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# Retail a Big Dilemma Buyin

**Jack Summersell**

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ave you ever given much thought to your ordering frequency? Does it really make a difference if you order from a supplier three times a year as opposed to say 10 or 12 times a year? I’m specifically talking about supplier orders for product intended for display on your showroom floor – not special orders.

Based on a recent survey, most “small” dealers (under \$500k retail) simply order from a particular supplier when they are low on stock - low enough to be able to “work up” an order or reach a free freight threshold. Some dealers simply wait for the next promotion to come around – which could be three or four months away.

While such “restocking triggers” seem to be practical and based on common sense, they do not typically result in effective inventory management. And effective inventory management is a major — and yet largely overlooked — key to maximizing profit as well as ensuring the survival of the business.

Infrequent ordering tends to lead to a situation where the dealer’s stock levels move from one extreme to the other - overstocked at the beginning of the cycle to under-stocked towards the end of the cycle. In extreme cases a dealer may order only two or three times a year from a supplier. This is driven from an over-emphasis on discount and lack of emphasis on effective inventory management, and is a major problem in the educational dealer channel today.

Here are a few of the problems created by the prevailing method of ordering (i.e. frequent large orders):

1. Forecasting: If you are a stocking dealer, then you are in the forecasting busi-

ness, like it or not. It is a fundamental challenge of any inventory-carrying business to estimate the product demand for the future. When we stretch the ordering cycle out to three, four or even six months, we compound this issue greatly.

**Question to ponder:** Have I ever experienced the challenge of trying to decide what quantity to buy, knowing full well that I won't be able to order from the particular supplier again for several months?


2. Lost Sales: If you are estimating your stock needs for three or four months at a time, you are almost certain to err on the low side on certain items. This leads to "holes" in your shelf while you are waiting to "build up" an order that will be large enough

bin at 25 percent off, 50 percent off or even 75 percent off. Some of it you may donate or discard. All of these options lead to reduced profit margins and reduced profit.

Even worse, some dealers hang on to this old stock like it was their best friend (the truth is that we are procrastinating "taking the hit" on the bottom line that occurs when we dispense of this excess stock). This is worse (hanging on to "dead" stock) because it ties up our cash and shelf space, preventing the healthy flow of goods through the retail store. Remember, the older stock gets, the less it is typically worth (obsolescence, aging, shrinkage, etc). Again, the longer the ordering cycle, the worse this problem of overstock gets.

each at a time, sell down to zero, then order 10 each again. They do this 12 times throughout the year. This dealer has only five each on hand on average, thus tying up only \$50 cash ( $\$10 \times 5$  each) on average. That's a cash savings of 75 percent compared to the example above (i.e. \$50 investment vs \$200).

So, if you've got \$200,000 in inventory on hand, with an excessively long ordering cycle, you might be able to service the same sales with an investment of only \$175,000 or \$150,000 by improving your ordering cycle moderately. Obviously, I have made several simplifying assumptions in this example. However, the fundamental principle holds: frequent ordering in smaller quantities results in greater inventory turnover, and thus less investment in inventory. This leads to better cash flow.



A dealer using a properly structured wholesale purchasing program will be more profitable, more solvent, have better cash flow and an easier time managing their inventory than one without such a program, all other things being equal.

to reach that free freight level or that promotional extra discount level. Those holes lead to lost sales which mean reduced profitability. This can happen to anyone. The point is, the longer the ordering cycle, the worse this problem of lost sales becomes.

**Question to ponder:** Have I ever considered that my purchasing methodology may be causing me to lose revenues?

3. Overstock: On the other hand, you are almost certain to err on the high side on other items. Here's the scenario. You've been burned by guessing too low on quantities, so you bite the bullet and order quite liberally. This works great for some items. But on other items, you end up with excess inventory at the end of the year. What happens to that stock?

Eventually you sell it in a clearance

**Question to ponder:** Have I ever felt like I was carrying too much excess inventory?

4. Cash flow: The dealer who orders three times a year is going to tie up more cash than the dealer who orders every month. Consider a hypothetical \$20 item (\$20 retail, \$10 cost) that sells 120 times a year. Inventory levels for the dealer who orders three times a year goes like this (roughly speaking): order 40 each then sell down to zero, order back up to 40 each, then sell down to zero, order 40 more and sell back down to zero (40 comes from dividing 120 unit sales per year by three supplier orders per year). On average, this dealer has 20 each on hand, or \$200 cash ( $\$10 \times 20$  each) tied up in the item on average all year. In contrast, the dealer who orders every month follows a similar up and down cycle. However, they order only 10

**Question to ponder:** Would my business benefit from improved cash flow?

Now that we can clearly see the issues that are affecting our bottom line, our cash flow and even our daily stress level, let's examine possible solutions. The logical question is: why not order every two weeks (or such) from every supplier? Clearly, this would minimize our average investment in inventory, smooth out our cash flow, minimize lost sales during order build-up and minimize excess inventory.

