

What is Inventory Shrinkage? A detailed guide to Inventory Shrinkage

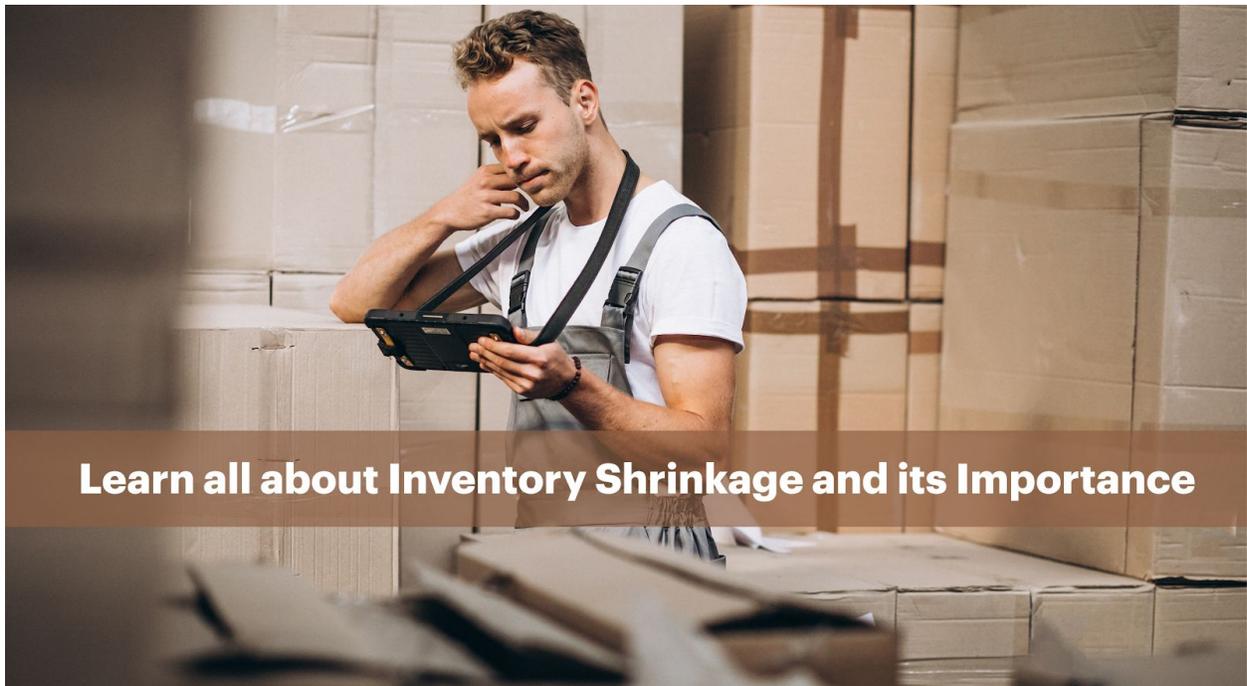


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What is Inventory Shrinkage?

If you have your own retail business, you might have probably faced Theft, Shoplifting, or other forms of fraud, bringing unforeseen inventory losses. This **unplanned inventory loss** due to a myriad of factors is called Inventory Shrinkage.

For Example: Rio Shoes Ltd. had 4820 pieces of shoes, but, upon a physical count, the inventory was only 3980. This loss of inventory can be described as Inventory Shrinkage. Also, as stated above, Inventory Shrinkage can be caused due to theft, shoplifting, damage, or any other form of inventory loss.

To emphasize, a [report](#) shows that more than 40 billion was lost in the year 2016 due to inventory shrinkage alone. Hence, it is evident for retailers to take steps to prevent this unwanted loss that brings down their profitability.

“In a business where we only make a penny on every dollar that comes in, it is especially important that we control our shrinkage.”

Fred Klein, VP Loss Prevention, Big V Supermarkets

In this post, we will go through the reasons to calculate Inventory Shrinkage and factors that contribute to this cost. We will also look into measures to prevent loss, theft, and overall inventory shrinkage costs.

