INVENTORY MANAGEMENT

If you aren't managing inventory properly, you are leaving money sitting on the shelf or throwing it away. Here are tips to avoid either of those scenarios!

By Kimberly S. Brown

One big area of potential financial loss and gain in a veterinary practice—whether you are a solo ambulatory practitioner or a multi-vet practice with a clinic—is inventory control. This covers items from the everyday gloves and supplies to OTC products and pharmaceuticals.

In this session Mark Reilly, DVM, DABVP, of South Shore Equine Clinic and Diagnostic Center in Plympton, Massachusetts, and Monty McInturff, DVM, of Tennessee Equine Hospital near Thompson's Station, gave veterinarians and practice managers some solid things to consider about proper inventory management.

Both agreed there must be a plan that works for your specific practice. Today there are changes in the way that clients obtain medications from veterinarians and other distributors, specifically online pharmacies. This has put pressure on veterinarians to become better at the business of inventory management.

Reilly said you first need to address whether you should even have a pharmacy. "Other medical professionals don't have pharmacies; they use prescriptions," he noted.

"There is increased competition from catalogues, FarmVet, large vet hospitals with pharmacies, and online drug companies," said Reilly. "Pet Med Express is now selling products that used to be sold through vets. Tack shops and grain stores sell dewormers, antibiotics, bandaging and medical supplies, and even syringes and needles … that increased competition means reduced profits (for veterinarians)."

The speakers noted that veterinarians can no longer afford to purchase mass quantities of a product or pharmaceutical, pay for it, then slowly sell it over time. They said that ideally, the product should be purchased and turned over before you have to pay the supplier for it.

If you look at your practice and determine that dispensing supplies and pharmaceuticals could be a profit center, both Reilly and McInturff recommended dedicating staff to ensure the process is handled professionally.

"An inventory manager's purpose is to realize the practice vision statement by maintaining and managing the central supply and inventory of the practice," the speakers noted. "Specifically, this position is responsible for maintaining the inventory budget at 15-18% of gross revenues, eliminating the possibility of inventory expiring, maintaining working inventory numbers by utilizing just in time (JIT) and on-line capabilities, improving client

Courtesy Tennessee Equine Hospital

Dr. Monty McInturff (pictured) and Dr. Mark Reilly focused on inventory management.

satisfaction, and taking charge of on-line pharmacy and shipping.

"Metrics for a successful person in this position include: accuracy of Top 20 counts (monthly inventory of your top 20 products by cost and profitability), total for online inventory purchases, total for in-clinic purchases, monthly budget as percentage of gross monthly revenue, frequency of unavailable backordered supplies, number of cost-cutting opportunities, number of growth opportunities, and number of client referrals. This position pays for itself in efficiency, increased capture of sales and decreased stock outs (running out of some product you need)."

Both speakers also stressed the need for a locked central stock room with some sort of accounting method to keep track of when inventory comes in, and especially when it goes out. Having monthly inventory of the top 20 items in the stock room and in all practice vehicles should allow you to reconcile the inventory on your most expensive/profitable items. (See section below on ABC classification for inventory.)

"If I had two (of a specific item) in my truck and the (monthly) inventory says I have four, in a month I should be able to remember who might have gotten that product that I forgot to bill," said Reilly.

An entire article could be written about the types of inventory systems that are available to veterinarians today. Suffice it to say that you need something that works for your practice, whether a pen-and-paper, sign-in/sign-out sheet or a sophisticated, computerized inventory system. Let's sum this up with what McInturff advised: "Get with your vet practice software company and get your inventory under control."

Not All Inventory is Created Equal

Reilly and McInturff reminded practitioners and practice managers that not all inventory is used at the same rate, costs the same or is as important to the daily operation of your practice. They recommended the ABC classification system outlined as follows.

The **A classification** is given to high-cost items that are important to the daily operation of your practice. "If a practice were to run out of one of these items, decreased production would result," they noted.

An A classification is given to the products that make up 10-20% of the total number of items you have and have 70-80% of the value of the total inventory.

