Just-in-Time Inventory:

What Is It and Which Businesses Should Use It?

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Just-in-time inventory is a supply management strategy that schedules products and materials to arrive as they are needed to fulfill orders. This reduces how much inventory is kept on hand and can help small businesses reduce waste, save space and improve cash flow. Instead of ordering a large volume of items, businesses make smaller, more frequent orders to limit their inventory specifically to what they know they will sell.

A company's business model, available cash flow, supply chain and consumer demand can all play a role in how well the method works. Business owners who implement this strategy need to be prepared to track consumer demand and navigate the supply chain swiftly.

How does just-in-time inventory work?

To use just-in-time inventory, a small business decides how much inventory it wants to have available at all times and orders small shipments of material to replace used stock as it fulfills customer orders. Let's look at an example.

Fiona wants to implement just-in-time inventory management in her knitting store. Instead of keeping a large volume of stock on hand, as she had previously, she decides to keep only a month's worth of inventory at a time.

After averaging out the monthly sales for each item, she adjusts her inventory orders over the next quarter until she has only enough of each item in stock for a month's worth of sales. At the end of each week, she orders replacements for what she's sold that week so that she constantly restocks to keep a month's inventory in her store.

This allows Fiona to invest a smaller amount upfront, improving her cash flow and allowing her to make profit before investing in more inventory each time.

Nerdy tip: Some small businesses that specialize in custom orders, such as an at-home cake business, might find that a similar approach of only ordering materials after a customer submits an order works better. Rather than replacing all of the materials that were used in the last order, the baker can purchase all of the ingredients after receiving an order so there is no risk of unused ingredients and wasted investment.

"If every day you replenish what you consumed, then you would need less inventory and you could adjust dynamically," says Dr Lisa Lang, who has a doctorate in engineering management and is president of Science of Business, Inc., a Theory of Constraints consulting company that has helped small businesses implement the just-in-time method.

For small businesses, the benefits of just-in-time inventory management include:

- Reducing waste by not over-ordering or having goods expire or go unpurchased.
- Minimizing inventory storage cost by housing a smaller inventory.
- Freeing up physical space that can be used for other operational purposes.
- Creating available cash to use for other operating costs, such as labor.

Just-in-time inventory management also creates flexibility for seasonal changes. In the same way that stores stock up on candy in the month leading up to Halloween, you can build up inventory for temporary changes in customer demand, says Lang, who is certified by the Theory of Constraints International Certification Organization, which aims to minimize bottlenecks in companies. In the example of Fiona's knitting shop, she can easily review her sales from the previous holiday season and order a little extra to account for the surge in customer demand.

What are the disadvantages?

These potential disadvantages do not occur for every business, but it's important to understand what can go wrong with this method. Have a plan in place in case you encounter:

- Higher spending on inventory rates if you switch from buying in bulk to smaller, more frequent orders.
- Supply chain disruptions that are beyond your control. Think COVID-19 or natural disasters.
- Running out of inventory if you do not accurately track sales or forecast customer demand.

Businesses that can benefit from just-in-time inventory

Small businesses that have regular sales and want to keep tabs on cash flow are good candidates for a just-in-time inventory strategy, especially if they find their inventory often sits for long periods.

Good Promotional Products, a provider of customizable merchandise for businesses, once had offices full of unsold products, said Joe Bass, CEO and founder, by email. Switching to just-in-time inventory helped.

"When I just ordered as much as I knew I needed, it freed up a lot of my office space as I didn't have a lot of unordered products just sitting around," Bass said.

But retail businesses aren't the only ones benefiting from rethinking their inventory management. Several business models have found just-in-time inventory helpful in lowering costs and creating a more streamlined process, including:

- Automotive repair.
- Bookstores.
- Coffee roasters and coffee shops.
- Construction.
- Florists.
- Manufacturing.
- Independent publishers.

Businesses that should avoid just-in-time inventory

Businesses that source materials internationally. For Illuminate Labs, a dietary supplement manufacturer, the need to frequently order materials internationally made the just-in-time method overwhelming.

“Dealing with suppliers is a time-intensive process,” says Calloway Cook, the company’s founder. By choosing to keep a lot of stock on hand, he says the company has been able to focus its efforts on scaling the business instead of worrying about long lead times from international suppliers.

Businesses that only process a handful of orders annually. A just-in-time inventory strategy tends to be “less effective for slow movers,” Dr Lisa Lang says. “This is for the fast-to-medium movers, where you replenish more frequently.”

Businesses with certain operational limitations. You might want to wait on implementing the method if you:

- Can't delay orders without drastically impacting business.
- Don't know how to track customer demand to anticipate inventory needs.
- Aren't confident in your supply chain to deliver on time.
- Don't have reliable employees who communicate well about supply issues.

What to do before implementing just-in-time inventory as a small business

Small businesses should ensure the following operational areas are working before implementing a just-in-time inventory approach.

Test your turnaround time

When you receive inventory just before you need it, you may still need time to create products and provide services using the materials you ordered. Research and test your process to be confident that you are able to get orders out the door on time without a large inventory.

Track consumer demand

Know how to gauge consumer demand for your products and how to anticipate changes in customer purchase patterns. Many point-of-sale software options include inventory tracking features; you can also use an inventory management app.

Some businesses replace the inventory they just used to fulfill customer orders; other businesses prefer to forecast inventory needs by averaging monthly totals and noting seasonal sales from previous years.

Find reliable suppliers

With such a tight turnaround time, you need dependable vendors that will deliver inventory when needed. If they can't, a just-in-time inventory strategy can fall apart. If your suppliers are inconsistent about deliveries, consider changing providers before implementing the new system.

Have a plan for supply chain disruptions

You must be able to adapt to supply chain disruptions and find alternative vendors when material orders are delayed or canceled despite your supplier's best efforts. Make a plan about how to respond to a bad situation to avoid delayed orders.
