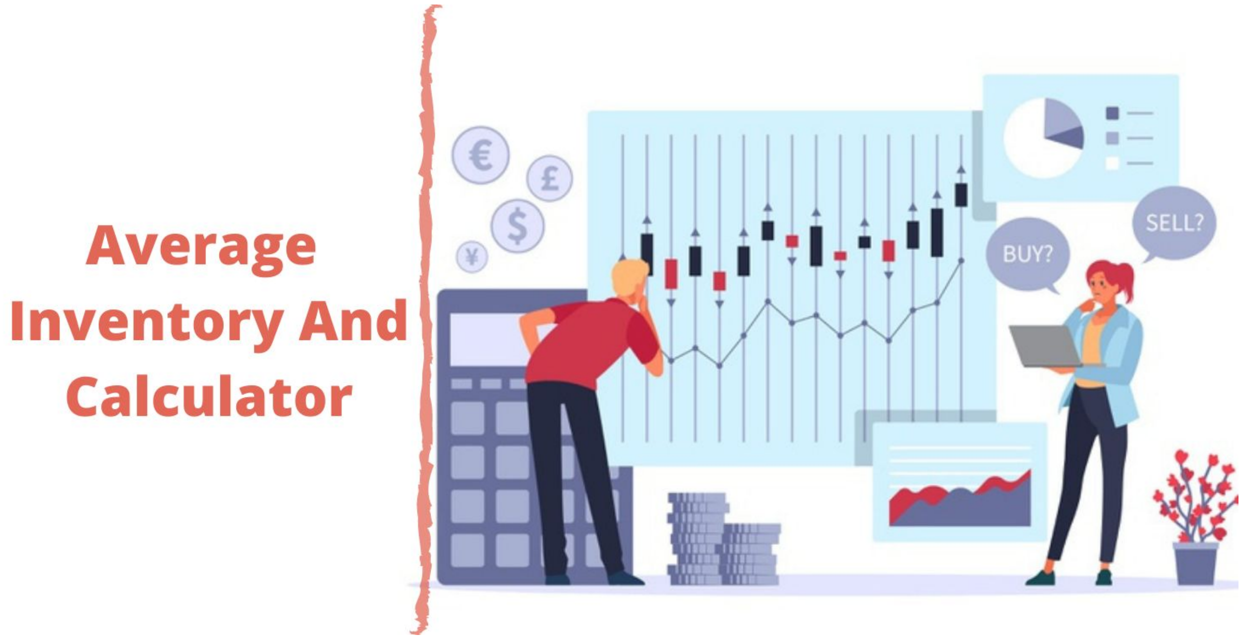
What is Average Inventory and Average Inventory Calculator



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Introduction

Average Inventory is a simple mathematical calculation for your inventory. Average Inventory is calculated to examine the value of inventory for a given time period. Many organizations follow this practice to identify the average inventory they will need at any given point of time. To understand better, let us break the term Average Inventory in two (Average + Inventory) . In plain mathematical terms, **Average** is normally called as the middle point. It is derived from the sum of values divided by the total number of units. And Inventory is the compiled list of merchandise or assets that you have at your disposal.

It was once said by Alice Walton, a successful business woman, heiress of Walmart, and it is rightly said,

“One of the great responsibilities that I have is to manage my assets wisely, so that they create value.”

You see, managing your assets, your inventory is very important for your business. To manage the inventory, there are many ways. Today, let us talk about Average Inventory.

Average is the value determined by dividing the sum of value by its number of items. Now, I know it may seem that I am taking you back to school, but it is fun and interesting to start from basic. And for some people, you can say, it is easier to understand by solving our sixth grade mathematical problems. So, what suits you best? With that, let me give you an illustration of Average Inventory.

Practical Illustration

Let us say, you are a fruit vendor and you want to know your average inventory for the last 6 months.

March - $ 8500, April - $ 12,000, May - $ 11,000, June - $ 5000, July - $ 6000, August - $ 11,500

The Average Inventory will be = **Sum** of the inventory **divided** by the number of units

Average Inventory Formula

Average Inventory = Sum of the Units / Number of Months
So, in this case,

$$\frac{8500 + 12000 + 11000 + 5000 + 6000 + 11500}{6} = \$\ 9000$$

This way, the average inventory for the last 6 months is $ 9000

Average Inventory Calculator

I can give you all the information and practical illustrations to understand Average Inventory. But, what better way to understand the term than using your own actual real figures. Find out your average inventory by using our average inventory calculator.

