

# An ABC-Analysis for Optimization of Non-Active Raw Materials in Inventory Management: A Case Study

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## Abstract

Inventory optimization is a popular topic among companies, especially in SMEs. Based on the traditional inventory management methods, some other operations management concepts were considered to improve the inventory performance more comprehensively. On the basis of a case analysis for an Induction Cooking Equipment Company which is located in Bangalore, some attempts were made to achieve the goal of optimizing inventory from purchasing activities and purchasing strategy points of view. Regarding the imbalanced inventory structure and imperfect inventory management system of Company, some new improvement solutions including ABC analysis, inventory replenishment method, overall purchasing strategy and JIT-QM Joint strategy were proposed in order to solve the current existing problems and promote the long-term development of the company. The recommended solutions described in the thesis were presented based on relevant literatures and theoretical calculations, thus the practicality of them needs to be tested empirically to demonstrate a broader support. Nevertheless, the new ideas and methods suggested in the thesis will enhance the vision of purchasing executives during the decision-making process, aiming at minimizing the inventory costs and maximizing the services.

**Keywords:** - Inventory Management, ABC Analysis, Purchasing, Just-in-Time Management.

## 1. Introduction

Inventories represent the second largest asset category for manufacturing companies, next only to plant and equipment. The proportion of inventories to total asset generally varies between 15 to 30 per cent. Given substantial investment in inventories, the importance of inventory management cannot be overemphasized. The present study is intended to determine the industry practice in inventory management and to evaluate management performance in this regard. In order to evaluate the performance of the inventory management referring the Monthly reports of the organization the required data have been collected.

An effective inventory management should:

- Ensure a continuous supply of raw materials to facilitate uninterrupted production.
- Minimize the carrying cost and time.
- Control investment in inventories and keep it at an optimum level.
- It permits a better utilization of available stocks by facilitating interdepartmental transfer within a company.
- Maintain sufficient stocks of raw materials in periods of short supply and anticipated price changes.

ABC analysis is an inventory categorization method which consists in dividing items into three categories, A, B and C: A being the most valuable items, C being the least valuable ones. This method aims to draw managers' attention on the critical few (A-items) and not on the trivial many (C-items). The ABC approach states that, when reviewing inventory, a company should rate items from A to C, basing its ratings on the following rules: A-items are goods which annual consumption value is the highest. The top 70-80% of the annual consumption value of the company typically accounts for only 10-20% of total inventory items. B-items are the interclass items, with a medium consumption value. 15-25% of annual al consumption value typically accounts for 30% of total inventory items. C-items are, on the contrary, items with the lowest consumption value. The lower 5% of the annual consumption value typically accounts for 50% of total inventory items.[4]

Steps for implementation of ABC analysis are

- Classify the items of inventories determining the expected use in units and the price per unit for each item.
- Determine the total value for each item by multiplying the expected units by its unit price.
- Rank the items in accordance with the total value giving first rank to the items with highest total value and so on.
- Compute the ratio (percentages) of number of units of each item to total units of all items and the ratio of total value of each item to total value of all items.
- Combine items on the basis of their relative value to form three categories A, B and C.

#### JIT Purchasing Concept:

As a buying process, the purchasing function is directly link to the inventory level control and cost management. The purchasing function plays a significant role in the whole supply chain, starting from the supplier selection to follow-up and evaluation. Even though the purchasing seems separated from some operations such as materials requirements planning, inventory management, incoming inspection and quality control, etc., in order to maximize the company's efficiency, purchasing operations are implemented interrelated with those activities. Especially in terms of the current global business environment, in which there are more competitions as well as cooperation, the purchasing function of an organization becomes increasingly critical towards the excellent performance of the organization and the whole supply chain.

