# Optimization for CS: Project

## Inventory Optimization for a Furniture Shop

Team Members: Labish Bardiya (2023BTECH106),
Himanshu Garg (2023BTECH108)

## 1. Abstract

Inventory optimization is crucial for managing costs and ensuring product availability in retail businesses. This paper introduces a **nonlinear inventory optimization model** designed for a furniture shop that sources products from wholesalers and manufactures items in-house. The model integrates **Economic Order Quantity (EOQ)** and **Reorder Point (ROP)** methodologies along with **nonlinear programming (NLP)** techniques to minimize total inventory costs while maintaining consistent product availability. The optimization is executed using **Python** and **SciPy's optimization tools**, which employ **gradient-based methods** for constrained optimization. Sensitivity analysis is applied to ensure the model's robustness under varying demand, cost, and lead-time conditions.

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# 2. Introduction

### 2.1 Problem Statement

The furniture shop faces three critical inefficiencies in its inventory management:

1. **Overstocking**: Excess inventory leads to high **holding costs** (e.g., storage fees and capital tied up in unsold products).

2. **Understocking**: Insufficient inventory results in **lost sales** and **customer dissatisfaction**.

3. **Poor Restocking Schedules**: Restocking is erratic, leading to **inventory imbalances** and potential stockouts.

The goal of this research is to develop a model that minimizes inventory costs while addressing these inefficiencies.

### 2.2 Objective Function

The primary aim of the optimization model is to minimize total costs, which include:

- **Ordering Costs**: Costs incurred when placing an order, such as administrative expenses and transportation.

- **Holding Costs**: Costs associated with maintaining inventory, such as storage fees, insurance, and opportunity cost of tied-up capital.

- **Understocking Penalty**: A penalty function f(Y_i), which increases the total cost when demand is unmet (i.e., when the inventory level is below the reorder point).

The model is designed to balance these costs to find the optimal **order quantity** and **reorder points** that minimize the overall cost while maintaining service levels.

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## 3. Literature Review

### 3.1 EOQ Model

The **Economic Order Quantity (EOQ)** model is a traditional inventory management method that determines the optimal order quantity by minimizing the sum of **ordering** and **holding costs**. The formula is:

$$EOQ = \sqrt{\frac{2DO}{H}}$$

Where:

- **D** = Annual demand
- **O** = Ordering cost per order
- **H** = Holding cost per unit per year

The EOQ model, however, assumes **constant demand**, **fixed lead times**, and **stable costs**, but these assumptions do not always hold in real-world scenarios.

### 3.2 Nonlinear Optimization Techniques

Real-world inventory systems often involve **nonlinear behaviors** such as variable demand and supply, capacity constraints, and changing cost structures. These cannot be effectively modeled using linear models like EOQ and ROP.

**Nonlinear programming (NLP)** is used to address these challenges. In NLP, we seek to **optimize** an objective function (e.g., minimizing total cost) subject to **nonlinear constraints** (e.g., demand or storage capacity limits).

One key technique in NLP is the **Karush-Kuhn-Tucker (KKT)** conditions, which are generalizations of the method of Lagrange multipliers. These conditions are used to find the optimal solution subject to constraints in optimization problems.

### 3.3 Reorder Point (ROP)

The **Reorder Point (ROP)** model is used to ensure that new stock is ordered in time to avoid stockouts. The formula is:

$$R = d \times L$$

Where:

- **d** = Daily demand
- **L** = Lead time (in days)

This model ensures that the inventory level does not fall below the reorder point before the new stock arrives, helping to maintain the correct inventory levels.

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## 4. Research Gap

### 4.1 Limitations of Traditional Inventory Models

Traditional inventory models like **EOQ** and **ROP** make several assumptions that may not be realistic in the context of modern retail:

- **Constant Demand**: EOQ assumes demand is constant throughout the year, but demand is often **seasonal** or influenced by external factors (e.g., promotions or market conditions).

- **Fixed Lead Times**: EOQ assumes constant lead times, but real-world lead times can fluctuate due to supply chain delays or production issues.
- **Stable Costs**: Ordering and holding costs in EOQ models are assumed to remain constant, but they can vary due to factors like **bulk discounts**, **economies of scale**, or changing rental rates.
- **Single-Item Focus**: EOQ and ROP models focus on **individual items** and do not handle complex interdependencies among products in a retail environment.

#### 4.2 Gap in Contextualized, Computational Approaches

The research gap lies in the fact that **small retailers**, especially in developing countries, face unique challenges that are not addressed by traditional models:

- **Dual-Sourcing Strategies**: Small retailers may source products from both **wholesalers** and **in-house production**, requiring models that can handle this **multi-source** scenario.
- **Limited Storage Capacity**: Retailers with limited storage capacity need models that optimize inventory levels within physical constraints.
- **Capital Constraints**: Small retailers often have limited capital, which requires balancing inventory with available funds, considering opportunity costs.

This research aims to bridge this gap by developing a **nonlinear inventory optimization model** using **advanced computational tools** like **SciPy's optimization** functions.

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## 5. Research Objectives

The objectives of this research are:

1. **Develop an EOQ-based inventory optimization model** with **nonlinear constraints**.
2. **Minimize total inventory costs**, which include ordering, holding, and understocking penalties.

3. **Determine optimal reorder points** (ROP) for different inventory items.
4. Implement **gradient-based nonlinear programming** solutions for optimization.
5. **Perform sensitivity analysis** to understand the effect of parameter changes (e.g., demand or cost variations).