AVERAGE INVENTORY CALCULATOR

Why is it important to calculate Average Inventory

Usually, the Average Inventory is calculated every month to figure out the average units required on a monthly basis. But, most organizations also perform this practice on a quarterly basis and most certainly for a fiscal period. This way, they can analyze their business operations, sales, and costs in a better and efficient manner. The sole purpose of calculating the average inventory is to know for sure the products that are mainly in demand and on average which goods are performing well and which goods are not. Also, businesses conduct comparisons between the average inventory calculated over the fiscal period and can understand their sales figures accurately.

So, to understand in a better manner, let us list down the benefits of calculating the Average Inventory

1. Analyze Business Operations

Every business runs on inventory. Now, inventory can be in any form, also, even the service industry deals with inventory. Thus, the companies perform repeated average inventory calculation for the entire operational year and compare notes to understand which inventory did better and which period performed better for their business. This way, they can make necessary preparations for the coming year and restock inventory accordingly. Let me explain to you with an easy example.

Nora is a prominent business owner of her home essentials business. She quarterly calculates her average inventory and for the current year too, she had calculated the average inventory of the last 4 quarters. This way, she can easily analyse her business performance.

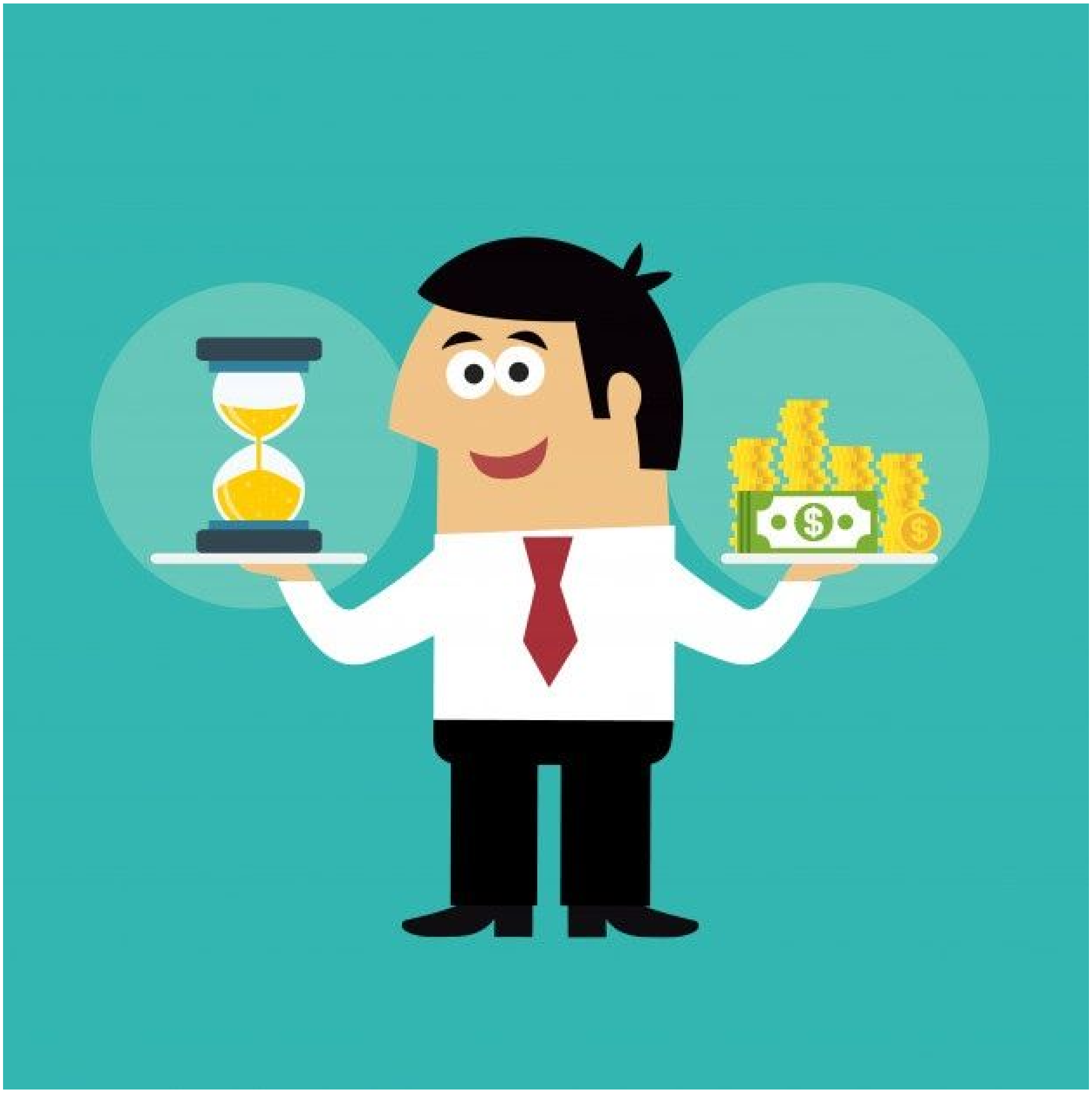
For 1st Quarter (Jan-Feb-Mar) - $ 8000
For 2nd Quarter (Apr-May-June) - $ 6000
For 3rd Quarter (Jul-Aug-Sept) - $ 5000
For 4th Quarter (OCt-Nov-Dec) - $ 10,000

