# *JS PG COLLEGE, SIKANDRABAD, BSR*

## ***REORDER LEVEL ………….***

In management accounting, reorder level (or reorder point) is the inventory level at which a company would place a new order or start a new manufacturing run.

Reorder level depends on a company's work-order lead time and its demand during that time and whether the company maintain a safety stock. Work-order lead time is the time the company's suppliers take in manufacturing and delivering the ordered units.

Identifying the correct reorder level is important. If a company places a new order too soon, it may receive the ordered units earlier than expected and it would have to bear additional carrying costs in the form of warehousing rent, opportunity cost, etc. However, if the company places an order too late, it would result in stock-out costs, for example lost sales, etc.

## Formula

Reorder level depends on whether a safety stock is maintained.

If there is no safety stock, reorder level can be worked out using the following formula:

**Reorder Level = Average Demand × Lead Time**

Both demand and lead time must be in the same unit of time i.e. both should in in days or weeks, etc.

If a company maintains a safety stock, reorder level calculation changes are follows:

**Reorder Level = Average Demand × Lead Time + Safety Stock**

## Examples

**Example 1:** ABC Ltd. is a retailer of footwear. It sells 500 units of one of a famous brand daily. Its supplier takes a week to deliver any ordered units.

The inventory manager should place an order before the inventories drop below 3,500 units (500 units of daily usage multiplied with 7 days of lead time) in order to avoid a stock-out.

**Example 2:** ABC Ltd. has decided to hold a safety stock equivalent to average usage of 5 days. Calculate the reorder level.

Safety stock which ABC Ltd. has decided to hold equals 2,500 units (500 units of daily usage multiplied by 5 days).

In this scenario, reorder level would be 6,000 units (2,500 of safety stock plus 3,500 units based on 7 days of lead time).