

Transaction Costs May be Affecting Profitability

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As manufacturers and distributors, we understand the importance of providing service to our customers. Whether the supply chain is large or small, it is filled with individuals negotiating and compromising for the net benefit of all involved. Going the extra mile to accommodate a customer request for special packaging or additional information on a packing slip or bar code label is how we add value to the customer/supplier relationship. Small gestures such as these more than pay for themselves as long-term supplier/customer relationships are usually grown this way.

But at what point do these extra requests add to our transaction costs in a way that affects profitability? How do we handle such requests and how can we control them before they become a problem? Where is the line between good business, where the customer is placated and smart business, where the customer is taught discipline?

Transaction costs are the extra clerical and administrative tasks that go into entering, processing and shipping an order. When we quote a customer, we are providing a price that should include all of these tasks as well as the actual cost of making and/or stocking the product. It may be a few minutes here or a couple of extra steps there but, over time, these extraneous steps compound and add no value to the finished product. If the customer requests other transactions over and above the basic services covered by the quote, they can drive up transaction costs that ultimately erode profit.

For example, some customers require suppliers to monitor web portals for ordering information. We run into this quite a lot, with multiple customers requiring multiple portals. This may seem like a way to use the latest technology to transmit orders, but they often amount to extra work for the supplier. Instead of receiving a purchase order from the customer clearly showing the quantity, product description and due date for the order, you now must build this information from data supplied on the portal. This can involve monitoring a customer's inventory including minimum/maximum levels to determine ordering quantities, adjusting future requirements as needed and even deciding on what method to ship depending on weight. The result is the supplier has now assumed the role of the customer's buyer, actually generating the order. A few customers will only communicate via portal, putting the onus on the supplier to constantly monitor the portal for fear of missing an urgent update, leasing the customer service representative to a time consuming task which may or may not result in a firm order.

Another area of concern is those instances where the customer changes the product specifications on which the price was based. For example, the customer may request that the products be 100% sorted. He may also insist that they undergo an extra processing step in manufacturing or that a tighter tolerance be imposed than that listed on the original drawing. In any case such changes should be a flag to suppliers to investigate the possible impact on transaction costs.

Customers also increase costs by not ordering in standard package quantities. Shipping below stated minimum quantities causes additional transactions such as breaking down packages to count out individual pieces and re-weighing and labeling these packages so that they can be put back on the shelf and into stock. If this is a regular occurrence, the supplier may want to re-examine package quantities. A few adjustments now may save a lot of cost later. Time has already been spent packaging the product; having to redo so without seeking some compensation from the customer is an

all-too-common way of driving up transaction costs.

Third party shipping companies often act on behalf of customers. They may require shipping departments to do certain manual func-

tions, such as making additional copies of packing slips and other paperwork, affixing additional labels to boxes, and manually filling out forms. Advanced Shipping Notices (ASN's) are usually generated automatically through Electronic Data Interchange (EDI) systems or a program written by the IT department. But some customers require ASN's to be generated manually through their web portal adding extra steps to launch this documentation

How can we compromise with our customers to ensure they receive the value added service they expect and reduce transaction costs to an acceptable level? Here are a few tips that can help you deal with these issues:

State Precisely What Your Price Includes

The exact terms of the price you are offering the customer should be clearly stated on the Request for Quotation. Stress that the customer is required to provide a valid purchase order that includes quantity, item description and due date. Note that additional transactions and accessing web portals will entail additional costs. You may want to work within your organization to determine actual costs for additional services and set up a price chart accordingly. You may also want to include a standard paragraph on all RFQ's similar to the one that follows:

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There is a fine line between providing good service to your customers and having to accept requirements that seriously increase your transaction costs.

"Changes made to designs, drawings, specifications, samples, descriptions, methods of packing, shipping, labeling, inspection, testing, quality control, the order/ASN process, the date or place of delivery of the Goods, the overall scope of the work and any additional value added services requiring additional processing that results in additional expense to Seller not covered by the initial agreement between the Buyer and Seller shall be subject to issuance and acceptance of a new quotation."

Address Problems as Soon as They Arise

If you don't take exception to a request for additional tasks, your customer will assume that you have no problem doing the extra work. They may not believe that their requests are extraordinary, expecting that the nature of the business permits slight deviations from the standard or original request. Let your customer know immediately that specific deviations have not been covered by your original price quote and that you need to have some discussion before the change is put into place.

Try to Accommodate Customer Requests

It can be both good and smart business not to say "no" to every customer change. In fact, you should make every effort to comply with customer requests. Discuss the matter with affected departments. Perhaps what the customer is asking will only be a minor

change. Or, you may be able to automate the request without any additional steps by company personnel. As with re-examining package quantities, searching for easily automated tasks can pay off greatly in the future. Make every effort to meet customer expectations whenever possible.

Negotiate. Negotiate. Negotiate.

Approach your customer with a positive attitude and tell them your concerns. Transaction costs affect us all and customers for the most part will want to work with you to find an amicable solution that works for both parties. Finding the least-costly solution to requests may permit you to pass on some of the potential savings to your customers. Investing in a long term business partnership will see profits both on and off the balance sheet.

There is a fine line between providing good service to your customers and having to accept requirements that seriously increase your transaction costs. Don't fret over the small things, but don't retreat where it is obvious added work is not creating added value. Make sure your team understands these costs and the importance of talking with your customers before agreeing to take on additional transaction tasks. Good communication between you and your customer will promote understanding and a partnership that works for both parties. ●