Inventory: Meaning & Types

Inventory, which describes any goods that are ready for purchase, directly affects an organization's financial health and prosperity. As an accounting term, inventory is a current asset and refers to all stock in the various production stages. By keeping stock, both retailers and manufacturers can continue to sell or build items. Inventory is a major asset on the balance sheet for most companies, however, too much inventory can become a practical liability.

Types of Inventory

1) Raw Materials:

Raw materials are the materials a company uses to create and finish products. When the product is completed, the raw materials are typically unrecognizable from their original form, such as oil used to create shampoo. A company that makes T-shirts has components that include fabric, thread, dyes and print designs.

2)Components:

Components are similar to raw materials in that they are the materials a company uses to create and finish products, except that they remain recognizable when the product is completed, such as a screw.

3) Work In Progress (WIP):

WIP inventory refers to items in production and includes raw materials or components, labor, overhead and even packing materials.

4) Finished Goods:

Finished goods are items that are ready to sell. A jewelry manufacturer makes charm necklaces. Staff attaches a necklace to a preprinted card and slips it into cellophane envelopes to create a finished good ready for sale. The cost of goods sold (COGS) of the finished good includes both its packaging and the labor exerted to make the item.

5) Maintenance, Repair and Operations (MRO) Goods:

MRO is inventory — often in the form of supplies — that supports making a product or the maintenance of a business. Maintenance, repair and operating supplies for a condominium community include copy paper, folders, printer toner, gloves, glass cleaner and brooms for sweeping up the grounds.

6) Packing and Packaging Materials:

There are three types of packing materials. Primary packing protects the product and makes it usable. Secondary packing is the packaging of the finished good and can include labels or SKU information. Tertiary packing is bulk packaging for transport

7) Safety Stock and Anticipation Stock:

Safety stock is the extra inventory a company buys and stores to cover unexpected events. Safety stock has carrying costs, but it supports customer satisfaction. If a raw material's price is rising or peak sales time is approaching, a business may purchase safety stock.

8) Decoupling Inventory:

Decoupling inventory is the term used for extra items or WIP kept at each production line station to prevent work stoppages. Whereas all companies may have safety stock, decoupling inventory is useful if parts of the line work at different speeds and only applies to companies that manufacture goods.

9) Cycle Inventory:

Companies order cycle inventory in lots to get the right amount of stock for the lowest storage cost. As a restaurant uses its last 500 paper napkins, the new refill order arrives. The napkins fit easily in the dedicated storage space.

10) Service Inventory:

Service inventory is a management accounting concept that refers to how much service a business can provide in a given period. A café is open for 12 hours per day, with 10 tables at which diners spend an average of one hour eating a meal. Its service inventory, therefore, is 120 meals per day.

11) Transit Inventory: Also known as pipeline inventory, transit inventory is stock that's moving between the manufacturer, warehouses and distribution centers. Transit inventory may take weeks to move between facilities. An art store orders and pays for 40 tins of a popular pencil set. The tins are en route from the supplier and, therefore, in transit.

12) Theoretical Inventory:

Also called book inventory, theoretical inventory is the least amount of stock a company needs to complete a process without waiting. Theoretical inventory is used mostly in production and the food industry.

A restaurant aims to spend 30% of its budget on food but discovers the actual spend is 34%. The "theoretical inventory" is the 4% of food that was lost or wasted.

13) Excess Inventory:

Also known as obsolete inventory, excess inventory is unsold or unused goods or raw materials that a company doesn't expect to use or sell, but must still pay to store.

A shampoo company produces 50,000 special shampoo bottles that are branded for the summer Olympics, but it only sells 45,000 and the Olympics are over — no one wants to buy them, so they're forced to discount or discard them.