

## ABC Analysis

ABC inventory control method includes an inventory control system that is used for materials and throughout distribution management. Also known as selective stock control or SIC. ABC analysis is a type of inventory classification method where inventory is divided into three categories, A, B and C, in a descending value. A has elements with a higher value, B has a lower value than A, and C contains the lowest value.

Overall inventory management and improvement is crucial for businesses to help keep their costs under control. ABC analysis works towards this goal by letting management focus most of their attention on the few highest value goods (the A-items) and not on the many low value, trivial goods (the C-items).

It has become an indispensable part of the business and ABC analysis is widely used for unprocessed, manufactured, parts, components, finished elements and assembly elements. The management method divides these items into three categories A, B and C; where A is the most important and C is the least valuable.

### **Item A:**

In the ABC model of inventory control, items classified under A are the commodities with the highest annual consumption value. It is interesting to note that the highest 70 to 80 percent of the company's annual consumption value comes from only about 10 to 20 percent of total inventory items. Therefore, it is important to prioritize these elements.

### **Item B:**

These are the items that have an average consumption value. This amounts to about 30 percent of the total inventory in a company that represents about 15 to 20 percent of the annual depreciation value.

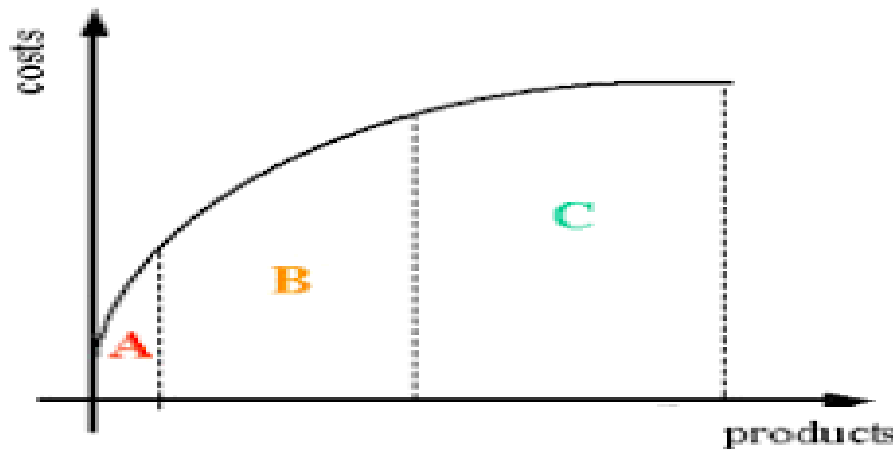
### **Item C:**

The items included in this category have the lowest depreciation value and make up less than 5 percent of the annual depreciation value that comes from about 50 percent of total inventory items.

In order to calculate the annual consumption value of any item or items:

$$\text{Annual consumption value} = \text{annual demand} \times \text{item cost per unit}$$

That way, the manager can determine which goods bring in the most value and separate those from the numerous goods that provide little profit.



### **Policies governing the ABC method**

The idea behind using ABC analysis is to take advantage of sales imbalances. This means that each component must be given the appropriate amount of weight according to its class:

#### **Item A:**

- A) These are subject to strict stock control and are given very safe storage areas
- B) These goods have better sales expectations
- C) These are also the items that require repeated daily or weekly re-ordering
- D) They are kept as a priority item and efforts are made to avoid unavailability or out of stock

#### **Item B:**

- A) These elements are not as important or as trivial as the items in Section A
- B) The important thing to note is that since these elements fall between A and C, they are monitored for possible inclusion in Class A or in a situation contrary to Class C

#### **Item C:**

- A) These items are often manufactured and follow the policy of having only one item on hand or in some cases being rearranged when a purchase has already been made.

B) Since these low-demand goods have a relatively higher cost in terms of excess inventory, it is ideal for these items to be stored after each purchase

C) The questions managers find themselves dealing with when it comes to items in category C is not the number of units that should be kept in stock but rather whether these items are needed in the store at all

### **Advantages of ABC method**

- 1) This method helps companies maintain control over the costly elements in which large amounts of capital are invested
- 2) Provides a mad way to track all inventory. It not only reduces unnecessary employee expenses, but more importantly, it ensures that the optimum levels of inventory are maintained at all times.
- 3) The ABC method ensures that inventory turnover is maintained at a relatively higher level through regular stock control
- 4) Storage expenses are greatly reduced with this tool
- 5) There is a need to maintain adequate Class C stock without compromising the most important items.

### **Disadvantages of using the ABC analysis**

- 1) For this method to work and achieve successful results there must be appropriate standardization of materials in the store.
- 2) Requires a good system of material coding already in operation for this analysis to work
- 3) Since this analysis takes into account the monetary value of the elements, it ignores other factors that may be more important to your business. Thus, this distinction is vital