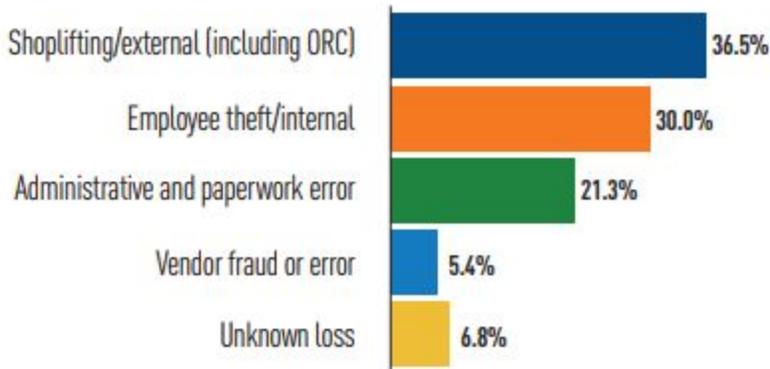
What are the leading causes of Inventory Shrinkage?

There are several reasons that contribute to inventory shrinkage. However, the top reasons are given as follows:

1. Shoplifting
2. Employee Theft
3. Administrative and Paperwork Error
4. Vendor Fraud or Error
5. Product Damage or Expired Product
6. Others

Here is a breakup of the main factors affecting inventory shrinkage according to a report from NRSS

Source of Inventory Shrinkage (Average Proportion)



| | 2017 | 2016 | 2015 |
|--------------------------------------|-------|-------|-------|
| Shoplifting/external (including ORC) | 36.5% | 39.3% | 38.0% |
| Employee theft/internal | 30.0% | 35.8% | 34.5% |
| Administrative and paperwork error | 21.3% | 16.8% | 16.5% |
| Vendor fraud or error | 5.4% | 4.8% | 6.8% |
| Unknown loss | 6.8% | 7.2% | 6.1% |

Source-NRSS

Why is calculating Inventory Shrinkage important?

It is a well-known fact that physical inventory in the retail business consumes an enormous working capital. You can say,

Inventory is money that is stashed in your warehouse.

Therefore, you must be aware of any type of theft in your warehouse or store. Also, be prepared to be accountable for any such circumstance and find ways to stop the same. There are definite chances that few items may go missing on account of damaged goods, but, losing inventory due to unethical reasons such as theft is a serious offense. It directly suggests that your workplace is lacking credibility, and you must take actions to encourage motivation and handle employee grievances.

Also, frequent Inventory Shrinkage can lead to complications related to [inventory control](#).

“Not controlling shrinkage is taking a shortcut to bankruptcy.”

John L. Pagliaro, President of Dana Associates

How to Calculate Inventory Shrinkage?

Inventory Shrinkage can be calculated by finding the total financial value of all inventory in the fiscal year/quarter and subtracting the total inventory as obtained after the cycle count. Most often, inventory shrinkage is calculated as *Inventory Shrinkage Rate*. This means, when calculated in percentage, you can easily understand how much inventory loss your company has borne. The critical aspects needed to consider *Inventory Shrinkage Rate* can be listed as follows:

- Calculate your On-hand Inventory
- Conduct a Physical Inventory Count

- Deduct the amount from the amount recorded in your accounting books
- To determine a percentage, divide the amount by your inventory value.

Inventory Shrinkage = Actual Inventory - Physically Counted Inventory

For Example: Joe's Accessories has 5200 pieces of mobile accessories. On a physical check, they realized there are only 4900 units. Thus,

Inventory Shrinkage = \$300 [5200 (Actual Inventory) - 4900 (Physical Count)]

Inventory Shrinkage Rate = 17.3% [5200 (Actual Inventory) / 300 (Inventory Shrinkage) * 100]

It can be said, Joe's Accessories has incurred 17.3% Inventory Shrinkage.

How to prevent Inventory Shrinkage?

