The Benefits of Using *Quick-Ship* Suppliers

By Steve Adams

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WHEN THE MARKET SHRANK IN 2009 AND 2010, many door and hardware distributors adopted a "low price" strategy to survive. Sales have improved somewhat since then, but profits have not returned to historical levels. Faced with weak margins, distributors now have three choices of how to raise profits: lower costs further, raise prices, or shift to a higher-margin business strategy based on better service.

The services most valued by DHI members' customers are:[1]

- A high fill rate
- A wide assortment of products
- Fast delivery
- Accuracy in order filling

Offering these services on your own can require lots of inventory, extra building space for racks and shop space, extra staffing and consistently high utilization. This can get costly. To always be fast requires constantly being staffed for the peak load—costly, too. To offer a wide assortment of products and always be accurate takes skilled people, sophisticated equipment and extra operational risk.

Instead of increasing operating costs and risks, there is a great alternative. Quick-ship and custom manufacturers can provide all the high-value services that customers want while keeping a distributor's operating costs low.

Most folks view using quick-ship as a necessary evil to keep customers happy while giving up margin in the process. Sometimes that is true, but there are a number of ways to use quick-ship and actually increase profits. This article discusses five of these benefits, and although not every company could implement all of them, most companies could increase profits from implementing some of them.

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1. Lower inventory. By keeping only the fast-moving products in stock, you can lower your inventory significantly. This can create immediate savings by increasing your inventory turns and, in turn, cash flow, as less of your resources are tied up in inventory. Using the "80/20" rule, the distributor keeps 80 percent of common fast-moving items in stock and then uses a trusted quick-ship partner to supply the various slow-moving items. This works when the quick-ship partner performs virtually 100 percent on-time and complete in lead times as fast as the next day.

With this savings, you now have a few new options:

- With lower overhead costs, you have money available to pay for quick-ship frames or doors as needed.
- With total overhead lower, you may be able to lower your prices to win new business.
- Keep your prices the same and immediately increase your net margin/profit on each project.
- Use the extra warehouse space in other ways (i.e., staging larger projects, coordinating material for deliveries, adding another fast-moving product line, etc.).
- Take advantage of a smaller footprint by moving to a smaller space, and save on your leasing costs.
- Take the one year "big win." For example, reducing your inventory from $500,000 to $300,000 could net you as much as $200,000 in the first year. Remember, that $200,000 will buy you as much as $400,000 worth of quick-ship at the same margin as your present scenario.

2. Reduce payroll and shop expenses. There are a number of ways to reduce payroll and operating expenses without sacrificing service. Payroll can be more than 70 percent of a distributor's total expense load, and small changes can lead to big swings in profit.[2] Payroll costs include base wage, health insurance and similar benefits, workman's compensation costs, FICA contributions, vacation and holiday pay, etc. Add in shop operating expenses, and that is most of the distributor's cost structure.

As with inventory reduction, using a smaller shop or putting more volume through an existing shop frees resources for better uses and increased utilization. Both of these drop dollars straight to the bottom line. And just as there is an 80/20 rule for inventory, there is an optimum shop capacity. In most cases, the optimum will be the same as minimum demand. That places the optimum well below the peak, and thus it becomes more effective to pay up to two times the potential cost of material versus paying underutilized people and equipment.

Here is an example for a hollow metal shop that needs one extra person to assure 100 percent service levels. Say that person costs $20 per hour. Take that $20 x 1.5 (benefits and other operating expenses per above) = $30 per hour, or about $60,000 annually. Add this $60,000 cost to as much as $100,000 of stock material, and that is the same as buying $160,000 annually from a quick-ship custom partner. This "break even" is just for fabricating stock material and does not include any of the other benefits of using a quick-ship partner.

This kind of outsourcing is a successful operating strategy used by distributors ranging from start-ups to some of the nation's biggest distributors. It is especially good when a company is going through rapid growth, is experiencing temporary surges in demand (i.e., summer volumes), or when serving customers beyond the reach of existing shops.

3. Reduce risk/exposure. As already noted, running a large shop has the risk of fluctuating demand. Running a shop also has the risks of losing key people, absenteeism, equipment failures and material shortages, not to mention fabrication mistakes, injuries from accidents, and other product and personal liability issues.

When a vendor is the source for complex items, it also takes on all of the associated risks. To manage these risks, it may make sense to use the same 80/20 rule used to

The 2013 DHI **Profit Improvement Report** notes that customers rely on distributors to provide services that make their lives easier. In order of importance, those services are:

- A high fill rate (service level)
- A wide assortment of products
- Fast delivery
- Accuracy in order filling

The challenge, according to the report, is to deliver these services while also controlling the major cost drivers in distribution. These are payroll and other costs, including inventory, occupancy and equipment. Using quick-ship suppliers is a way to offer these highly valued services without increasing operating expenses.

streamline inventory—and do the same for special preps and other shop work. Keep the easy work, and let the quick-ship partner handle the harder or riskier work. After all, most of the risks and most errors made are on the more difficult preps. Outsourcing should have a big impact on reducing errors and therefore total shop expenses. Some of these savings will not show up immediately, but they ultimately will show up in the bottom line, as many errors and fixes are not reported and are hidden from management.

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4. Reduce lead times, and gain a competitive advantage. By keeping a healthy stock of fast-moving items and using a great quick-ship partner for the other items, you can now go to market with two- to three-week lead times (or faster) on most projects.

Not surprisingly, this is the business model for most quick-ship custom suppliers. They can ship as fast as the next day, and they have a comprehensive product line—usually accomplished by building "just in time" to your customers' exact specifications. This would likely make you the service leader in your area.

5. Streamline your ordering process. On fast-moving projects, pull standard items from stock, and order the balance from your trusted quick-ship supplier (which often has a much easier ordering process). Then move on to the next project.

The key is ease of ordering. Make sure your quick-ship partner gives you great service, like fast order confirmations, order acknowledgements, shipping acknowledgements and timely questions (if any) so that you can order an item and be assured that you can move on to the next thing on your list quickly. A good quick-ship partner should take care of all of your questions—before you have to ask them. If you have to call to check on orders or have to deal with late shipments, find a new supplier!

This fast-moving process will decrease your project management time and thus allow you or your project managers to handle more work. What is the value of adding another 10 percent of capacity to you or your PMs?

So how could your business profit by strategic use of fast-moving stock and quick-ship? Only you know for sure, but with the market trending toward faster and faster lead time requirements, you should at least net some happy customers—and hopefully a little more profit. dh

Endnotes

1. *Profit Improvement Report* by Dr. Albert D. Bates, available at www.dhi.org/shared/forms/PDFforms_Secured/ProfitReports/ProfitImproveReport_Vol22-2.pdf
2. See DHI reports *Overview of Financial Trends in Distribution for 2003-2007* and *Profitability Patterns in 2012* at www.dhi.org/INDUSTRY/membership/DistributionResearch.php.

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