Financial Returns to Household Inventory Management

Abstract

Households tend to hold substantial amounts of non-financial assets in the form of consumer goods inventories that are unobserved by traditional measures of wealth, about $725 on average. Such holdings can eclipse total financial assets among households in the lowest income quintile. Households can obtain significant financial returns from shopping strategically and optimally managing these inventories. In addition, they choose to maintain liquid savings---household working capital---not just for precautionary motives but also to support this inventory management. We demonstrate that households with low levels of inventory earn high marginal returns from investing in household working capital, well above 20%, though these marginal returns decline rapidly as inventory increases. Nevertheless, average returns from inventory management affect household portfolio returns substantially for all but the top income and asset quintiles. We provide evidence from scanner and survey data that supports this conclusion. For many households, working capital is therefore an important asset class that has been largely ignored by the household finance literature, and inventory management provides them with an alternative to investing in risky financial markets at low levels of liquid wealth.

This paper is joint work with Scott Baker (Northwestern University and NBER) and Stephanie Johnson (Rice University, Jones Graduate School of Business).

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