Unfortunately, this is simply not practical. First of all, you would never build up a large enough order to meet the supplier's free freight level (which is a key point - if you are paying inbound freight on your purchases, you are at a distinct disadvantage). You might not even meet their minimum order size if you ordered every month, for example.

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Even if you could get free freight from the suppliers on very small orders, it would not be practical to order from every supplier on a frequent basis because you would never get anything else done. You would spend your entire day placing orders, receiving orders, putting up stock, paying many small bills, etc.

So the BIG DILEMMA is this: if I place a few large orders each year, I can potentially get promotional extras such as free freight and extra discounts, but I will have poor inventory control leading to lost sales and excess stock — which results in markdowns which defeat the purpose of the extra discounts; on the other hand, if I place smaller frequent orders, I will maximize inventory turnover, maximize sales and minimize overstock issues, yet I will get “eaten up” by freight expenses and spend too much of my time ordering and receiving.

Allow me to propose a solution to this dilemma that manages to accomplish the best of both worlds: you get all the benefits of a frequent ordering method (steady cash flow, minimal missed sales due to holes in the shelf, minimal excess inventory, good inventory turnover, all leading to maximized profit) but none of the problems discussed in the above paragraph - namely freight expense. The answer is a WHOLESALE PURCHASING PROGRAM through a wholesaler/distributor. This has worked in the office products industry successfully for decades and is sorely needed in the education market.

By “wholesale purchasing program” I mean an organized approach whereby the dealer diverts 5 to 20 percent of their direct supplier purchasing to a wholesaler/distributor. It works like this: the dealer continues to order the vast majority of his/her shelf-stocking inventory direct from the supplier. However, he/she orders much more conservatively - you buy in smaller quantities such that you have a high level of certainty that you will be able to sell everything you buy before your next direct order. Where you “guessed low”, you order from the wholesale

distributor to keep your shelf stocked continuously. The key is to establish a regular weekly free freight order from the wholesale distributor. The goal is for you to virtually eliminate your freight expenses. This provides a reliable, one-stop-shop source of to quickly fill in the holes on you shelf so they do not linger.

The comment dealers normally offer at this point is: I cannot make as much money if I buy at 45 percent off from a wholesale distributor. While it is human nature to try to get the best discount, we must think deeper to get to the correct answer. A dealer using a properly structured wholesale purchasing program will be more profitable, more solvent, have better cash flow and an easier time managing their inventory than one without such a program, all other things being equal.

Let’s look at an example. Consider a hypothetical wholesale distributor price plan where you get 45 percent off retail and free freight at \$400. And let’s consider a dealer who spends \$100,000 in total purchases each year. What is the actual up-front cost to that dealer in order to participate in a wholesale purchasing program? Assuming the dealer diverts 5 percent of their direct purchasing through the wholesaler, that’s \$5,000 in purchases. Instead of buying that \$5,000 of merchandise at 50 percent off, they buy at 45 percent off. So it is going to actually going to cost \$5,500. So the premium to participate in the program is only \$500 for the year — on the surface.

If we look deeper, that \$500 will be made up potentially many times over during the year. First of all, look at your freight expense for the year. For most dealers, annual freight expense itself far exceeds \$500. Under a wholesale purchasing program, you have little or no freight expense because you will be sending free freight orders direct to the supplier several times a year, and getting all the small fill-in inventory through your wholesaler free of freight. Since the wholesaler carries all the vendors under one roof, you are able to reach the free freight level (\$400 in the example) very easily because you are working up an order for your entire store. Also, you will make up the \$500 as your sales increase as a result of always having a full compliment of stock on your shelves. You will also make up the \$500 by virtually eliminating your clearance section.

And, perhaps most importantly, you will improve the chances for long-term health of your store. Based on the aforementioned survey, the primary reason educational dealers go out of business is poor inventory control. The classic case goes something like this: the dealer pays relatively little attention to inventory turnover and proper inventory levels. Instead, they jump at every opportunity to receive an extra discount and at every extra dating program. All these habits tend to lead to excess inventory which becomes the demise of the business.

Until very recently, these types of programs were not available from wholesaler/distributors in the education market. The true wholesale distribution function is rapidly developing. In just the last year, hundreds of dealers have begun to take advantage of these new programs.

If you answered “yes” to one or more of the four “questions to ponder” above, I encourage you to contact your wholesaler/distributor and inquire about such programs. Make certain that you partner with a wholesaler/distributor that fully understands this business model and is committed to making it work for the dealer. A wholesaler/distributor that is not committed to this process may not have the breadth of inventory, inventory control expertise and educational/training support that you will need in order to be successful. If you are not certain which wholesaler/distributor you should choose, a good place to start would be to survey the sales representatives of your key suppliers. It is important that the program be fully supported by your suppliers.

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Jack Summersell is VP of Operations for Educators Resource, a 30 plus year old, family owned and operated wholesale/distribution firm that has been 100 percent committed to the school market for more than a decade. Readers interested in further discussion on this topic can reach Summersell at [jack.summersell@edresource.com](mailto:jack.summersell@edresource.com).