inventory control. Generally it is used to control 'C' category inventories. According to this technique stock each item is separated into two pipes, Bins or Groups. First Bin contains stock just enough to last from the date a new order is placed until it is received in inventory. The second Bin contains stock which is enough to meet current demand over the period of replenishment.

5) VED CLASSIFICATION:

According to this classification inventories are grouped based on the effect on production and inventories are grouped into three, they are vital, essential and desirable inventories. It is specially used for classification of spare parts.

6) HML CLASSIFICATION:

Here the materials are classified based on the unit value and annual value. The inventory is classified into three categories such as, High, Medium and Low as it is adopted in selective inventory control (ABC) technique.

7) SDE CLASSIFICATION:

This SDE Classification is made based on the availability of inventory. It is very much useful in the cases of scarcity of supply of inventory. Here 'S' refers to scarce inventory items, generally imported and those, which are in short supply category. 'D' refers difficult inventory items that are available indigenously but are difficult to procure. 'E' refers to items, which are easy to acquire and which are available in local markets.

RESEARCH METHODOLOGY:

The proposed study is an empirical and analytical in approach and instrumental prospective. Primary and secondary data relating to cash management in the selected sugar mills have been collected from the office of the companies. The questionnaire is designed to collect primary data, personal interview is held to obtain technical information and where classification required.

The secondary data have been collected from the published

annual reports and accounts of the company and varies other publication of the industry.

SCOPE OF THE STUDY:

In the present study following sugar mills of Haryana have been taken.

- 1) Saraswati Industry Syndicate Limited, Yamunanagar (SISL)
- 2) Kaithal Cooperative Sugar Mills Limited, Kaithal. (KTC-SML)

SIZE OF INVENTORY:

The size of inventory in the sugar mills under the study has been shown in table 1. The inventory is inclusive of the raw material, work-in-process and finished goods.

TABLE 1

**Size of inventory of SISL & KTC-SML
(From 2003-04 to 2009-10) Rs in Lakhs**

Year	SISL	KTC-SML
2003-04	18108	5074
2004-05	19079	3001
2005-06	25862	1870
2006-07	35570	2854
2007-08	51475	5144
2008-09	27790	3017
2009-10	36675	1203
Average	30651.30	3166.14
S.D.	10800	1374.91
C.V.(%)	35.24	43.43

Source: Calculated from Annual report and accounts of SISL & KTC-SML for the period from 2003-04 to 2009-10.

As shown in Table 1 the size of inventory in SISL varied from Rs 18108 Lakhs in 2003-04 to Rs. 51475 Lakhs during the period under study. The size of inventory marked an increasing trend during the period from 2003-04 to 2007-08. Average size of inventory in SISL was Rs. 3065.30 Lakhs with standard deviation of Rs. 10800 Lakhs. The coefficient of varieties was 35.24% denoting a moderate varieties into quantum of inventory which further denoted that the management was having an adequate control over the inventory management in SISL the size of inventory was high, so it can be suggested that the company should try to reduce inventory by adopting better selling and distribution policies.

The size of inventory in KTC-SML was Rs. 5074 Lakhs in 2003-04 which decreased to Rs. 3001 Lakhs in 2004-05, to Rs. 1870 Lakhs and to Rs. 3244 Lakhs in 2006-07. The size of inventory increased to Rs. 2854 Lakhs in 2006-07 and to Rs. 5144 Lakhs in 2007-08. Average size of inventory in KTC-SML was Rs. 3166 Lakhs with coefficient of variation at 43.43 present denoting higher variations in the value of inventory which should be controlled by the management.

INVENTORY TO WORKING CAPITAL RATIO

The inventory to working capital ratio shows the relationship between inventory and working capital and explain the proportion of inventory in working capital. The inventory to working capital ratio of the sugar mills under study has been calculated by using the following formula.

Inventory to W.C. Ratio = size of inventory x 100 working capital

The data of inventory to working capital ratio of the selected sugar mills have been shown in Table 2.

Table 2

**Inventory to Working Capital Ratio of SISL and KTC-SML
(From 2003-04 to 2009-10)**

Year	SISL	KTC-SML
2003-04	196.30	-226.71
2004-05	260.17	-113.07
2005-06	528.71	-42.32
2006-07	278.71	-194.19
2007-08	239.23	-410.41
2008-09	184.71	463.35
2009-10	470.49	163.99
Average	308.33	-51.34
S.D.	125.74	265.99
C.V. (%)	40.78	-518.12

Source: Calculated from Annual report and accounts of SISL & KTC-SML for the period from 2003-04 to 2009-10.

