CHOOSING THE RIGHT SUPPLIER

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Are you a buyer of product or an investor of company money? This is the question I invite all purchasing professionals to ask themselves. Those of you who are familiar with my inventory management philosophy know that I am constantly asking buyers to look beyond the clerical function of the job. We buy sophisticated computers to handle those mind numbing tasks. The fact that many distributors do not use their software to free up the buyers time is a whole other can of worms. When you make the move to investor of company money, don't be satisfied with price analysis alone. When did we develop this myopic view about the role of the inventory investor? If you are just focused on saving the net price nickels, you are missing the big dollars available in total return on inventory investment.

Total return on investment is achieved by working with suppliers who support your overall inventory replenishment goals. Do they ship complete? Do they have consistent lead times? Do you get the products you ordered? Do they help you manage your dead and slow moving inventory? When we choose suppliers that do not live up to these ideals, there is a cost. We invest money to cover up these substandard practices. This investment comes in the form of safety stock. Bear in mind, safety stock is an insurance policy designed to protect our customer service goals from poor performing suppliers. I sure hope our insurance premium is smaller than the percent we saved in net price. If you really go back and do the math, you will start to understand the value of those suppliers who give you a total return on investment.

I recently had the opportunity to spend some time with a supplier who exemplified what I am looking for in a total return on investment. This is a company that understood the cost structure of a distributor. Let me ask you something. When was the last time a manufacturer understood the terms: inventory turn, carrying cost and gross margin return on investment. When most of us mention relationship concerns in any of these areas, the majority of our suppliers look like a deer in the headlights. It just isn't where they are trained. Uh, I don't know about that, I just sell stuff.

One of the most frustrating things I experienced as a purchasing professional was erratic lead time. Early on, I was naïve enough to believe that I could guess on an arrival date by looking at the geographical distance between myself and the manufacturer. What I failed to understand was the time it took for my order to get out the door of the supplier. If my customer called at noon, they expected it to ship the same day. It was a customer service expectation. When a supplier doesn't ship quickly, what does it really cost us?

Let's say that I have two suppliers in Charlotte and I am located in Seattle. Supplier A ships in 24 hours. Supplier B ships in 3 days. Both have the same transit time to Seattle. In order to meet my customer service obligations, I will need to order Supplier B 3 days sooner than Supplier A. I will have 3 days more inventory in my facility when I have to make the investment to Supplier B. What is the carrying cost on that 3 days of inventory? Do I really trust that they will get my order out the door in 3 days? Been burned enough times on that one. Since I can't trust Supplier B, I need to insure my customer service obligation. Let's add a couple of days of safety stock. Now I have 5 extra days of inventory accumulating carrying costs. Are you getting the picture here?

Just to make sure that we are on the same page, carrying costs are the dollars we invest to feed, clothe and shelter the products we bring into stock. It is usually represented as a percentage of overall inventory dollars. That percentage can fluctuate between 20-30% of inventory value. Some of the components include: rent, insurance, interest, labor, shrinkage and opportunity cost. The longer we hold on to something, or the more we have, carrying costs escalate. This is the hidden cost behind every inventory management decision.

We are all familiar with Supplier B. The industry is littered with them. With ever tightening margin pressure, can you really afford to subsidize an erratic shipper? One of the things I really liked about this enlightened manufacturer is that they call penalties on themselves when they do not perform. If they do not meet their order fulfillment guarantees, they discount the invoice by 5%. In an industry where the margins tend to hang out in the low teens, this is a fairy stiff penalty. I am not sure how many times they have had to honor the discount, but it is nice to see a supplier put their money where their mouth is. Do any of your current suppliers guarantee their shipping commitments?

What is the biggest killer of inventory turns in a distribution company? Besides the gut level SWAG (silly

wild assed guessing) that many buyers substitute for purchasing logic, dead and slow inventory is like an anchor when it comes to spin. By the way, the SWAG method tends to breed large surpluses as well. Good investors of inventory understand that inventory turn is a key component in determining the return on investment. If you can turn the inventory faster, gross margin pressure is less critical. Remember, your gross margin is often dictated by the marketplace. A large portion is controlled outside of your four walls. Inventory turn is largely controlled by your company and the suppliers you choose to partner with.

How can a supplier affect inventory turn? Earlier in the article, we talked about their ability to get orders out the door quickly. This allows us to slim down the average investment in the line and inventory will turn more quickly. Again, the greatest inventory turn gains are achieved by removing dead and slow inventory from a line. What is the return policy of your current supplier? Do you have to jump through several hoops and pay a restocking charge? Do they run you around until you eventually get tired enough to quit asking? All of you have had these relationships. The company I spoke to takes responsibility for their products in a distributorship. They have a fairly simple policy – if you can't sell it, they can. Choose the folks that support your need to return unproductive inventory.

VMI or Vendor Managed Inventory is one of those concepts that many distributors shy away from. The basic concept behind VMI is simple. The supplier takes over the fulfillment function of the inventory management process. The distributor supplies the vendor basic sales transactional data. The supplier runs it through their purchasing algorithm. Inventory is fed to the distributor as needed.

The theory looks good, but many distributors are scared to give up that much control. There is a fear that the supplier will just load them with more inventory in order to make their own sales goals. In order to combat this, most VMI relationships have very specific inventory turn goals. If you expect 6 or more turns, the supplier better be very cautious about loading you up.

Although most manufacturers have a relatively low percentage of customers using their VMI solution, it is really the next step in the relationship. This is the program that cements the partnership between distributor and manufacturer. Sure, it ties you to one brand in the marketplace. But let me ask you this, how many of your current lines turn 11-13 times per year?

Some of you might know that I have been on a campaign for the last few years to teach manufacturers, particularly their sales representatives, how distributors really make money. I encourage them to be more consultative, rather than product focused. Start to look for those suppliers that support your need for total return on investment. Challenge your current suppliers to become more distributor driven in their approach. You will quickly separate the wheat from the chaff.