

Case study: A live network for dead stock

by Doug Levin

Executive summary: This article outlines how 16 distributors — using their common technology platform to create a trading network — are gaining visibility to dead stock across 11 product lines at each distributor’s locations. The pilot project to date has seen total dead stock transactions in excess of \$100,000.

Distributors by nature are great sales people. They are also, by nature, great buyers. Their livelihood depends on buying at a low price and selling at a profit. The better the price they can buy a product at, the better their bottom line.

As mentioned in the previous article on dead stock in the last issue of MDM, dead stock gets created when distributors cannot find buyers for products they have in stock. This happens because they either overbought or the customer that had been buying that product stops buying the product from them.

We have gone into how dead stock can have a huge negative impact on both the cash flow and bottom line of a distributor. We have explained how an Internet trading network has the ability to match a buyer with a seller, in real-time, and at a very low cost. And, we reviewed the research that states distributors are willing to sell dead stock at up to a 50-percent discount off cost, while at the same time are willing to buy needed inventory from an unknown source at a discount of at least 20 percent below cost.

This article presents an example of what 16 distributors focusing on just 11 vendor lines were

able to accomplish – what dollar amount of dead stock was removed from the distribution channel, and what bottom line benefit was realized by both the buying and selling distributor.

For more than 34 years, Prophet 21 has watched distributors struggle with the negative impact dead stock has on their businesses. Using the knowledge we gained from our observations and working with distributors, Prophet 21 has built an Internet trading network for distributors, Trading Partner Connect. Among the many business issues addressed by Trading Partner Connect is the problem of dead stock. The results below are from distributors that are live on Trading Partner Connect.

The following distributors participated in this project. Next to each of their names is the number of the 11 vendor lines used in this study that they carry (see chart below left).

Since not all of the distributors studied carry all 11 vendor lines, the chart below tracks the number of distributors in the study that carry each manufacturer/supplier line.

For this case study we defined dead stock as any inventory that had not been sold for a period of one year. We also used as fact the following premises:

1. One distributor’s dead stock might be another distributor’s active items.
2. Distributors are willing to sell dead inventory at a price below their cost.
3. Distributors are willing to take a risk and buy inventory from an unknown source if it was discounted below cost enough.
4. Distributors would buy six-months worth of active inventory if they were getting it at a discount price and it is moving.

Distributor	# of active vendor lines
Decatur Custom Tool – Decatur, IL	3
Duncan – Oklahoma City, OK	10
E&R Industrial – Detroit, MI	8
Ellsworth Adhesive Systems – Germantown, WI	2
General Tool – Portland, OR	8
Herrick Industrial Supply – Ogden, UT	5
Hub Supply Company – Wichita, KS	5
Industrial Supply – Salt Lake City, UT	2
Industrial Supply Corporation – Richmond, VA	4
Lane Supply Company – Denver, CO	2
Lewis Supply – Memphis, TN	6
Oliver Van Horn – New Orleans, LA	7
Quality Mill – Columbus, IN	4
Salem Tools Inc. – Salem, VA	6
Shearer Industrial, IDG – York, PA	10
Todd Tool – Topsfield, MA	5

Vendor	# of distributors
3M Corp	16
American-Saw	5
Carboloy	4
Cooper	11
Greenfield	10
Loctite	13
Milwaukee	9
Norton	5
Sandvik	6
Standard Abrasive	1
Stanley	7

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Because all the distributors in this study are members of Prophet 21 Trading Partner Connect, their item databases are rationalized against each other. What that means is even though they all have different item codes, the Internet trading network can compare items as if they all had the same item code, or all had accurate Uniform Product Codes (UPC). This solves a huge problem that past dead stock solutions never overcame.

Prophet 21 queried each of the distributors' system and identified the dead stock. We found more than \$1.6 million of inventory collecting dust and costing money in the warehouses of these distributors. In the first article of this series we said that carrying costs fall somewhere between 25 and 35 percent. For this case study, we will use a conservative 25 percent, meaning that the dead stock in this study costs these 16 distributors more than \$400,000 in carrying cost per year.

Next Prophet 21 queried each of the distributors' systems and identified items listed as dead to at least one distributor, but active to at least one other distributor: (see chart below right).

