

How to Win at Finished Goods Inventory Management

Finished goods inventory management: A complete guide



You can't make strategic production and sales decisions with inaccurate or missing finished goods inventory data. Closely monitoring this inventory means you can slow or speed up production as necessary to meet fluctuating customer demands and pivot when supply chain issues arise.

Learn how to find finished goods inventory totals and explore the advantages of monitoring your stock of customer-ready products.

What are finished goods?

Finished goods are ready-to-purchase products. They're the polished outcome of raw materials transformed through production, assembly, and quality check phases. Examples of finished goods range widely, from smartphones and furniture to clothing and packaged foods — each representing the final sellable product.

The raw materials to finished goods journey covers three essential steps:

- **Production:** This phase involves converting raw materials into components for the final product.
- **Assembly:** Here you combine various work-in-progress (WIP) parts and components to assemble the final product. For products like electronics and vehicles, this might involve part assembly, wiring, and software installations.
- **Quality assurance:** Finally, your team ensures products meet quality standards. This includes testing, conducting inspections, and making necessary adjustments to guarantee consumer satisfaction.

In most industries, the finished product's value surpasses raw materials and labor costs. Businesses often measure this inventory in monetary terms or unit count, with the former revealing the finished products' numerical value.

The importance of tracking finished goods inventory

Tracking finished goods is crucial for aligning production with market demand and optimizing cash flow. This knowledge provides a clear picture of available stock and the capacity to satisfy customer needs.

Say a customer wants a newly released 85-inch TV, and it's unavailable at their nearest store. An effective finished goods

inventory system lets staff quickly source the item from another store or distribution center, ensuring customer satisfaction.

Typically, businesses use inventory management software like Fishbowl to monitor these goods alongside WIP and raw materials. This software offers real-time inventory updates, helping businesses adapt to stock level fluctuations. As businesses sell finished goods and produce items, the value and volume of their inventory fluctuate, highlighting the importance of efficient inventory tracking.

Here are some more ways calculating and tracking finished goods benefits businesses:

- **More accurate budgeting:** By closely monitoring finished goods inventory, you gain precise insight into the value of a company's most significant assets. This lets you create accurate financial statements and budgets, offering clarity on your inventory's worth.
- **Less waste:** Excessive materials storage ties up capital and increases obsolescence and waste risks, especially for perishable goods. Accurate inventory management ensures you order and store only what you need, reducing holding costs and minimizing saving resources.
- **Enhanced demand forecasting.** Tracking inventory costs and trends over time reveals seasonal fluctuations and other demand changes. This insight lets you adjust production, prioritizing high-demand items and reducing manufacturing for slower-moving products.
- **Greater asset clarity:** Differentiating between materials, WIP, and finished goods enhances your grasp of stock levels, which is vital for making more informed material acquisition and production decisions.
- **Streamlined inventory workflows:** Tracking finished goods inventory provides clarity into product availability and demand fulfillment. This oversight lets businesses efficiently adjust production schedules and inventory levels, reducing overstock and stock outs.

The difference between finished goods and other inventory

Understanding the transformation of different materials' value and liquidity throughout the manufacturing process lets you make informed decisions about inventory management and financial planning. And it ensures you use resources efficiently, aligning production with market demand.

Raw materials

Raw materials are the inputs required to produce finished goods. Staying in your inventory as assets, raw materials are valued at their initial purchase cost, until they enter the production process. Since they're unmodified, you have the flexibility to resell these materials to recover their initial purchasing costs.

For example, if a manufacturer over-purchases copper wire for electronic devices, selling the surplus helps recoup the initial expenditure.

Work-in-progress

WIP inventory refers to unfinished products in the manufacturing process. Once raw materials undergo any modification, like cutting and assembling, they transition into WIP items. This represents a critical point where assets are less liquid, posing challenges for resale. While you can still return unused raw materials and put finished products to market, partially completed items typically lack a resale market.

For businesses with swift production cycles that transition raw materials to finished goods directly, bypassing detailed WIP accounting might be feasible. But industries with extended manufacturing timelines, such as automotive manufacturing, require precise WIP tracking to accurately reflect the production status and inventory value of these sectors.

How to calculate finished goods inventory

No matter your industry, calculating your finished goods is key for understanding your available stock and planning for future sales. This process involves the following calculations.

Determine the Cost of Goods Manufactured (COGM): This represents the total cost of producing goods during a certain period. Here's how to calculate it:

COGM = beginning WIP inventory + total manufacturing costs - ending WIP inventory

Figure out the Cost of Goods Sold (COGS): COGS calculates how much it costs to produce the goods you sell. Here's the formula:

COGS = beginning inventory + purchases during the period - ending inventory

Calculate finished goods inventory: With COGM and COGS in hand, you can determine the value of your finished goods inventory:

Finished goods inventory = (COGM - COGS) + value of previous year's finished goods

Here's a breakdown of the process with examples and best practices for clarity.

Choose a consistent time period

Establish a specific time frame for your calculations, ensuring consistency across all formulas. So if you're focusing on Q4 of 2023, all data must be from this period. And make sure your start and end dates match across all formulas.

Gather necessary data

Next, collect data relevant to your chosen time period, including:

- Beginning and WIP inventory
- Total manufacturing costs
- Beginning and ending inventory levels
- Purchases made during the period
- Value of the previous year's finished goods

For illustrative purposes, we'll use these values in upcoming examples:

- Beginning and WIP inventory: \$1,000
- Total manufacturing costs: \$200
- Beginning and ending inventory levels: \$200
- Purchases made during the period: \$300
- Value of the previous year's finished goods: \$200

Calculate COGM and COGS

Next, calculate the COGM and COGS:

$$\text{COGM} = (\$1,000 + \$200) - \$200 = \$1,000$$

$$\text{COGS} = (\$300 + \$500) - \$200 = \$600$$

Apply the finished goods inventory formula

Finally, use the finished goods inventory formula to determine your inventory value:

$$\text{Finished goods inventory} = (\text{COGM} - \text{COGS}) + \text{value of previous year's finished goods}$$

For our example, this is $(\$1,000 - \$600) + \$200 = \600 .

Gain better inventory insights with Fishbowl

Calculating finished goods inventory offers valuable insight into your supply chain and stock management practices. But to turn this insight into actionable strategies, you need Fishbowl.

Fishbowl Inventory not only enhances your inventory management practices but also transforms your supply chain efficiency, ensuring you always meet customer demands. And Fishbowl's seamless integration with Xero, QuickBooks and Reckon means it's a complete solution for managing every order fulfillment stage.

Book a demo today to discover how this comprehensive tool can assist your team.