## 2. Literature Review

It is possible to utilize the concept of ABC model in formation of rational inventory policy which should give the best possible service level to production while minimizing investment costs (Fuller, 2000) .ABC analysis tends to measure the significance of each item of inventory in terms of value. According to Onwubolu and Dube (2006), when ABC analysis is applied to an inventory situation, it shows the importance of items and level of control placed on the items. ABC classification is a method of classifying inventory items according to the money value to a firm [6]. Class A items though smaller volumes but tends to generate higher sales value followed by the class B items. The class C items are of a very large volume but generate a very small sales value. Class 'A' items normally range from 5% to 20% of all inventory items and account for between 50% and 80% of sales value. The class B items normally range from 20% to

40% of all inventory items and account for 20% to 40% of sales value. The class C items normally constitute 50% to 70% of all inventory items and account for 5% to 25% sales value. Reported that is the basis for material management processes and help to define how stock is managed and is an appropriate technique for classifying inventory items according to the importance of their contribution to the annual cost of the entire inventory system.

Particulars	A items	B items	C items
Control	Tight	Moderate	Loose
Requirement	Exact Close	Exact Same	Estimated
check	Regular	Some	Little/No
Expenditure	Industrial	Individual	Group/None
Safety Stock	High	Medium	Rare

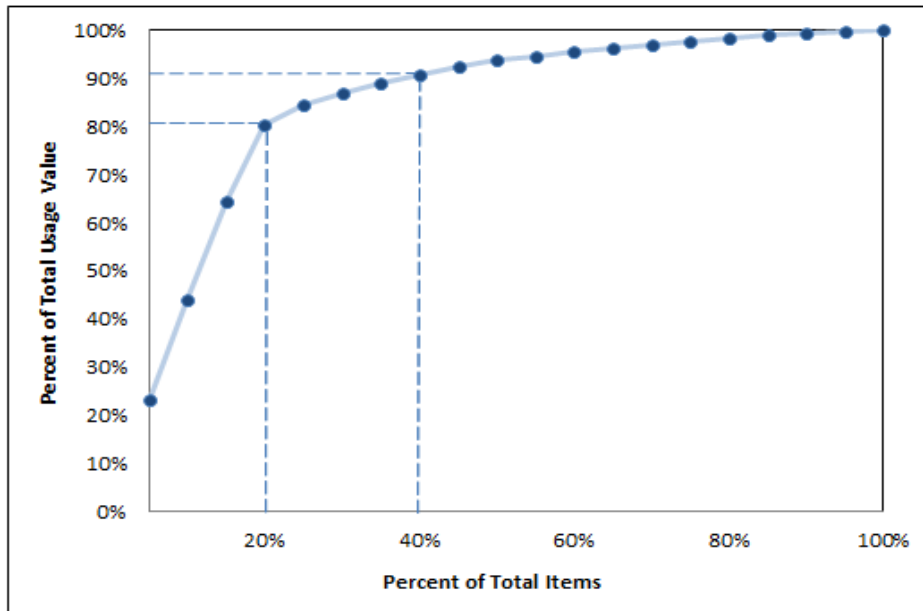


Figure 1- Presentation of ABC – Analysis  
Source: Wannewetsch (2006)[6]

### 3. Methodology

The research was based on the case company. All the data were collected from the company’s database, interviews of the personnel from the related departments and the company’s website. By implementing an ABC analysis and update their inventory System, detailed information about Inventory items and transactions could be found. In addition, according to the expectations of the company, appropriate approaches needed to be found in order to eliminate the stocks with 0 turnovers and prevent the related problems from happening in the future. In terms of the inventory system, the overall structure could be thus optimized by adjusting the percentage distribution of active and non-active products. Meanwhile, the most suitable purchasing strategies were expected to be designed as well regarding different groups of items, in order to reduce inventory cost and improve efficiency. The main academic approaches include inventory

management, JIT Management and Quality Management. Concerning the research and analysis methods, a combination of qualitative and quantitative methods was applied.

#### PROCESS OVERVIEW

Step1:- Collect Primary Inventory Data From Case Company.

Step2:- Data Observation.

Step3:- Historical Data Analysis.