Nora immediately worked on her analysis to understand the reason for these changes. Out of all the reasons, she could figure out seasonal changes as one factor. Others were festivities and ceremonies, and one other factor was damages of goods during transit.

This way, each company calculates their average inventory to further analyze the working operations of their business.

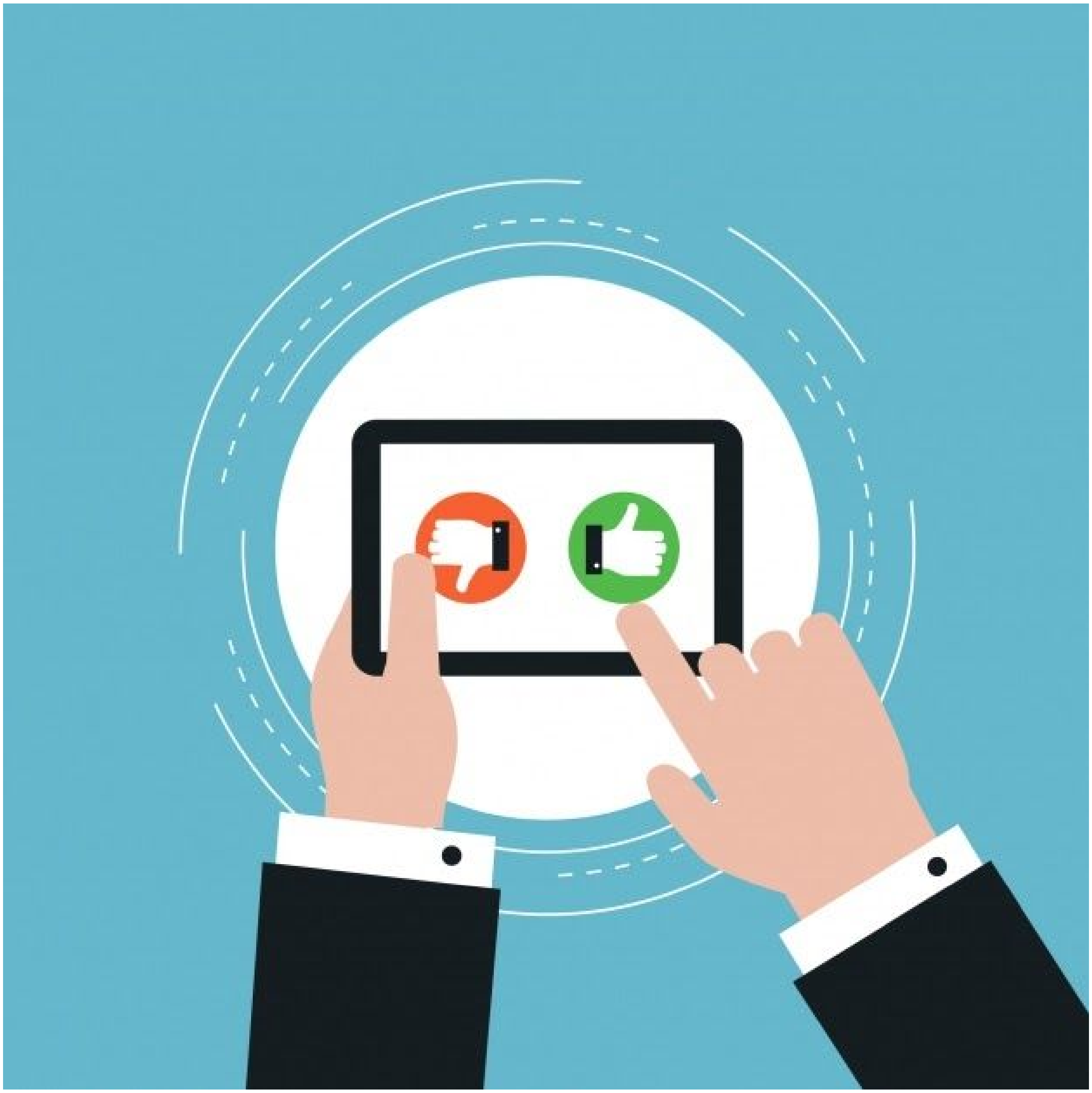
2. Comparison between Average Inventories

