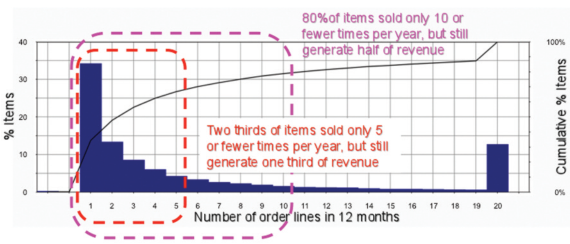
MINIMUM ORDER QUANTITIES

Must MOQs cast a shadow over your business?

In a market like Australia, with so many different models of cars on the road, we have very large ranges of parts and unfortunately, because of our market size, many do not have high sales volumes.

The Pareto graph shows a pattern that is very typical of many aftermarket businesses.
What it shows is that a lot of the business rests on some very slow moving parts.



Things are not helped when many of these slow moving items also have Minimum Order Quantities (MOQs).

MOQs literally compound the problem. If you have something that sells only five units per year, and you have an MOQ of 20 then you have to buy four years of stock. If stock carrying cost is assumed to be 20 percent, then this means you would have to have an extra 40 percent of gross profit (you need to fund two years of stock on average) or else you take a bath on the lifetime profitability of the product. 20 percent holding cost is of course on the low side as with very slow moving products you also have to factor in obsolescence.

So MOQs can be a big issue. How can they be managed better?

Strategies to mitigate the effects of MOQs

Participate and Price Right

If you are faced with MOQs, the first thing to do is decide whether you should participate in the market and how you should participate. Too often that decision is made by a purchasing officer who buys the four years of stock without properly considering the impacts on the P&L, Balance Sheet or market positioning. Does your inventory management and purchasing system even warn you that such a decision might need review? Ideally, you should consider factors like:

- Is the product an important adjunct to an existing range of products, or a key part of a new range you wish to develop?
- Is it important to key customer relationships, or developing new sales?
- Does the business case rest on this one customer?
- How much of the purchase is committed against one or more orders?
- Can the risk be shared?
- Has the pricing been set to properly reflect the risks? The carrying costs over the life of the product?

If after weighing these up the decision to stock the product looks sound, then fine, buy it and sell it, but do so profitably because the whole case has been thought through. Ideally, this should be embodied in 'new product' introduction policies and the company's culture. And of course that may force you to also ask:

- Does your incentive system only recognise gross margin, or are people aware of carrying costs?
- Who is allowed to price a new product where it is being brought into the stocked range? i.e. not just a one-off buy-in?

Buy Better

It can be all too tempting to accept the great deal to buy 20 units because you can get a 5-10 percent cost advantage. Often however that can prove to be a very bad decision, when the carrying costs might be 40-50 percent. It is often better to buy just one or very few units, even though you might pay a 20 percent cost premium for that flexibility.

For such a slow moving part, a 20 percent uplift can usually be priced in as well. So how can you get a 'unit of one' purchase? Have you pressed your normal vendor? If your customers can go to the Internet why not you? It certainly gives you a very good benchmark of exactly what might be possible. You might even be able to get some breaks if you buy five units or so, but you do not have to buy 20. If you can factor in your genuine transaction costs you can often find that buying in 'units of one' or thereabouts, can make a lot of cents.

Source Strategically

OK, maybe you buy most of your volume from a few key suppliers. They might have economies of scale and lower costs but they could also have MOQs associated with that business model. That could well work fine for your fast movers, but maybe you need a different sort of supplier in your stable, someone who can provide product at low volumes and at reasonable uplifts.

Who knows, an Internet based supplier could be just such a supplier. Maybe it's time to negotiate some buy breaks with distributors so you can easily work out the optimum buying quantity given the current demand picture.

Alternate supplier optimisation

It takes a bit more work in terms of master data maintenance, but for some products, maybe you have to have an alternate supplier on file as well. This could make sense for a product that is perhaps declining in volume, or seasonal. The purchasing software can optimise the sourcing of the product considering perhaps an MOQ and lower cost from one supplier, and no MOQ, but a higher cost from another supplier. While you may not be ready to switch totally to the second supplier, maybe the next couple of purchase orders should go to this alternate supplier, while there is some uncertainty over the demand, and you need to manage the inventory risk down.

Supply Smarter

If you have multiple DCs and multiple branches, you also have one other area of flexibility. Rather than supplying everything direct from supplier to branches, and have to wear the MOQs in every branch, there is often a case for importing the stock with a high MOQ into one DC, breaking the bulk, and then shipping pieces to individual warehouses. Your transaction costs might be higher but your carrying costs will be a lot lower.

Know when to say NO

Ideally, your software should red flag recommended purchases that really require your attention. Buying over 24 months of stock should normally be a red flag. It is important that people know that such a recommendation needs careful consideration before you commit to a potentially 'bad' purchase decision. Maybe someone does need to spend a few minutes checking with the product manager or the account rep. As products get towards end of life, an MOQ might just be the trigger to say NO to any more.

MOQs – A Fact of Life, not something to Rule our Lives

In Australia, MOQs are unfortunately part of the landscape and they exist often for sound reasons. They do not have to be regarded as hard and fast rules though. With the right policies, strategies, disciplines and inventory management software, you can do a better job of managing around them.

For further information consult www.horizoninventory.com.au or email info@horizoninventory.com.au.