Step4:-Present System Analysis.

Step5:- Carrying Cost Analysis.

Step6:- Apply ABC Analysis Method in Inventory Items.

Step7:- Update Inventory System.

Step8:- Apply & Suggest JIT Purchasing with ABC analysis as per aspect.

#### 4. Data Collection, Analysis and Findings

Raw Material Inventory management of Lorman Technology pvt. Ltd. Bangalore: A case study.

Lorman technology pvt. Ltd. Located in Bangalore. The company is principally engaged in the business of manufacturing and sales of commercial induction cooking equipment. The company manufactures various types of products which include Tawas, Deep Fryer, Rice Boiler, Stock Pot, Brit Pan, Thermic Boiler, Idly Pan etc[3]. The company has total 575 raw material items with 11 different aspects like circuit board, hardware, electronics, electrical, packing, coil winded, coil groove, bits, vessel, glass and wheels. To improve their Raw material inventory management system so as to be classifies the items in different aspects. The data used for calculation is collect from company. Table 1 shown below shows the summary of Available items cost, used items cost of raw materials from the month Nov-16 to Mar-17.

	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17
<b>Available Items Cost (Rupees)</b>	5315717.12	8081209.95	7007365.95	5631331.27	4377758.94
<b>Used Items Cost (Rupees)</b>	1476583.23	1073844	1376034.68	1253572.33	1306585.84
<b>Total Raw Material Cost(Rupees)</b>	6792300.35	9155053.95	8383400.63	6884903.6	5684344.78

*Table: 1 Monthly Price Summery of Raw Materials*

ABC-Analysis performs for Mar-17 available raw materials inventory. The ABC Analysis done for all items but due to large amount of stock items this paper shows only circuit board items (in Annexure). Table 2 shown below shows the ABC analysis of 11 different items and also shows the non-active raw materials.

Serial No.	Particulars	Total Items	A-Class Items	B-Class Items	C-Class Items	No. of Non-Active Items
1	CIRCUIT BOARDS	36	4	11	21	14
2	HARDWARES	101	18	37	46	43
3	ELECTRONICS	171	33	63	75	29
4	ELECTRICAL	96	14	30	52	40

5	PACKINGS	31	3	12	16	20
6	COIL WINDED	18	3	6	9	7
7	COIL GROOVE	18	2	6	10	7
8	BITS	18	3	5	10	8
9	VESSEL	44	6	13	25	40
10	GLASS	12	2	4	6	9
11	WHEELS	30	3	8	19	1
	<b>Total</b>	<b>575</b>	<b>91</b>	<b>195</b>	<b>289</b>	<b>218</b>

Table 2 ABC-Analysis of 11 different aspects of items for Mar-17

Source: Raw material items form company (Lorman Tech.)[3]

After ABC analysis performed for all items, categorised into three classes that is A-class, B-class, and C-class and also calculate the number of non-active items after that analyse and calculate the cost of non-active items as shown in table 3

	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17
<b>Available Items Cost (Rupees)</b>	53,15,717.12	80,81,209.95	70,07,365.95	56,31,331.27	43,77,758.94
<b>Used Items Cost (Rupees)</b>	14,76,583.23	10,73,844	13,76,034.68	12,53,572.33	13,06,585.84
<b>Total Raw Material Cost(Rupees)</b>	67,92,300.35	91,55,053.95	83,83,400.63	68,84,903.60	56,84,344.78
<b>Non-Active Material Cost(Rupees)</b>	15,57,631.32	16,37,123.71	17,00,637.91	18,35,073.67	20,90,626.57

Table 3 Cost summary of items including non-active raw material cost

#### Findings:-

Our analysis shows that company follows the ABC analysis for multiple items. It observed that there are 218 items out of 575 items are non-active and also increasing their non-active items in inventory, and month to month the cost of non-active items is increasing.

