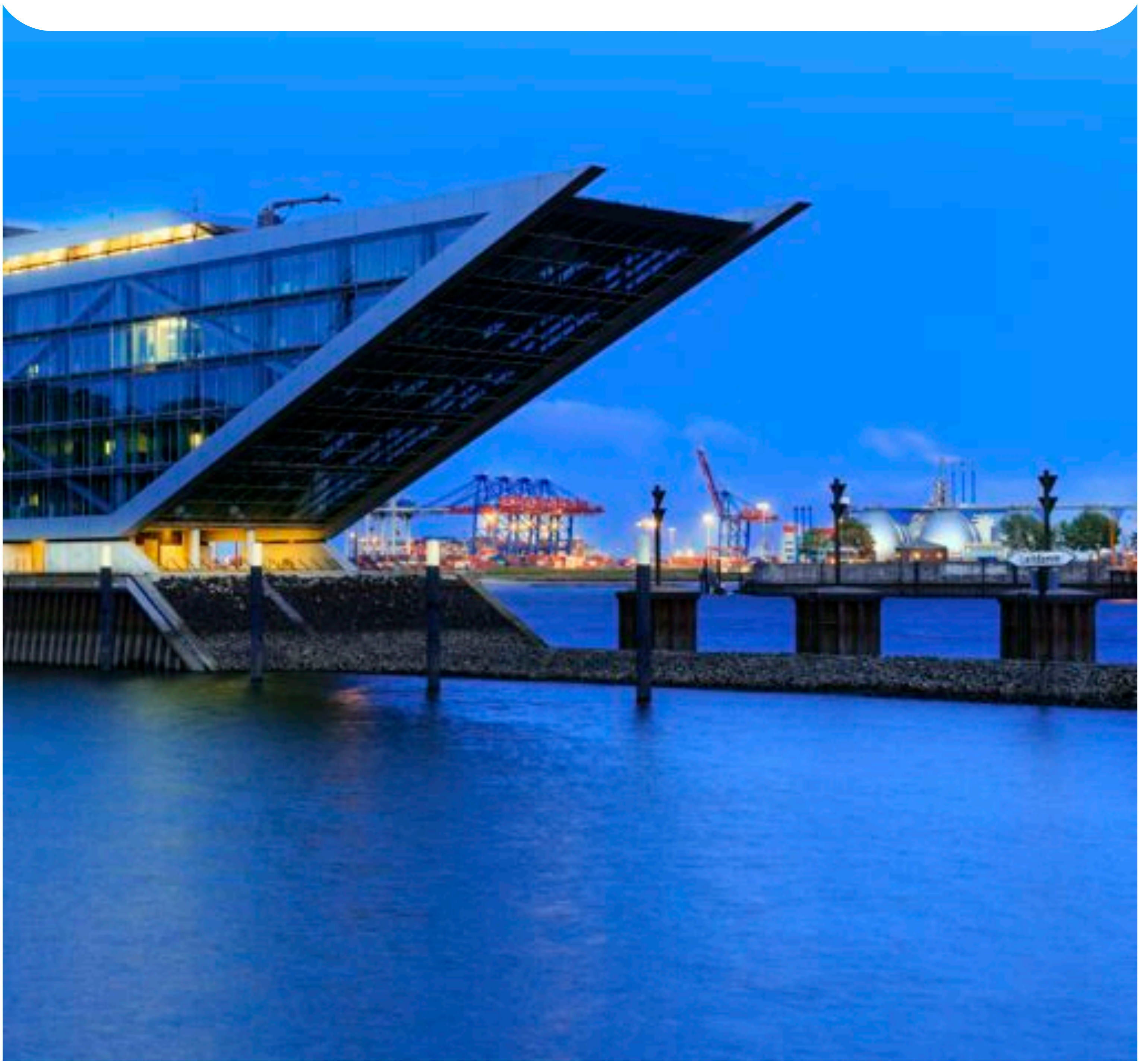
THE Parker Avery GROUP

retail consulting and industry thought leadership

Total Cost to Serve: Considering Purchasing Factors Impacting Sourcing Costs



www.ParkerAvery.com

be selective.