Examples they gave for these types of items might be injectable joint products or GastroGard.

The **B classification** is given to support items. These items make up 30% of the total inventory and have 15% of the total value of the inventory.

Examples they gave for these items were injectable antibiotics, surgical supplies and anesthetic sales.

The **C classification** is given to common items that make up 50-60% of the total inventory and have 10% of the total value of the inventory.

Examples they gave include bute, oral antibiotics and surgical gloves.

They noted that the high numbers of this category of inventory requires automation of some sort to reduce the amount of time (thus added expense) you spend tracking these inventory items.

"To run out of C items can affect the ability to perform services or potentially the sale of items in class A," they noted.

Ordering Costs

Reilly and McInturff stressed that the price paid for an item does not equal the cost of that item to the practice. They reminded veterinary professionals that quantity discounts do not necessarily change the total cost.

The Total Cost of an item can be calculated by taking the ordering cost divided by the quantity + the carrying costs divided by 2. The equation is:

Total cost = $CoD/Q + CcQ/2$

The carrying cost is simply the cost to your practice to hold the increased quantity of that item. This is typically 30% of the cost of the inventory.

There are some items that you must maintain in inventory to avoid running out. However, having too much inventory is like having dollars sitting on your shelves. Those dollars are tied up and can't be used for other things.

So increased turnover equals less of your dollars tied up in inventory sitting on the shelves.

Inventory Turnover

As mentioned before, the speakers encouraged practitioners to have regular inventory turnover (meaning you purchase inventory, stock it, sell it, pay for it, then reorder).

"It is prudent to keep inventory supplies at less than a 30-day supply as this indicates it is sold before the invoice from the vendor comes due," they explained.

To calculate inventory turnover, first determine the average cost of drugs and supplies in the trucks and stockroom. Add the total cost of supply inventory from the beginning of the year and add the cost of supply inventory at the end of the year, then divide this total by 2. Now divide the cost of goods sold by the average inventory for the year by the average cost of drugs and supplies; this is the turnover rate for inventory. The goal for newly managed inventory systems

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is to achieve turnover 10 to 12 times a year.

Here that process is simplified:
Step 1 Calculate average inventory
Step 2 Calculate turnover rate
Step 3 Divide by time period or by product

Here is the turnover rate explained a different way:
Turnover of 6 = 60 days on shelf
Turnover of 8 = 45 days on shelf
Turnover of 10 = 36.5 days on shelf
Turnover of 12 = 30.4 days on shelf

Here is their example for calculating turnover rate for a specific product:

Cost of total Banamine paste inventory at *start of year* = $4,000.
Cost of total Banamine paste inventory at *end of year* = $800.
Average inventory cost of Banamine paste during year = $4,000 + $800 / 2 = $2,400
Total dollars spent on Banamine paste during one year at your clinic = $19,200
Turnover rate of Banamine paste ($19,200 / $2,400) = 8 inventory turns per year

The recommended goal is 10-12 turns per year (to sell it before you pay for it, but not run out), they offered three strategies to improve turnover rate:

1. Decrease inventory numbers
2. Increase sales of inventory
3. Combination of both

Having said all that, McInturff admitted that he has an inventory turnover of six times a year, and he is still making money.

Pricing (AKA Opportunities in Inventory)

Reilly and McInturff noted that with the decreased number of visits by veterinarians to horses each year, and with increased competition for services and products that used to be strictly provided by veterinarians, practitioners need to find new ways to improve their profitability. One of those ways can be inventory.

By properly managing inventory in your practice, they said, you can increase the cash flow needed to improve veterinarian and business profitability.

Unlike our human counterparts, veterinarians have the ability to supply items to patients for successful clinical outcomes. Inventory is a tool to optimize your patient care.

However, they stressed that you should eliminate products and services that do not produce a profit or expand the business.

So how do you know if you are pricing your products correctly?

"There are many issues that affect price points," noted the presenters. "Competition from online pharmacies, catalogues and feed stores are the most pressing issues. Veterinarians are constantly reviewing the competition instead of establishing a culture where drugs are part of the treatment plan which can be conveniently delivered. A common fear is that medications fairly priced will require adjusting services down due to commodity pressures. This is not necessarily the case. Continue to charge what the market can bear for these services while delivering the products at a profitable price point."

