IDEA
rethinking retail

Supplier Reliability - Or Lack of It

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This article will address issues caused by poor supplier due date performance on various types of businesses. Also covered will be the effect of these businesses' natural reactions and their consequences. Once the undesirable effects are detailed, it would be cruel not to suggest some ways to permanently improve the situation.

Every company that deals in physical products must manage the consequences of supplier unreliability. Late shipments can shut down production, short deliveries may cause you to run out before the next shipment arrives and you have the hassle and expense of expedited deliveries. At retail, unreliability can mean stock outs, which in the extreme case can cause you to lose a customer for life. This problem exists for manufacturers, distributors, large and small businesses, and ones that do business domestically or internationally.

The natural reaction to late delivery is to hold more inventory but how much more safety stock can you afford? In many competitive arenas, holding more requires so much investment that the returns are too low to make sense. If this sounds familiar, you are fighting against the perpetual conflict that comes from increasing inventory to protect sales versus reducing inventory to meet the financial expectations of your business. The conflict is frequently exacerbated due to fickle demand and replenishment that sometimes just takes too long.

If you have been around for a while, you have likely noticed that the sales versus investment clash makes for different actions at different times. Like a pendulum swinging, there are times when the company has prioritized sales and bought piles of inventory to support growth and then other times when surpluses, discounting and disposals are high and overflowing warehouses and carrying costs force fiscal restraint as the order of the day. Making a compromise has a severe impact on your business. But, unless you have found a permanent solution, you have never experienced the improved state. Your only frame of reference is an impaired one.

So, what else could you do? You could add suppliers, force them to compete and even replace them. But now you have the hassle of having to find supplementary or replacement suppliers who must be qualified for your requirements. Probably you picked the best supplier already. If you fire the old and hire the new, can you expect better performance? With respect to purchased product quality, you will face having to convince your production people, in the case of raw materials, or your customer, in the case of finished goods, that the new product is as good and can deliver the same results. The effort is expensive, disruptive and time consuming and often results in similar supplier unreliability problems or even worse.

What we have discussed so far usually does not make things better. Yet, walking too close to the definition of insanity: *taking the same actions over and over and each time expecting a different result*, most companies stay on the same old treadmill and make no progress. To avoid a life of futility and finally make some real progress requires another approach.

We want lasting improvements which require a win-win solution for you and your supplier. The solution must result in lower inventory for you along with much better availability. While we are at it, if we really want to have our cake and eat it too, the approach's savings ought to exceed its costs. If we can achieve all that, profitability will improve due to increased sales (in response to better availability) as well as lower costs and investment will be lower, hiking return on investment.

IDEA offers a complete turn-key approach but here are some actions you can take on your own.

1. First, work with your suppliers to set your prices based on annual purchases, not order size. Now that there is no longer an incentive for you to place large orders, place smaller orders more frequently. This step by itself will improve availability and lower inventory.

2. For every SKU you buy and in every location where you keep it, determine the most you expect could be consumed in the supplier's average lead time. Then, add to that amount the expected consumption during the period of time they might be late. The sum is an ordering Target for each item.

3. As soon as you can develop the capability, send to your suppliers the amount of their product you consume each day. It can usually be handled electronically, without human intervention. This makes a huge difference to them (you may have to explain it) because they can smooth the demand on their plant. The typical approach is to place a blanket order with the supplier and tell them to consider your daily consumption as a release against that purchase order. Delivery frequency should be chosen to improve your return on inventory investment. If you buy 50 truckloads from the supplier each year, it probably makes sense to authorize them to ship when your accumulated releases will fill a truckload. Deliveries should arrive about once a week.

4. When not to order: if the inventory on hand is ever more than the Target, quit sending consumption (orders) until your on hand inventory drops below the ordering Target. Order exactly enough so that the on hand plus the orders placed and still inbound are equal to the Target. (In the cases where you still have a minimum order quantity, order the MOQ as soon as demand pulls on hand below the Target.)

5. Periodically, correct the Targets for changes in reality. If on hand inventory for an item falls to less than 25% of the Target, raise the Target by 1/3. If the on hand inventory remains above 66% of the Target for the supplier's lead time, reduce the Target by 1/3. After any Target change, don't reset the Target again until two lead times have passed.

If these five rules are followed, you can expect shortages to decrease to a fraction of their current levels while inventory drops in half. The result will be a nice increase in sales and profits because less business will be turned away. Inventory turns will double, producing significant cash.

Once your suppliers get daily demand, they will no longer be surprised by your orders. They can plan production more easily and have less emergency orders. Less rush orders mean fewer disruptions to their production and better due date performance. You are selling more and that means they sell more to you. Everybody wins. Nice huh? Try it. Call us if we can help.

IDEA'S WAY OF THINKING

- *Neither an accurate forecast nor changing vendors is required for success*
- *There is a way to both increase sales and reduce inventory*
- *Supply chains sell less when clogged with inventory*
- *In the long term, unless the supply chain sells more no link can sell more*
- *We must help clients gain buy-in internally and with supply chain partners*
- *The majority of our fees are based on improved return on inventory*

IDEA'S METHOD

- *Verify the existence of inventory imbalances and the benefits of moving from a "Push" to a "Pull" system*
- *Gain top management buy-in to the assessment and support of the approach*
- *Build knowledge and understanding across the supply chain, at all levels*
- *Utilize systems that deliver actionable information, integrated with existing software*
- *Work with you until expected results are achieved*
- *Share the tools and know-how to continually improve results*

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