How to Calculate Days Inventory Outstanding

There are different ways with the help of which you can measure your business' efficiency. It's really important to understand the way your inventory is flowing so that you can make important decisions to improve it. Days inventory outstanding is one such metric that helps you get hold of your operations and sales proficiency.

Let's understand what is Days Inventory Outstanding and How to calculate it?

What is Days Inventory Outstanding?

Days Inventory Outstanding is a metric that gauges the efficiency of your inventory. It tells you the average number of days you hold your inventory before selling it.

The ratio varies with the industries you choose and should compare the enterprises working in similar domains. Companies that have costly equipment will have more Days of Inventory Outstanding than a retailer.

Days of Inventory Outstanding is inversely proportional to the company's sales. Smaller DIO indicates a higher number of sales over some time and vice versa.

Calculation of Days Inventory Outstanding

Days Inventory Outstanding depends on the cost of average inventory and prices of goods sold. Hence, to calculate the Days of Inventory Outstanding, you need to divide the average inventory cost by the cost of goods sold and multiply the result with 365 to calculate for a year.

Days Inventory Outstanding (DIO) =

{Cost of average inventory/cost of goods sold}*365

The increase or decrease in DIO depends on the type of your industry, your business model, the variety of products you are dealing in, geographic locations, etc.

Advantages of Days Inventory Outstanding

- Days Inventory Outstanding plays a critical role in the Cash Conversion Cycle - By knowing your DIO and decreasing it, you can free up the money tied to your inventory quickly so that you can invest the money for other business-related expenses.
- Tells you that you need to reinvent or innovate your business strategies – Continuously higher DIO tells you that you are doing something wrong and need to take immediate steps to improve your sales. You can introduce discounts, create combos, and start new, more unique advertising campaigns.
- Improves Inventory Management – By tracking your DIO, you can make smarter and accurate decisions on purchasing new inventory and managing it.

- Helps businesses dealing with Perishable Goods – Days of Inventory Outstanding keeps you informed and alert about your inventory flow so that the perishable goods are sold before they go stale. With seasonal items, you need to set a very low Days of Inventory Outstanding benchmark; otherwise, the seasonal item will soon be seen as a deadstock, thus getting your money stuck.

Conclusion

There are lots of metrics that need to be looked after when running a business, and days inventory outstanding is one of them. The reason why it's important is that it tells you about the flow of your inventory. You can use the given formula to calculate your inventory's DOI.

Essential Resources

- https://www.investopedia.com/terms/d/days-sales-inventory-dsi.asp
- https://corporatefinanceinstitute.com/resources/knowledge/accounting/days-inventory-outstanding-dio/
- https://ycharts.com/glossary/terms/days_inventory_outstanding