Considering Purchasing Factors Impacting Sourcing Costs

In the world of sourcing, most sourcing managers make purchase decisions based on the estimated target margin of a product. Target margin is calculated using the expected retail minus the estimated landed cost. Unfortunately, the estimated landed cost is not the product's total cost to the organization. When making purchasing decisions, sourcing managers need to look at all factors that go into delivering a product, from the factory to the store. The total cost that encompasses all aspects of the delivering the product is called "Total Cost to Serve."

What is the Total Cost to Serve?

A traditional Estimated Landed Cost (ELC) tool normally includes the vendor's first cost, duty charges, freight charges, agent commissions, vendor profits, etc. Total Cost to Serve (TCS) considers other factors that may drive up a product's cost. Factors such as fabric logistics costs, quality/rework costs and clearance costs will increase if the product is not delivered on time. Leading retailers will consider these additional costs when comparing offers from competing vendors.

Let's take a deeper look into three of these components.

Fabric Logistics

For many years, retailers have been purchasing their products from China and other countries in Southeast Asia. Over the last five to ten years, there has been a push to source product from other parts of the world, including East Africa and the Middle East. The driving force behind the move to these other locations has been due to a lower ELC. This lower ELC is typically the result of lower labor costs, lower product costs or favorable duty charges.

In many cases using ELC alone is appropriate. However, when shipping components from a nominated supplier or mill, the sourcing manager needs to account for longer lead-times to ship components to these non-traditional locations. They must also account for the possibility that the shipping days for some of these countries are not as readily available as the traditional China ports and may add to the lead-time. They may find that these new ports are not as reliable or that it may take longer to have enough products to ship a full container because they do not have as many suppliers to consolidate their shipments.

When considering moving the sourcing of a product to a new country, keep in mind that you need to consider the logistics of having all components shipped to that new factory.

Quality/Rework Costs

Another area of TCS is the quality or rework costs that may be incurred if a new supplier does not have the same quality control as your current supplier. While the new supplier may offer a better price, the sourcing manager needs to determine whether the new factory has appropriate quality controls in place. If not, it will take time and money to determine how much a rework is going to cost and/or how long goods may be delayed due to the rework.

These costs are not readily visible in the traditional ELC model. When considering a new vendor, sourcing managers need to understand the potential risk to quality and how much it might cost. Is it worth the risk to save 1-2% in margin?

Sell-through versus Clearance

Another area that usually has a lot of visibility is sell-through versus clearance. However, clearance pricing is generally not part of the purchasing decision. When considering sourcing options, the sourcing manager must take into account the factory's ability to manufacture and deliver the product on time. A low first cost does not necessarily mean that a factory provides the best deal. If a less expensive factory has a longer or less reliable lead-time, you may end up selling a higher percentage of your product at a reduced price. When the purchase decision was first made, the initial IMU looked great. But in reality the actual gross margin is lower due to late shipments and increased markdown sales. Sourcing managers need to think about timing before making the decision to move orders.

Final Word

Leading retailers make purchasing decisions based on factors other than estimated landed cost alone. If you are not, you may want to take a step back and evaluate what drives your sourcing decisions. A company that wants an advantage over its competitors does not settle for the traditional estimated landed cost models, or, even worse, simple first cost. Leading retailers consider other factors that may impact a product’s cost, which is the total cost to serve.

The Parker Avery Group

The Parker Avery Group is a boutique strategy and management consulting firm that is a trusted advisor to leading retail brands. We combine practical industry experience with proven consulting methodology to deliver measurable results. We specialize in merchandising, supply chain and the omnichannel business model, integrating customer insights and the digital retail experience with strategy and operational improvements. Parker Avery helps clients develop enhanced business strategies, design improved processes and execute global business models.

Learn more about us at:

www.ParkerAvery.com

for more details contact:

Robert Kaufman
CEO | robert.kaufman@parkeravery.com

David Birdsall
Senior Manager | david.birdsall@parkeravery.com

770.882.2205