The "Dollars that could be bought" column accounts for all of the dead inventory that each distributor could buy and not exceed a six-month supply. The "Dollars that could be sold" column includes what each distributor could potentially sell to the other distributors. So of the \$1.6 million dead stock inventory, more than \$227,000, or 17 percent, is re-sellable. Although, this number appears low, remember, this study included only a small sampling of both distributors and manufacturers/suppliers.

The beauty of this model is that both parties benefit.

To motivate the buyer to purchase the product from the selling distributor instead of the normal manufacturer/supplier, the seller has to discount the product, directly impacting the buying distributor's bottom line. The additional gross margin the buying distributor receives from buying at a better price flows right to their bottom line.

Many times this is accomplished without the selling distributor discounting the product as much as the 50 percent he's willing to go. This is possible since the selling distributor has not sold this item in more than a year – and presumably hasn't brought this item in more than a year – the manufacturer/supplier's price has increased over the course of the year. Therefore, if the selling distributor discounts the product from the replacement cost, which is what the buying distributor would pay if he bought the item directly from his normal channel, he won't need to offer as great a discount. In addition, the buying distributor expects only a 20 percent discount, which further lessens the amount of markdown the selling distributor needs to offer.

For example, Oliver Van Horn had a need for

almost \$23,000 in inventory and had more than \$38,000 worth of inventory that could be sold – at a carrying cost of 25 percent or \$9,500 annually. If Oliver Van Horn achieved a 20 percent discount over replacement cost, they would save more than \$4,400, which translates to more than \$4,400 in profit.

"For years, distributors have been unable to properly deal with the issue of dead stock," says Lee Eagan, Jr., chairman and CEO of Oliver Van Horn. "With the advent of Trading Partner Connect, we are able to have identified for us items that are 'dead' at our company, but are actively moving at other distributors in the country. With an estimated 20 to 25 percent of many distributors' inventory dead, or not moving, this is a tremendous resource that will, in part, re-capitalize and reenergize the industry. Having already sold dead inventory utilizing Trading Partner Connect, I am excited about this opportunity."

In our study, Oliver Van Horn benefited on both sides of the transaction process since its need of inventory (\$23,000) to buy was pretty close to the amount of dead inventory (\$38,000) it had to sell. Todd Tool, on the other hand, benefited more from selling its dead stock (valued at more than \$25,000) than from purchasing dead stock from others (with a need of less than \$9,000), while Ellsworth got all their benefit on the buy side (almost \$14,000) and virtually none on the sell side (less than \$300). What this shows is that even distributors with fantastic inventory management and no dead stock will still benefit from this solution on the sourcing side.

This study proved technology can save distributors carrying costs, while at the same time, depending on the discounts on the dead stock, add additional

Continued on next page

Distributor	\$ that could be bought	\$ that could be sold
Decatur.....	\$7,706.19	\$7,900.30
Duncan.....	\$18,115.29	\$17,262.71
E&R Industrial	\$26,930.63	\$35,506.63
Ellsworth	\$13,893.62	\$287.69
General Tool.....	\$40,555.05	\$13,521.74
Herrick	\$4,009.32	\$4,873.45
Hub Company	\$11,647.19	\$34,923.41
Ind Sup - UTAH.....	\$9,659.86	\$7,782.41
Ind Sup - VA	\$7,744.03	\$10,720.90
Lane	\$1,147.89	\$2,132.71
Lewis	\$20,092.79	\$25,962.04
Oliver Van Horn	\$22,959.37	\$38,435.02
Quality Mill	\$25,860.96	\$17,605.98
Salem Tools Inc	\$8,705.98	\$6,602.73
Shearer	\$49,684.05	\$28,692.76
Todd Tool.....	\$8,878.49	\$25,380.24
Total	\$277,590.71	\$277,590.71

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margin. Specifically, the 16 distributors in this study saved more than \$83,000 in carrying costs and added \$20,000 to \$40,000 in additional margin. When you take those numbers and apply them to the more than

2,000 distributors and more than 6,000 supplier/manufactures that Prophet 21 is connecting through Trading Partner Connect, the issue of dead stock may finally be resolved.