A combination of safety measures and employee engagement tactics should be put into use to bring down inventory shrinkage. Some of these include:

1. Safeguard the Expensive Inventory

This is by the norm, one of the most effective ways to bring down shrinkage. Understand that shrinkage is expressed in financial value. Hence, the expensive inventory must be safeguarded on priority. Any valuable inventory can be stored in a separate location, which can be an enclosed room or a sealed-off space.

In addition to that, employ separate employee(s) to handle that inventory and assign them special privileges. This will prevent shrinkage and in easy trackback of any item in the event of a theft.

2. Prevent Vendor/ Purchase Order Fraud

Often, a Purchase Manager may inflate the demand, making you pay more for the PO. The vendor may personally know your purchase manager and might be involved in a scam where both benefit each other.



To solve that, follow up with vendors from time to time. Make sure your purchase manager is not involved in any type of transaction with the vendors that are questionable or unethical in nature.

Also, double-check on damaged goods that are filtered out of your PO. You must also go for an [inventory management software](#) that provides trackbacks and [purchase order](#) history, allowing you to tally all the historical transactions.

3. Eliminate Loopholes and Improve Process

- Credit History
- Past employment history etc.



5. Employee Training and Incentives

It is important to train your employees on loss prevention. It can be accomplished in several cost-effective ways. You can

- Create educational videos
- Impart work ethics and cultivate a culture to sustain that
- Create communities and engage them in activities
- Give them incentives on honesty and integrity
- Surprise gifts on festivals



6. Invest in a Security System

A lot of hardware [systems](#) with software support are available in the market to safeguard your inventory from being stolen. These systems may include CCTV cameras, intrusion detection, door auto lock systems, door access control and so many other features.

Alternatively, you can install a custom system according to your needs and budget in order to reduce theft and any unwanted access to your warehouse to bring down Inventory Shrinkage.

Finally, we all agree that inventory shrinkage is a significant issue that needs careful consideration of your business processes and identifying associated loopholes. Once they are identified, an optimal solution can be implemented to reduce inventory shrinkage.