#### 5. Conclusion and Suggestion

In conclusion, this paper is focused on operations management in order to achieve inventory optimization and purchasing activities improvement for the case company. In general, the study paper is of great reference and the output of it is useful, since some recommended solutions were found to solve the current existing problems through in-depth investigation and comprehensive research, and some attempts were made to improve the current performance and prevent the problems recurrence in the future. The contribution for the company is optimizing the current inventory structure, eliminating non-active stocks, and improving the quality of purchasing activities and organization. And from a scholar point of view, the thesis deeply analysed the relationship between purchasing activities and inventory level control.

#### Conclusion:

1. Due to undefined purchasing management system the non-active raw material cost is gradually increasing.
2. To keep down capital investment in inventories.
3. To minimize the possibility of disruption in the production schedules of firm for want of raw material, stock and spares.
4. To minimize the excessive carrying cost.

5. Minimize investment in inventories and minimize the carrying cost and time.

Suggestion:

1. For purchasing of raw material suggest the ABC analysis report.
2. Use JIT purchasing management system.

## 6. References

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## Annexure

The ABC analysis perform for circuit board items as show below in table 4, in this table first we rank the all 36 items in accordance with the total value giving first rank to the items with highest total value and so on. And calculate the total monthly demand cost of Mar-17.

Item No.	Material Name	Particular	Monthly Demand	Unit Cost	Monthly Cost of Used Items
1	SEMIKRON	SET	38	3325	126350
2	MODULE CARD READY	5KWH	23	3450	79350
3	GEYSER READY	FC SMALL	16	3325	53200
4	POWER CARD READY	0.3MF/4C/CC	36	425	15300
5	POWER SUPPLY READY	3PHASE	25	425	10625
6	POWER CARD READY	10MF/2C/CC	25	396	9900
7	RAILWAYS READY	5KWH	5	1873	9365
8	BFW PCB	LORMAN-2A	78	92.11	7184.58
9	POWERCARD FULL BOARD	LT--3P30KW	10	287.02	2870.2
10	RAILWAYS	LT-RL3KW	10	273.06	2730.6
11	AUTOMATIC KEYPAD	LT--103	108	25	2700
12	AUTOMATIC KEYPAD	5KWH	45	54	2430
13	FLAT CARD READY	5KWH	2	838	1676
14	POWER SUPPLY	LT--DRV	64	24.69	1580.16
15	MANUAL KEYPAD	LT--102	28	55	1540
16	MODULE CARD	LT-RL3KWCON	145	10	1450
17	AUTOMATIC KEYPAD	BFW	20	52	1040
18	FLAT RC PCB	LT-- 1PMB3	1	787.2	787.2
19	MANUAL KEYPAD READY	5KWH	13	32	416
20	DRIVE CARD	LT--DRV1	20	20	400
21	DRIVE CARD READY	3PHASE	2	150	300
22	POWER CARD READY	0.15MF/4C/CC	40	5	200

23	DRIVE CARD READY	LT-IGBT2C	0	23.63	0
24	POWERCARD	CAPACITOR SIDE	0	287.2	0
25	POWERCARD	TERROID SIDE	0	430	0
26	POWERCARD	CENTER PIECE	0	430	0
27	POWER CARD READY	0.3MF/4C/WHC	0	804	0
28	POWER CARD READY	0.3MF/2C/CC	0	396	0
29	POWER CARD READY	10MF/2C/WHC	0	564	0
30	POWER CARD READY	0.3MF/2C/WHC	0	1128	0
31	MANUAL KEYPAD READY	3PHASE	0	56	0
32	MANUAL KEYPAD READY	BFW	0	68	0
33	AUTOMATIC KEYPAD	3PHASE	0	35	0
34	BFW PCB READY	2A	0	1096	0
35	DRIVE CARD READY	NEW	0	23.63	0
36	GEYSER	LT--SP3KW1	0	202.92	0

Table 4

The table 5 shows Computation of ratio (percentages) of number of units of each item to total units of all items and the ratio of total value of each item to total value of all items, it means the cumulative % of items in term of cost and item number and Combine items on the basis of their relative value to form three categories A, B and C shown in table 6.