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## 6. Methodology

### 6.1 Data Collection

The following data is collected for the model:

- **Ordering costs** (O) for each item, representing the cost per order placed.
- **Holding costs** (H), including costs like storage fees, insurance, and opportunity costs.
- **Demand** (D) for each item, including base demand and seasonal adjustments.
- **Lead time** (L) from suppliers.
- **Minimum Order Quantities** (MOQ), specifying the minimum number of units that must be ordered.

### 6.2 Model Formulation

The model minimizes the total cost, which includes the following components:

$$TC = X.O + \sum\left(H_i . Y_i + f(Y_i)\right)$$

Where:

- $X$: Number of orders
- $Y_i$: Inventory level of item i
- $H_i$: Holding cost per item
- $f(Y_i)$: A nonlinear penalty function:
  - If $Y_i \geq D_i$: No penalty.
  - If $Y_i < D_i$: Penalty $= P_i \cdot (D_i - Y_i)^2$

    Where $P_i$ is penalty per unit of unmet demand.

The constraints include:

1. **Demand Constraint**: Ensures that the inventory level satisfies at least the monthly demand for each item.

2. **Storage Capacity Constraint**: Ensures that the total volume of inventory does not exceed the available storage capacity.

3. **Reorder Point Constraint**: Ensures that the inventory level stays above the reorder point.

4. **Non-negativity & KKT Conditions**: These conditions ensure that stock levels cannot be negative, and the solution is optimal under the given constraints.

### 6.3 Implementation

The optimization problem is solved using the **SciPy library** in Python. The optimization method used is **Sequential Least Squares Quadratic Programming (SLSQP)**, which is a gradient-based optimization method suitable for nonlinear problems with both bounds and constraints.

The **Golden Section Search** and **Fibonacci Search** algorithms are used to refine the **order quantity** and **reorder point** values to achieve the optimal solution.

## 7. Results and Discussion

### Cost Reduction

The nonlinear optimization model led to an **18.6% reduction** in total inventory costs compared to traditional EOQ models. This reduction is primarily attributed to **better reorder points** and **optimal order quantities**.

### Improved Reorder Points

The optimized reorder points reduced **missed sales incidents** by **30%**, as the model ensures that inventory is reordered before running out, even during peak demand periods.

### Sensitivity Analysis

The model demonstrated robustness to **demand fluctuations** of **±10%**. Sensitivity analysis confirmed that the optimization results remain stable under these variations, ensuring the model's adaptability to **real-world conditions**.

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## 8. Conclusion

This research presents a comprehensive **nonlinear inventory optimization model** for small retail businesses. By integrating EOQ, ROP, and nonlinear programming techniques, the model provides a practical solution for minimizing inventory costs while maintaining optimal stock levels. The model's robustness is further validated through **sensitivity analysis**, ensuring its applicability in dynamic and uncertain environments.

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## 9. References


1. Harris, F. W. (1913). How many parts to make at once.
2. ResearchGate. (2021). Nonlinear Optimization in Retail.
3. PubMed. (2020). Demand Forecasting and Inventory Control.
4. SciPy Documentation.
5. Lecture Notes on KKT Conditions, JKLU.
6. Nocedal, J., & Wright, S. J
7. Model Implementation and GUI Implementation Code: Google Drive

## 10. Appendix: Data

Below is the **data used for the inventory optimization model**:

**Table 1: Item-Specific Data**

| Item | Monthly Demand (Units) | Annual Demand (Units) | Ordering Cost (₹) | Holding Cost (₹/unit/year) | Volume per Unit (Cubic Feet) | Lead Time (Days) | MOQ (Units) | Importance Factor |
|---|---|---|---|---|---|---|---|---|
| **Bed** | 6 | 72 | 500 | 300 | 50 | 3 | 2 | 1.2 |
| **Sofa** | 7 | 84 | 500 | 400 | 70 | 5 | 2 | 1.2 |
| **Table** | 9 | 108 | 400 | 250 | 60 | 4 | 3 | 1.1 |
| **Office Chair** | 8 | 96 | 300 | 200 | 40 | 3 | 2 | 1.0 |
| **Almirah** | 6 | 72 | 400 | 250 | 30 | 5 | 1 | 1.3 |
| **Stool** | 10 | 120 | 200 | 100 | 20 | 3 | 3 | 1.0 |
| **Shoe Rack** | 6 | 72 | 200 | 100 | 30 | 3 | 3 | 1.0 |
| **Dressing Table** | 5 | 60 | 300 | 200 | 40 | 4 | 2 | 1.1 |

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|---|---|---|---|---|---|---|---|---|
| **Dining Table** | 3 | 36 | 400 | 250 | 50 | 3 | 2 | 1.2 |
| **Study Table** | 6 | 72 | 300 | 200 | 40 | 3 | 2 | 1.0 |
| **Pillow** | 20 | 240 | 100 | 50 | 10 | 3 | 5 | 1.0 |
| **Mattress** | 25 | 300 | 500 | 400 | 20 | 5 | 2 | 1.3 |
| **Bedsheet** | 6 | 72 | 100 | 50 | 10 | 3 | 5 | 1.0 |
| **Wooden Mandir** | 3 | 36 | 200 | 150 | 30 | 4 | 2 | 1.2 |
| **Plastic Chair** | 100 | 1200 | 150 | 75 | 10 | 3 | 10 | 1.0 |

**Table 2: Inventory Parameters (Common to All Items)**

| Parameter | Value (₹) | Description | Source/Justification |
|---|---|---|---|
| Ordering Cost (O) | 10,000 | Cost per order placed with supplier or incurred for in-house production of Almirahs | Based on industry standards including administrative work, transportation, and receiving costs. |

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|---|---|---|---|
| Holding Cost (H) | 8,400 | Cost of holding one unit of inventory for one year | Derived from rent (₹9000/month) and electricity (₹1500/month), allocated equally across all items. |