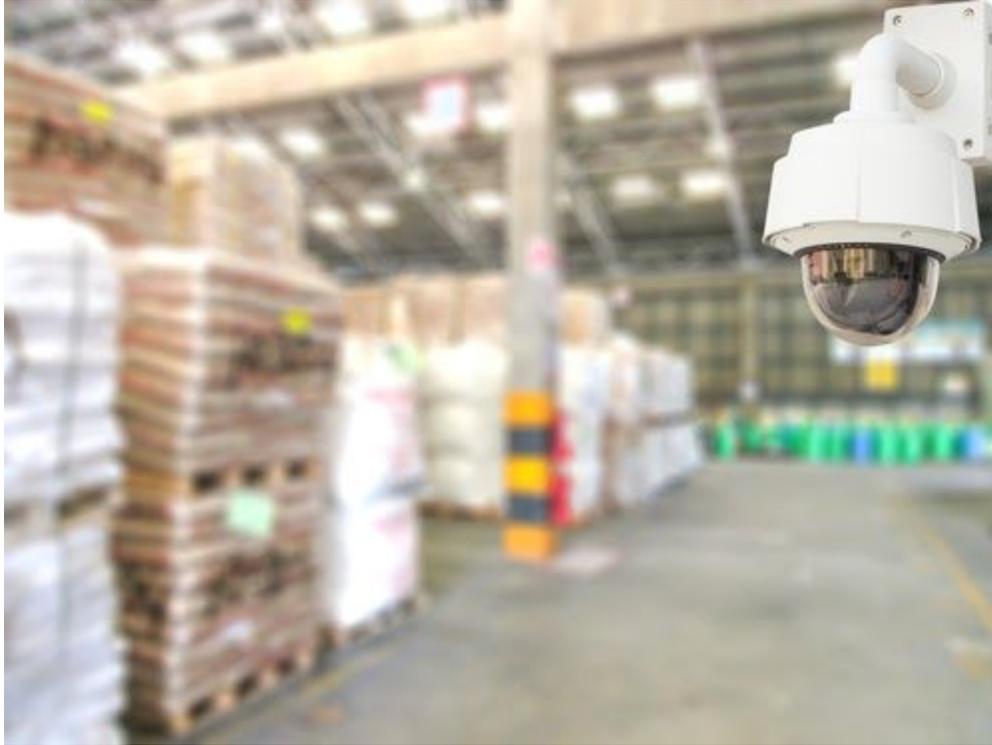
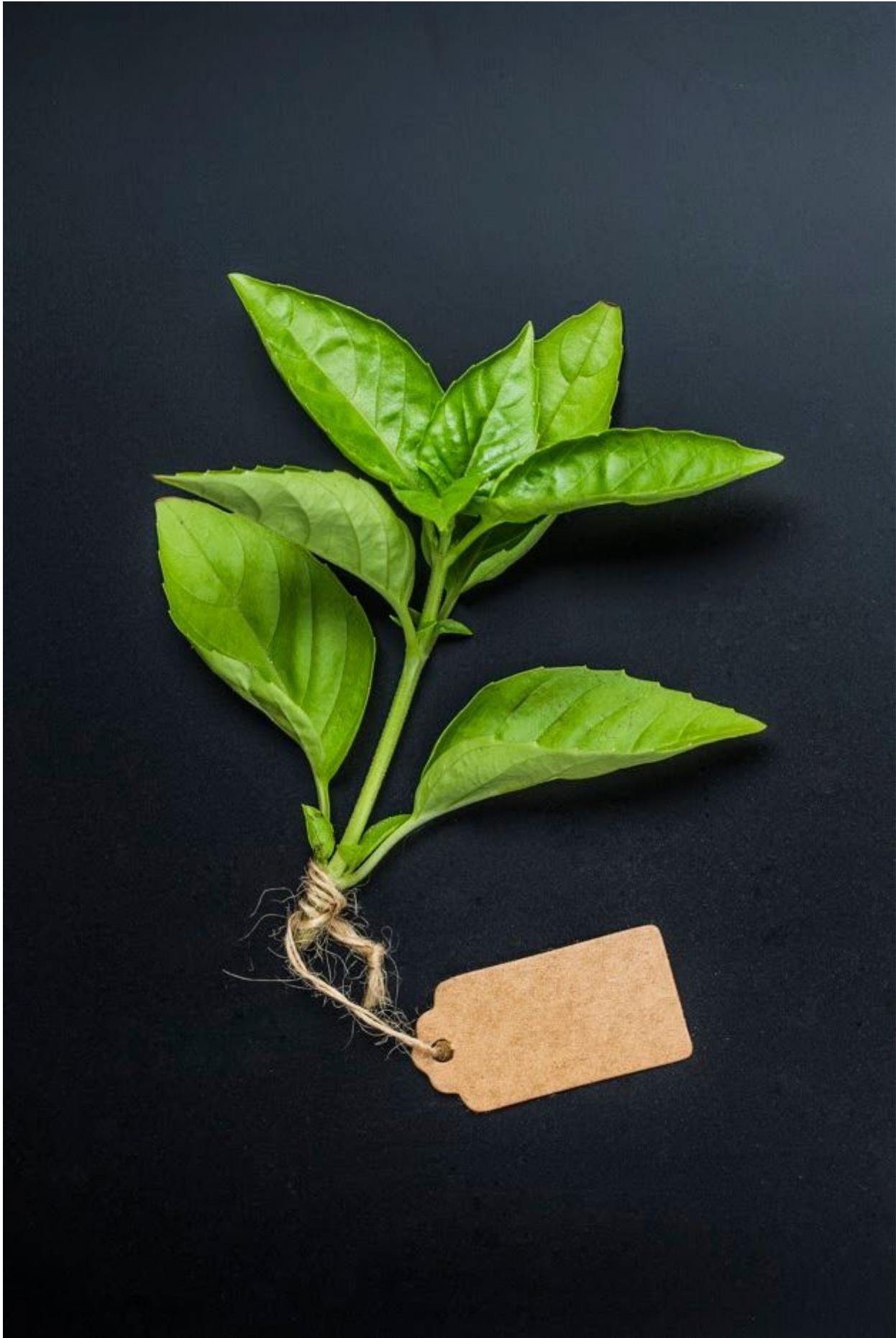