Item No.	Material Name	Particular	Monthly Demand	Cumulative % of Materials	Unit Cost	Monthly Cost	Cumulative % of total usage
1	SEMIKRON	SET	38	5.039787798	3325	126350	38.12673671
2	MODULE CARD READY	5KWH	23	8.090185676	3450	79350	62.07099123
3	GEYSER READY	FC SMALL	16	10.21220159	3325	53200	78.12435406
4	POWER CARD READY	0.3MF/4C/CC	36	14.9867374	425	15300	82.74120464
5	POWER SUPPLY READY	3PHASE	25	18.30238727	425	10625	85.94735088
6	POWER CARD READY	10MF/2C/CC	25	21.61803714	396	9900	88.93472479
7	RAILWAYS READY	5KWH	5	22.28116711	1873	9365	91.76065981
8	BFW PCB	LORMAN-2A	78	32.62599469	92.11	7184.58	93.92864232
9	POWERCARD FULL BOARD	LT--3P30KW	10	33.95225464	287.02	2870.2	94.79473935
10	RAILWAYS	LT-RL3KW	10	35.27851459	273.06	2730.6	95.61871139
11	AUTOMATIC KEYPAD	LT--103	108	49.60212202	25	2700	96.43344973
12	AUTOMATIC KEYPAD	5KWH	45	55.57029178	54	2430	97.16671423
13	FLAT CARD READY	5KWH	2	55.83554377	838	1676	97.67245551
14	POWER SUPPLY	LT--DRV	64	64.32360743	24.69	1580.16	98.1492766
15	MANUAL KEYPAD	LT--102	28	68.03713528	55	1540	98.61397921
16	MODULE CARD	LT-RL3KWCON	145	87.26790451	10	1450	99.05152387
17	AUTOMATIC KEYPAD	BFW	20	89.9204244	52	1040	99.36534901
18	FLAT RC PCB	LT-- 1PMB3	1	90.0530504	787.2	787.2	99.6028905
19	MANUAL KEYPAD READY	5KWH	13	91.77718833	32	416	99.72842055

20	DRIVE CARD	LT--DRV1	20	94.42970822	20	400	99.84912253
21	DRIVE CARD READY	3PHASE	2	94.69496021	150	300	99.93964901
22	POWER CARD READY	0.15MF/4C/CC	40	100	5	200	100
23	DRIVE CARD READY	LT-IGBT2C	0	0	23.63	0	0
24	POWERCARD	CAPACITOR SIDE	0	0	287.2	0	0
25	POWERCARD	TERROID SIDE	0	0	430	0	0
26	POWERCARD	CENTER PIECE	0	0	430	0	0
27	POWER CARD READY	0.3MF/4C/WHC	0	0	804	0	0
28	POWER CARD READY	0.3MF/2C/CC	0	0	396	0	0
29	POWER CARD READY	10MF/2C/WHC	0	0	564	0	0
30	POWER CARD READY	0.3MF/2C/WHC	0	0	1128	0	0
31	MANUAL KEYPAD READY	3PHASE	0	0	56	0	0
32	MANUAL KEYPAD READY	BFW	0	0	68	0	0
33	AUTOMATIC KEYPAD	3PHASE	0	0	35	0	0
34	BFW PCB READY	2A	0	0	1096	0	0
35	DRIVE CARD READY	NEW	0	0	23.63	0	0
36	GEYSER	LT--SP3KW1	0	0	202.92	0	0

Table 5

ABC Classification				
Category	Item No	Approximate Percentage of Items (%)	Percentage Usage (%)	Action
A	1 To 4	15%	82.74%	Close Purchasing Control
B	5 To 15	53%	13.87%	Regular Purchasing Control
C	16 To 36	32%	3.39%	Rarely Purchasing Control

Table 6