As we discussed above, average inventory can help to understand the business, but, you can take it to the next level. Compare the figures of all the average inventory for each quarter. By performing a comparative analysis, the company can understand which quarter performs better and the exact reason behind the fluctuation. Also, you can understand the goods that were lost in transit, damaged, or even returned.



Disadvantages of Average Inventory

Average Inventory has quite a few benefits. But, it does carry few disadvantages as well. It is always better to use actual and real figures instead of estimates. This way, your calculations can never go wrong with actual figures. Also, there are a number of factors that can affect the value of average inventory. Thus, there may be times when your figures are lower than expected or the average inventory is not as accurate as you may have wanted. Let us point out a few disadvantages to know the term ‘Average Inventory’ in a better manner.



1. **Seasonal Changes and Occasions can Affect Average Inventory**

Every business keeps track of the yearly occasions. Infact, companies eagerly wait for occasions as they know that month the sales are going to be great. To name a few occasions, Diwali, Thanksgiving, Christmas, New Year, and many more celebrations. Though there is a lot of fun and happiness, it is a little trouble tracking your inventory. Also, this definitely causes inaccuracy in calculating the average inventory. The seasonal months will show higher results but then again, the sole cause is the festive season.

2. Estimate Figures and Numbers

Another major drawback of calculating the average inventory is that all the derived figures are based on estimations. Isn't it better to use actual figures rather than average? Though average inventory is absolutely helpful but always be prepared to know that the average inventory is more of an estimation than real value. This problem occurs as most of the companies who have uncountable inventory are unable to physically count their inventory. Thus, they give an estimated value and based on that, companies calculate the average inventory.

3. Working Culture Differs of Different Companies

Every company has a different working culture. Few companies start making sales since the first week of the month itself, such as Grocery stores or Ration stores. But, few other companies work on sales targets and the first week or two are generally quite slow. And then in the last two weeks or one, the sales team pushes out big numbers and achieves sales targets. In such firms, averaging the inventory results in misleading numbers towards the productivity of the team on a daily basis. You will most certainly get an average on the inventory but if you calculate daily average, it will show some very different numbers. Also, it will show the first few weeks are less productive than the last week.

Important Terms related to Average Inventory

A lot revolves around Average inventory. Till now, we have understood why organizations tend to calculate average inventory. For those, who have forgotten, here it is, once more. Companies calculate average inventory to understand the standard inventory they need to hold at all times so that they are always in stock.

But, there are few more terms to learn regarding average inventory. Few of them are:

Inventory Turnover Ratio - The **Inventory turnover** is a measure of the number of times inventory is sold or used in a time period such as a year.

Inventory Turnover Ratio (Formula) - You can also check your Inventory Turnover Ratio by using the below formula.

INVENTORY TURNOVER RATIO

Cost of Goods Sold - Also known as is the carrying value of goods sold during a particular period.

References

[Know more about Inventory Turnover Ratio]
[Know more about Cost of Goods Sold]
[More about Average Inventory]
[Average Inventory and Moving Average Inventory]