

1st Period / 22/4/21 / 10-11 AM

MB-104 AFA / MBA SEM-I / DATE OF  
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PERIOD - IST

## VALUATION OF INVENTORY Dr. Nasir Ahmad

When we study about the production of product, first we think about the basic ingredient of product is — raw material

and raw material is basic & important things. Thus the material management is tremendous need of every manufacturing concern in modern world industry.

Inventory management is related with regulating and controlling the quantity and value of materials. It includes raw materials, semi-finished goods and finished goods and spare spares part & stores.

The basic objectives of inventory management (material management) is to maintain the quantity and price of material at required level.

In previous online class, we discussed the need of the valuation of the inventory but not in detailed.

Today we discuss the why important the valuation of inventory of a concern.

In the context of this statement we can say that various reasons may lead for valuation of inventory

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The following reasons behind the fixation of value of particular inventory. They are

1. for minimise the wastage

Wastage of material at all the levels should be minimise. During the storage or at work in the factory, lot of material are waste, so we avoid normal and abnormal wastage.

Normal wastage is done in its nature but abnormal wastage must be avoided. They increase cost

2. fixation of price of a product.

Valuation of inventory helps in fixing the price of products. Once a value is determined then, - the total cost automatically summed-up. Total cost includes value of material plus labour & overhead. These 3 elements are so important for fixing the price of product. More than 50% portion of cost is material value. Therefore, 1st & starting calculation of tender price is that the material.

3. To Regulate own policy  $\rightarrow$  The product policy is differ from industry to industry. So, Policy of valuation of inventory related to its price. Price is final things for a product. In such a ~~and~~ ~~event~~ profit also and even

## 4. Minimize the cost <sup>(2)</sup>

In a product, 2 types of costs are involved. 1. is the product cost and 2nd is the period costs. Both cost have smart role in fixation of pricing of material and also manager able to decide on the basis of data, when should be active and earn more profit or shutdown the business.. Naturally we can say that if you purchase the material at cheaper rate, the total cost will be affected.

## 5. How much cash available for purchase of material.

By nature, stock is a current asset and a huge cash investment in the stock of material. So best, it is necessary to keep the sufficient cash in the concern so that the flow of liquidity should be maintain & production should <sup>not be</sup> suffered from unavailability of material.

## \* NEED TO HOLD INVENTORIES

The question of managing inventories arises only when the organisation holds inventories. Maintaining inventories involves tying up of the company's funds and incurrance of storage and handling costs. If it is expensive to maintain inventories, why do companies hold inventories?

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There are 3 general motives for holding inventories

1. TRANSACTIONS MOTIVE
2. Precautionary motive
3. Speculative motive

The first motive emphasises the need to maintain inventories to facilitate smooth production and sale promotion.

The precautionary motive necessitates holding of inventories to guard against the risk of unexpected changes in demand & supply forces and other factors, and the last motive influence the decision to increase or reduce inventory levels to take advantage of price fluctuations.

\* A firm maintain adequate stock of materials for a continuous supply to the factory for an uninterrupted production. It is not possible for a company to procure raw materials when ~~ever~~ ever it is needed. A time lag exists between demand force of inventory and supply force of inventory. Also, there exists uncertainty in procuring raw materials in time on many occasions. The procurement of materials may be delayed because of such factors as strike, transport disruption or short supply. Therefore, the firm should keep and maintain sufficient stock of raw material at a given time.

Others factors which may necessitate purchasing and holding of raw material inventories are quantity discount and anticipated price increase. The firm may purchase large quantities of raw materials than needed for the desired production and sales levels to obtain quantity discounts of bulk purchasing. At times, the firm would like to accumulate raw materials in anticipation of price rise.

another aspect of work in progress. WIP buildup because of production cycle. Production cycle is starting point of introduction of raw material into factory for production and withdrawal of finished goods from factory after completion of production. Till production cycle (PC) complete, stock of WIP has to be maintained.

An efficient firm constantly try to make production cycle smaller by improving their production techniques.

\* Stock of Finished goods has to held because production & sales are not (instantaneous) equal in volume. A company cannot produce immediately when goods demanded by customers, therefore, to supply FG on regular basis, their stock has to be maintained. Stock of FG, also important in sudden demand, Peak demand of seasonal product. Substantial FG inventories should be kept to meet such a type of demand. Failure to supply would mean loss of firm's sale to competitors. The level of FG would depend upon the coordination of sale & production as well as on production time.