

To stock up or stock out? That is the question

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Stock is the lifeblood for many private businesses. A stockout situation is a major problem for a private business owner and potentially deadly.

The unpredictable nature of the COVID-19 outbreaks and consequent government measures continue to create headaches for private businesses when it comes to stock management. Business owners are forced to rethink their approach in achieving the ideal balance between product mix and volume and also consider COVID-19 related factors that could influence their strategy towards stock management.

Demand factors

Restrictions aimed at limiting travel movements and human interaction has led to a sales boom for many industries who also have strong and established e-commerce platforms. Businesses within these sectors should already be considering the potential downfall in demand when Australia achieves the vaccination targets leading to the possible end of snap lockdowns, and the opening of interstate borders and international travel. A scenario plan should be conducted with these key events in mind and the potential domino effects.

Conversely, industries which could benefit from a return to a pre-pandemic environment may have more optimistic demand forecasts and stock up in anticipation whilst also trying to get ahead of supply chain disruptions.

The pandemic may have permanently changed the way in which humans interact with each other and consume goods and services. To help predict what may remain in high demand post pandemic, it may be useful to look at how much value was gained from adopting new channels or behaviours, how much people enjoyed it and if they have to make significant investments in adopting new ways of consuming.

While many businesses shift away from the traditional approach of utilising historical pre-pandemic figures to forecast demand, they should also be wary of the impact of Jobseeker and other stimulus measures which may have provided a boost to their bottom lines from March 2020 and into 2021. Consideration will also need to be given to the impact of multiple states in lockdown compared to the same period last year when it was mainly just Victoria. These factors may have a significant impact on your demand forecast given that they are materially different from 2020.

Supply chain factors

A common complaint we hear from our frustrated clients is that demand is there, but we just cannot get the stock in to sell. Global supply chains are still being disrupted with the COVID-19 virus wreaking havoc on countries, forcing them to impose varying degrees of restrictions to combat community spread. As a result, longer lead times through a combination of labour shortages, manufacturing plants shutdown, blocked ports and higher shipping costs have limited the flow of raw materials and finished goods, particularly across international borders. Additionally, the rise in demand for some products has caused a back log of orders. Our clients are advising us that supplier lead times have extended from what was 3 to 4 months to anywhere between 6 to 12 months.

Getting ahead of these disruptions by jumping at opportunities to stock up may be a viable tactic if you anticipate shortages in the supply chain, have the cash to spare, and can successfully predict demand levels.

There is also the opportunity to bulk buy at a discount if you can successfully negotiate with the supplier. There may be an opportunity to leverage negotiations if there is urgency on the suppliers end to offload as much stock as possible due to the risk of COVID-19 restrictions and lockdowns.

While trying to predict when the next COVID-19 outbreaks will be is nigh on impossible, especially in international regions, a review of how the local government is managing outbreaks and their vaccine rollout programs can assist in predicting the extent and magnitude of supply chain disruptions. Understanding where exactly your supplies are sourced from and having a regular sense check of that regions COVID-19 conditions can assist in identifying potential disruptions to the supply chain.

Businesses should also consider strategically stocking up on core stock while holding off on others. Organic goods from raw ingredients may be deliberately stocked out to keep the product fresh and new in line with fashion or seasonality trends. However, packaging materials, especially those metal or glass based which may be harder to source can be stocked up due to the difficulty in procurement and because of the non-perishable nature.

Diversifying your supplier base across different regions, countries or even to local suppliers can also help mitigate the supply chain risks. Though you may end up having a higher price and or have longer lead times if looking at other overseas options, the alternative may be that you lose out on the stock completely. A local supplier may provide the strong advantage of shorter lead times, though potentially at a greater cost per unit. When faced with the prospect of a stock-out versus potentially reducing your margins, many businesses are choosing the latter.

Banks

Banks are aware of the supply chain disruptions experienced across all sectors and can be amenable to assisting businesses with a temporary or permanent increase in their working capital facilities. We observe clients requiring more funds to be invested in stock due to lead times being extended, hence more stock by volume together with supplier price increases. Banks are generally comfortable if the inventory is core with a low risk of obsolescence, you have a diverse customer and supplier base and you have achieved a bulk buy discount. As with all conversations with your bank, it is important to be upfront and honest about the situation, and to communicate early, and often.

Stocking up risks

Whether you decide to stock up to meet higher forecasted demand or to get ahead of supply chain disruptions, the following key risks should be considered:

1. **Stock obsolescence** – an analysis of when your stock is at risk of becoming obsolete should be conducted to assist in determining how much stock you may wish to hold and a

- stock turnover target.
2. **Storage capacity and costs** – the cost of storing all the extra stock on a temporary or permanent basis could contribute to increased working capital and reduced margins. Some businesses may decide to purchase more storage space or refit current facilities to accommodate the extra stock. You may want to consider if the extra space is required in the long-term and the potential fall-out if demand drops. Consider third party logistics options.
 3. **Exchange rate risk** – retaining an excessive amount of stock could have a greater financial impact due to exchange rate fluctuations. Consideration should be given towards hedging the risk given the potential for this to significantly hurt the bottom line.
 4. **Business model** - if by catering to the high demand for a product line caused by COVID-19, are you re-purposing your business model towards too much reliance on one product line? The risk if that particular product line drops in demand and the associated costs to bring the business model back in line to its core products should be considered before stocking up.
 5. **Cash flow** – if you are unable to turn over the stock at your target rate, you may compromise cash flow and prevent the business from taking up future opportunities.

Stocking out risks

Choosing to stock out could place your business in a disadvantaged position from a competitive standpoint. The following risks should be reviewed:

1. **Loss of sales and customer confidence** – stocking out carries the risk of losing sales to competitors and diluting customer loyalty. Customers who cannot buy what they want when they want will often cease to be customers in the future.
2. **Unpredictable supply chain** – it may be difficult to predict with confidence when the next opportunity to acquire stock may occur. By missing out on the first opportunities to stock up, you are allowing a competitor to acquire scarce resources while your business watches from the sidelines waiting for the next shipment.
3. **Supplier relationship** – you may be competing in a market where competitors are snatching up your core stock as soon as they become available. Where your business is in the pecking order may not just come down to cost but also the relationship and leverage you could have formed from previous transactions. You need to be a priority for your suppliers.

At Fordham Business Advisors we can assist private business owners to successfully navigate through the impacts of COVID-19 and to help them devise strategies on stock management by understanding the key risks, conducting scenario planning, regularly reviewing real-time data and ensuring your governance is in place to make rapid and agile key decisions.

If you need assistance, please contact your [Fordham Partner](#).

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