

THE WHOLESALER

Innovative Programs

Legend Valve

Total return on inventory investment

BY JASON BADER

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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



David Hickman (left), CEO of Legend Valve, and executive vice president Walter Jann take pride in the value their products and programs offer to customers.

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

Legend Valve puts faith in VMI

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 that exemplifies what I am looking for in a total return on investment – Legend Valve. This is a company that understands the cost structure of a distributor. Let me ask you something. Do your manufacturers understand the terms inventory turn, carrying cost and gross margin return on investment? When distributors mention relationship concerns in any of these areas, some of our suppliers look like a deer in the headlights. It just isn't where they have been trained; their focus has been to sell stuff.

I usually refrain from talking about any supplier by name, but this is a unique situation. Legend Valve is expanding on its Downstream Thinking Initiative by actually quantifying the cost of poor supplier performance, a concept that literally mirrors the inventory management philosophy I have been teaching for the last several years. This extension of their Downstream Thinking program is a tool that they provide customers – at no charge – that enables them to measure all of their vendors' performance by simply inputting supplier-specific data. It's all about educating distributors on the true cost of inventory management and why Legend provides a better return on investment. This is from a manufacturer of a product often considered to be a commodity. I should be careful here. I have been getting paid to edu-

cate distributors on these concepts for several years. These guys are giving it away for free.

One of the most frustrating things I experienced as a purchasing professional was erratic lead times. 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

can't trust Supplier B, I need to ensure 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%

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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 on the East Coast and I am located in the West. Supplier A ships in 24 hours. Supplier B ships in 3 days. Both have the same transit time to my warehouse. 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

and 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.

Unfortunately, we are all familiar with vendors like Supplier B. With ever-tightening margin pressure, can you really afford to subsidize an erratic shipper? One of the things I really like about the folks at Legend Valve 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

VMI a new direction for Legend Valve

is a fairly stiff penalty. It is nice to see a supplier put their money where their mouth is.

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 more surplus than anything else. 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,

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your gross margin is often dictated by the marketplace. A large portion is controlled outside 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 are the return policies of your

current suppliers? Do you have to jump through several hoops and pay a restocking charge for any of them? Do any of them run you around until you eventually get tired enough to quit asking? Most likely, all of you have had these relationships at some point or another.

When choosing your vendors, look to the folks that support your need to return unproductive inventory. Legend Valve takes responsibility for their products in a distributorship. David Hickman, CEO of Legend Valve, outlined their straight forward policy with this simple statement: "If you can't sell it, we can." He also likes to use this gem with his own people: "The ultimate ruse being perpetrated against wholesaler distributors is the cost of poor performance being hidden by a low price."

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 Legend Valve has a relatively low percentage of customers using their VMI solution, it is really the next step in the relationship, according to Walter Jann, executive vice president. This is the program that really cements the partnership between distributor and manufacturer. Sure, it ties you to one guy in the marketplace. But let me ask you this, how many of your current lines turn 11 to 13 times per year?

Some of you might know that I have been on a campaign for the last few years to teach manufacturers, and particularly their sales representatives, how distributors really make money. I encourage them to be more consultative, rather than product focused. The Downstream Thinking initiative from Legend Valve is the best example of a manufacturer putting this into action. As they roll out the program, I encourage you to give them the opportunity to show you where total return on investment beats net price every time.

Good luck. ■

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