

Is Inventory Really an Asset? (Most Business Owners Get This Wrong)

Let's talk about something that might seem straightforward on the surface, but actually has a lot of depth. Inventory. Is it an asset or a liability?

Technically, inventory is an asset. You'll find it listed on your balance sheet under current assets, because it's something your business plans to sell or use within a year. But that's not the full story. Inventory represents future value. It's the products you plan to sell and the materials you'll turn into finished goods. It's tied directly to your ability to generate revenue, but it also ties up cash. You've already paid for it, and until it moves, that money is not coming back.

How you value your inventory also makes a difference. There are three main methods: 1) First In, First Out, 2) Last In, First Out, and 3) Weighted Average method.

First In, First Out, also known as FIFO, assumes the oldest inventory gets sold first. When prices are rising, FIFO usually results in higher profits on paper.

Last In, First Out, or LIFO, uses the most recent costs first and can lower your reported income and taxes when prices increase.

And finally, there's the Weighted Average method, which smooths things out by averaging the cost of all of your inventory over time.

No matter which method you use, tracking inventory turnover is key. That's how often you're selling and replacing your inventory. A high turnover usually means strong sales. A low turnover might point to overstocking or slow moving parts. This is where inventory can start to feel like a liability. If it sits too long, becomes outdated or gets damaged, it may need to be written down. That impacts your financials and can even skew your understanding of the business performance.

So, is inventory an asset or a liability? The answer is: it depends, and how well it's managed. When you stay on top of turnover, choose the right valuation method, and avoid letting products collect dust, inventory stays a valuable part of your business.

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