Far too many purchasing departments are still pressured into expediting material as a result of non-existent or inaccurate material demand forecasts. This type of environment is most prevalent where the purchase of Maintenance, Repair and Operations (M.R.O.) material is not supported by a predictive maintenance strategy and collaboration between demand planning and procurement is weak, or in some instances, non-existent.

Lack of proper demand forecasting creates a tremendous strain on the supply chain and directly impacts material costs by creating a premium total cost of ownership. These material costs consist of both expenses that are prevalent (direct) and those which are not as obvious (indirect). Some examples of direct costs include:

- Premiums charged by vendors to reflect compressed or reduced delivery schedules
- Expedited freight charges
- Cost of reduced quality (due to compressed lead-times)
- Increased buffer inventories (safety stock)

Indirect costs can include:

- Increased staff turnover as a result of frustration and burnout
- Inability to negotiate reduced costs with the vendor community due to historically sporadic demand and unreasonable delivery expectations
- Increased costs in stress related benefits for staff
- Lack of employee motivation to apply industry best practices
- Poor vendor relations affecting quality and delivery

In addition to these direct and indirect costs, there are also numerous hidden costs which are not as easily quantified such as:

- Inflated vendor pricing to improve margins
- Increased transportation costs as a result of under-utilization of freight
- Cost of poor quality due to reduced vendor lead-times

A supply chain organization functioning in a reactive demand environment can experience material supply costs 30 per cent greater than those working to an accurate demand forecast. Fortunately, many companies have recognized the value of supply chain organization as a tactical tool to achieve lowest total cost of ownership. However, there are still numerous companies unaware of the power of an efficient supply chain, many of which spend inordinate amounts of capital to purchase materials at costs well above market value. A vast majority of the companies in the later group are the same companies struggling to increase profits and, in turn, are those that resort to internal cost cutting measures that exacerbate the situation. Such cost cutting measures often include reduced staffing levels and reduced spend on capital projects related to supply chain efficiency (for example, improvements in I.T. infrastructure). These cost cutting measures tend to drive key individuals to leave the company in search of more stable employment, thereby creating additional costs to attract and retain new talent.

In a reactive demand supply chain organization there is not much opportunity for involvement in strategic sourcing or other proactive strategies. Vendor relations are usually poor however, the interpretation of the broader organization is that relations are positive as a consistent stream of new vendors are eagerly pursuing business opportunities. Based on such circumstances, this should come as no surprise.

How can this atmosphere be rehabilitated to reflect a more proactive and efficient supply chain?

The most important tool in the arsenal of every purchasing professional that will quickly catch the attention of senior management is the ability to quantify costs. A small investment of time to create a premium cost model will allow for tracking and quantifying of such costs. Key costs to be included in this model include:

1. Expedites costs – Quantify both vendor premium charges and freight charges. Send a formal document to vendors on corporate literature requesting that all expediting and premium costs be...
identified on a separate line of the invoice. If worded appropriately, the majority of vendors will cooperate. Although vendors may manipulate charges to appear favorable, identification of the impact of expediting costs will begin to emerge and will be easily recognizable.

2. Obtain quotes - Make time to obtain quotes for high value and long-lead items and compare against existing prices. If order lead-times for high value items are short, place Request for Proposals to determine valid market pricing. This will assist in identifying both items where premium prices are being charged, as well as the costs associated with transactional purchases versus volume based agreements with key suppliers.

3. Freight rates - Carriers today have a multitude of reports readily available as part of their standard services. Request key carriers of inbound freight to provide reports by month identifying expedite freight costs and areas where freight utilization is low and sort this information by supplier. These reports often expose areas where additional freight costs are being incurred and identify areas where freight consolidation, increased re-order points or opportunities for re-sourcing to a reduced vendor base may provide benefit.

4. Material demand - All organizations have a long term plan for maintenance activities. This may range from a two week plan created in a spreadsheet to a custom software program. Obtaining access to either forum will provide insights into frequently ordered materials, and custom high value items.

Information will take time to collect and analyze, therefore obtaining the assistance of an outside organization is ideal. However, if you are in a smaller firm and budget restraints will not allow for such an option, try contacting your local college or university as there are often numerous students searching for temporary job assignments and small project experience.

A company which does not understand or take advantage of the skills offered by purchasing professionals is sending a clear message to the vendor community which will create an environment where material costs are at a premium. Time spent to complete the analysis above will catch the attention of senior management and demonstrate the power held within the purchasing organization to identify costs which impact company profits. Demonstrating the value a purchasing professional can bring to the organization will enhance reputation within the company, and if all goes well, move the company to a heightened predictive purchasing strategy.

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