It is evident from the above table that the ratio of inventory to working capital in SISL showed a mixed fluctuating trend though out the period under study and varied within the range of 184.71 percent in 2008-09 to 528.71 percent in 2005-06. After 2005-06 the inventory to W.C. ratio showed a decreasing trend and came down to 184.71 percent in 2008-09. During 2009-10 the inventory to working capital ratio of SISL increased to 470.49 percent. The average of ratio was 308.33 percent which cannot be regarded favorable. The coefficient of variation was 125.74 percent which indicates a greater amount of variability and should be controlled by the management.

In KTC-SML, the ratio of inventory to working capital cannot be regarded satisfactory because this ratio was negative up to year 2007-08 because of negative working capital but in last two years, the ratio was positive as the company improved its working capital position and the ratio became 463.35 percent in 2008-09 and 163.99 percent in 2009-10. Because of negative working capital, the average of the ratio was negative at 51.34 percent with coefficient of variation at 518.12 percent which was highest among all the companies under study. It is suggested that the management should try to control this situation and improve the working capital position.

INVENTORY TO CURRENT ASSETS RATIO:

The inventory to current assets ratio explains the relationship between inventory and current assets and indicates that what proportion of current assets has been invested in the inventory.

The inventory to current assets ratio has been calculated by the following formula:-

Inventory to C.A.R. = Inventory x 100

Current Assets

The inventory to current assets ratio of the sugar mills selected for study has been shown in the following Table 3.

TABLE - 3

**Inventory to Current Asset Ratio of SISL & KTC-SML
(From 2003-04 to 2009-10) (Ratio in percentage)**

Year	SISL	KTC-SML
2003-04	89.24	93.47
2004-05	66.25	92.26
2005-06	54.58	86.30
2006-07	57.99	88.03
2007-08	56.40	94.01
2008-09	34.81	81.97
2009-10	34.05	72.80
Average	56.19	86.98

S.D.	17.51	7.04
C.V.(%)	31.17	8.10

Source: Annual Report and Account of SISL and KTCMSL sugar Mills for the period from 2003-04 to 2009-10.

It can be observed from the above table that the inventory to current assets ratio in SISL registered decreasing trend though out the period under study expect 2006-07 and 2007-08. This ratio between 34.05 percent in 2009-10 to 89.24 percent denoting a major part of current assets blocked in inventory. The average of the ratio of inventory to current assets was 56.19 percent with 31.17 percent as coefficient of variation.

In KTCMSL, the inventory to current assets ratio showed a mixed fluctuating trend throughout the period under study and varied within the range of 72.80 percent in 2009-10 to 94.01 percent in 2007-08. The average of inventory to current assets ratio was 86.98 percent which is again indicating that the company has invested excessively in the inventory. It is suggested that the management should try to reduce the investment in the inventory and maintain the liquid resources. The coefficient of variation was 8.10 percent which is satisfactory.

INVENTORY TO TOTAL ASSETS RATIO

The inventory to total assets ratio shows the proportion of total assets invested in the inventory. It is calculated as follows.

Inventory to Total Assets & ratio = inventory x 100

Total Assets

The inventory to total assets ratio of the sugar mills under study has been calculated and presented in the following table 4

Table – 4
Inventory to total Assets Ratio of SISL and KTCMSL
(From 2003-04 to 2009-10)

Year	SISL	KTCMSL
2003-04	57.05	58.92
2004-05	45.23	46.55
2005-06	38.49	34.81
2006-07	42.21	44.17
2007-08	41.92	57.33
2008-09	24.67	40.66
2009-10	23.02	11.94
Average	38.94	42.05
S.D.	10.98	14.66
C.V.(%)	28.20	34.85

Source: Annual Report and Account of SISL and KTCMSL sugar Mills for the period from 2003-04 to 2009-10.

It is evident from the above table 4 that the inventory to total assets ratio in SISL showed a decreasing trend expect for the year 2006-07 to 2007-08. The ratio fluctuated within the range of 23.02 percent in 2009-10 to 57.05 percent in 2003-04. The decreasing trend of inventory to total assets can be regarded favorable as the company is reducing its investment in inventories. The average of inventory to total assets was 38.94 percent which is not high; however, the management should try to reduce this proportion.

In KTCMSL the ratio of inventory to total assets registered a mixed fluctuated trend as the ratio which was 58.92 percent in 2003-04 decreased to 34.81 percent in 2005-06 but increased to 44.17 percent in 2006-07 to 57.33 percent in 2007-08 and reduced to 40.66 percent in 2008-09. This ratio highly decreased to 11.94 percent in 2009-10.

CONCLUSION:

From the above study it can be concluded that the inventory management of SISL was better than that of KTCMSL. The management of KTCMSL should try to improve the inventory management position.

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