Image Courtesy: singaporecctv.com

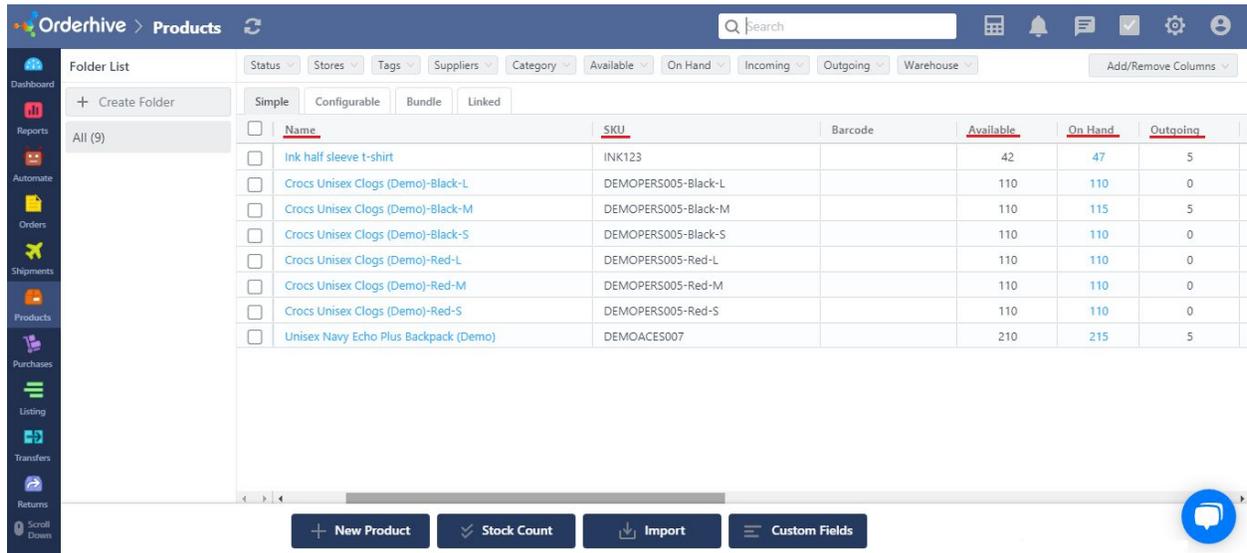
7. Track your Inventory

It is highly important to keep track of your inventory. Well, imagine Joe's Accessories has 5200 pieces of inventory, how will he keep track on a regular basis? He can start by using a tagging system and tag every product. This way, he can track the movement of every product, even without his physical presence.



8. Invest in a Good Inventory System

The role of a good inventory system is to access the visibility of products in one place. It also keeps track of the product movement and tracks the location of the product to the bin or shelf number.



The screenshot shows the Orderhive 'Products' page. It features a search bar, navigation filters (Status, Stores, Tags, Suppliers, Category, Available, On Hand, Incoming, Outgoing, Warehouse), and a table of products. The table has columns for Name, SKU, Barcode, Available, On Hand, and Outgoing. Below the table are buttons for '+ New Product', 'Stock Count', 'Import', and 'Custom Fields'.

| Name | SKU | Barcode | Available | On Hand | Outgoing |
|---------------------------------------|---------------------|---------|-----------|---------|----------|
| Ink half sleeve t-shirt | INK123 | | 42 | 47 | 5 |
| Crocs Unisex Clogs (Demo)-Black-L | DEMOPERS005-Black-L | | 110 | 110 | 0 |
| Crocs Unisex Clogs (Demo)-Black-M | DEMOPERS005-Black-M | | 110 | 115 | 5 |
| Crocs Unisex Clogs (Demo)-Black-S | DEMOPERS005-Black-S | | 110 | 110 | 0 |
| Crocs Unisex Clogs (Demo)-Red-L | DEMOPERS005-Red-L | | 110 | 110 | 0 |
| Crocs Unisex Clogs (Demo)-Red-M | DEMOPERS005-Red-M | | 110 | 110 | 0 |
| Crocs Unisex Clogs (Demo)-Red-S | DEMOPERS005-Red-S | | 110 | 110 | 0 |
| Unisex Navy Echo Plus Backpack (Demo) | DEMOACES007 | | 210 | 215 | 5 |