They noted that you could categorize your inventory by market pressures to help establish price points. "The most-shopped being one category, and knowing what the market can bear being the other group," they noted. "Then establish the lowest possible price point a product can sell for and still be profitable. This will establish the floor price and help to maintain profitability on shopped items (those items horse owners "shop around" for the best price). The other group should be priced as high as the business climate will allow without being overpriced for the consumer."

Reilly and McInturff noted that wholesale plus 40% would be the *bottom* price on any inventoried item. "Items that fall below this markup are non-commission items or scripted," they noted.

Here is their formula for the lowest price point:

Wholesale Price + 15% Business Profit + 10% Commission to provider + 15% Shrinkage = ***Minimum Retail Price***

Example: $10.00 (Wholesale Price) + $1.50 (Business Profit) + $1.00 (Commission) + $1.50 (Shrinkage) = $14.00 Minimum Retail Price

Keep in mind that your inventory manager also has to be very good at just-in-time ordering. That person needs to know the ebb and flow of minimums and maximums of all goods through each practitioner's vehicle and through the clinic. That means understanding seasonal and practitioner variations. That means doing a Top-20 count monthly and a quarterly inventory of everything.

Here are two definitions they said you need to understand in order to manage your inventory profitably:

Profit margin is the percentage of profit realized by a business per dollar of sales.

Markup is the difference between the cost of a good or service and its selling price.

Reilly and McInturff noted that competitive items (i.e., GastroGard, Legend, Adequan or dewormers) might carry a profit margin of 15%. Most other standard items (i.e., antibiotics, NSAIDs, topical creams and ointments) might carry a profit margin of 25%. Non-competitive items (i.e., tranquilizers, injectable antibiotics, ophthalmic medications or Elevate) might have a profit margin of 40%.

"Keep in mind a portion of the profit margin must be set aside as commission to the providing clinician," they noted. "This number varies from 8-15% in different practices."

For example, if the total cost of an item is $20, and a profit margin of 10% ($2) is added, the list price (the price for which you sell it to the customer) would be $22. A commission of 10% would enable the providing clinician to receive $2.20, meaning the practice would take a loss on the sale of the item. Therefore, this item either needs a higher profit margin, a lower commission or both if the practice is to profit from the sale.

Total Cost + Profit Margin + Commission = List Price

McInturff advised that you build a culture in your practice where inventory matters to everyone. He recommended that you:

- have a leader or inventory manager
- build a strong distributor relationship ("This is huge and they can help you!")
- make sure your supply chain is established ("You need a real-time knowledge of where drugs are.")
- have regular audits
- make sure supplying products is a convenience to the customer
- be ready to compete for the sale (set a fair price). Let everyone benefit!

McInturff also notes that, "If I administer this drug, I have a higher commission, so I have a higher fee."

They said if product does not meet the minimum pricing model (the practice and vet can't make money) then the product is sold as a non-commission item, it is scripted to an ethical pharmacy or it could be sold to the customer through a distributor operating an online delivery system.

McInturff emphasized that veterinarians are not salesmen; "We are marketers."

Convenience often drives sales. You have the product (or it's at the clinic and can be delivered or picked up), and the client can get it ASAP. Therefore, think of inventory as opportunity.

"The drug business is being methodically taken from veterinary medicine, and we can recapture it!" stressed McInturff.

Take-Home Message

Reilly and McInturff said the following is true of inventory control:

- Practices can provide a total experience (including products).
- Veterinarians can offer quality products/service at a fair price.
- Automated inventory management to control flow of products in/out of your practice can help you be profitable.
- Designate one person to manage the inventory chain in your practice.
- Provide convenient product delivery to your customers.
- A healthy product/service mix for vets varies, ranging from 10/90 to 50/50 (product/service, respectively).
- Be the trusted source!

"Your clients would rather do business with you, so make it possible and enjoy the growth," they concluded.