Stock Count Form

Warehouse Name : Orderhive Name : Signature :

| Name | SKU | Barcode | Available | OnHand | Outgoing | Incoming | Counted | Difference | Remark |
|---------------------------------------|---------------------|---------|-----------|--------|----------|----------|---------|------------|--------|
| Crocs Unisex Clogs (Demo)-Red-S | DEMOPERS005-Red-S | | 110 | 110 | 0 | 1 | | | |
| Crocs Unisex Clogs (Demo)-Red-L | DEMOPERS005-Red-L | | 110 | 110 | 0 | 1 | | | |
| Crocs Unisex Clogs (Demo)-Red-M | DEMOPERS005-Red-M | | 110 | 110 | 0 | 1 | | | |
| Ink half sleeve t-shirt | INK123 | | 42 | 47 | 5 | 0 | | | |
| Unisex Navy Echo Plus Backpack (Demo) | DEMOACES007 | | 210 | 215 | 5 | 0 | | | |
| Crocs Unisex Clogs (Demo)-Black-M | DEMOPERS005-Black-M | | 110 | 115 | 5 | 1 | | | |
| Crocs Unisex Clogs (Demo)-Black-S | DEMOPERS005-Black-S | | 110 | 110 | 0 | 2 | | | |
| Crocs Unisex Clogs (Demo)-Black-L | DEMOPERS005-Black-L | | 110 | 110 | 0 | 1 | | | |

What if Inventory Shrinkage goes Unnoticed?

With the inventory shrinkage rate increasing, the company can encounter a big hit on their profits. The cost of inventory may increase, and your revenue also gets affected. Let's list out the things that can get severely affected.

1. Lower Profits

When your inventory is missing, it solely means that it's going to affect your profits. As rightly said by [Alasdair McKichan, President, Retail Council of Canada](#).

“Shrinkage is the single greatest threat to profitability in our industry.”

For instance, Joe's Accessories had \$40,000 worth of goods. He sells his accessories at 20% profits. Out of which, \$1000 worth goods went missing. Thus,
Total Loss he incurred = \$1200 [1000+20%]

Joe's Accessories lost nearly \$20,000, only because of inventory shrinkage. This is how inventory shrinkage affects your profits.



2. Loss of Inventory

It is an unimaginable feeling when you purchase goods for your store and few of them go missing. It is that time when you realize that you have incurred a loss, and your valuables are gone. With inventory shrinkage, companies lose their goods, and are not able to retrieve them ever.



3. Mismatch in Accounting Books

At the end of the day, when you sit to tally your accounting records and realize a few values are not adding up, it is a frustrating feeling! But, at that moment, you also realize that a few of your goods are missing. If accounting books are not matched, it causes audit and taxation problems. So, be careful with inventory shrinkage problems.



4. Monetary Investment Loss

Every piece of inventory is worth a significant value. When you purchase your goods, and few of them go missing, you are losing a considerable amount of money and draining out your resources. This is how Inventory Shrinkage affects your wealth.



Final Thoughts

Inventory Shrinkage can affect your business on many levels. It can also affect your team or employee relationships. You must lower your inventory shrinkage issues and increase your profits. To do so, use the latest and most efficient method of [Inventory Management](#).

With the use of proper [software](#), you most definitely see the depths of your issue and resolve it with efficiency. Also, you can scan the other features like inventory tracking and product listing, to make sure you are always virtually aware of your good flow.

References

- [Corporate Financial Institute on Inventory Shrinkage](#)
- [Inventory Audit Procedures](#)
- [Impact of Inventory Shrinkage on a Company](#)

[Another Example of Inventory Shrinkage Calculation](#)
[Inventory Terms and Formulas](#)