A Cost-Effective Approach to the Vendor Relations Challenge:

The Case of West Marine, Inc.

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How does a retail firm that replenishes $320 million in stock to some 250 stores manage over a thousand vendors? Add to this the challenge of special orders. Here is the story of how this was accomplished in an economical manner for both the retailer and its vendors.

Section 1: The Background of West Marine

West Marine, Inc. is the world's largest specialty retailer of recreational boating supplies and apparels with stores in 38 states and Puerto Rico. Products include everything from tackle to brass lamps, batteries and outboard motors. In 2001, the company had revenues of approximately $513 million. In addition to its stores, it has built a highly successful Catalog and Internet business that offers customers approximately 50,000 products, far more than any of its competitors. An advantage that the company offers is that Internet purchases may be exchanged at any retail store.

Even though the United States experienced one of its worst disasters on September 11, 2001, and the country experienced a general economic slowdown, West Marine was able to post impressive financial performance for 2001. Gross profit margin increased by 29% and net income was up by 88%. This was accomplished on an overall sales increase of 1%. Plans for 2002 were aggressive, calling for 20 to 25 new stores including expansion into Canada as a new market, increasing the total number of stores to approximately 250.

According to West Marine's President, John H. Edmondson in his statement for the 2001 Annual Report, "A major contributor to West Marine's success is improved distribution and order fulfillment. More than 98% of our inventory replenishment is automated. And our in-stock rate for orders is the best in our industry." He goes on to say, "Vendor relations are a key..." How do these vendor relations enable West Marine to develop this key? The answer to this question is addressed in the following discussion.

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Section 2: The Challenge of Vendor Relations

The company was facing a 50,000 SKU base with some 1,200 stocking vendors. Some of these vendors represented over $25 million in sales to West Marine, while many others were two or three person shops with only several orders per year. Orders were faxed and no visibility existed—it was not known when the order was received, or if it was received. The shipping date was often ambiguous. To quote a West Marine manager, “Crisp, functional acknowledgement did not exist.”

In 1997, West Marine began to look at the possibility of EDI. As the company grew, it became more and more obvious that managing the replenishment was a bottleneck, and it was only going to get worse with growth. The two Distribution Centers (D.C.s) were using progressive practices such as cross docking but with any such operations, labor costs were an issue. As with any D.C., holding and handling simply cost money. Also, top management believed that improved company performance was directly related to improved order fulfillment cycle time. Was there a way to improve these processes?

Potential EDI capabilities were analyzed and an RFP was developed. Five proposals were reviewed but the IT department didn’t find what it was looking for. The estimated cost of such a project was around $150,000 to $200,000 just for the software and Value Added Network (VAN). And it could be $750,000 for the necessary staff, testing and related costs. But maybe even the bigger concern was the cost to the vendors. Unfortunately, the vendors would have to make a cost-prohibitive investment in a system that matched West Marine’s capabilities.

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Although key management had the underlying “feeling” that something needed to be done, the solution was not apparent. Traditional EDI did not seem to be the answer. The purchase orders (P.O.s) continued to be faxed, order fulfillment had a cycle time that was simply too long and visibility did not exist. The vendor relationship system had little accountability because of the lack of visibility.

In 2001 another issue further demonstrated the need for a more efficient vendor relations system: a direct vendor-to-store initiative. When the CEO stated, “On my watch, we will never open another D.C.” it became apparent that something had to be done. One way to overcome the inherent inefficiencies of a distribution center was to ship the product directly from the vendor to the store without going through the D.C. But this had a related problem: each store would have to manage the vendor information and this made the need for automation even greater. In other words, if a brass clock was being sent to 250 stores rather than two distribution centers, the P.O.s, shipping notices and related paper work would increase a hundred times over.

A better information system would have to be developed; however, no cost-effective solution was obvious.

Section 3: The Solution

The issue was building yet the solution was not obvious, but in 2000 the solution appeared. A technology solution provider for vendor communication, SPS Commerce, contacted West Marine about their situation. SPS offered a non-exclusive vendor enablement and management program with a hosted integration service approach that allowed vendors to cost effectively and securely exchange documents over the Internet. To quote an IS manager, “We weren’t previously aware of the possibilities, but we immediately saw that this was the solution for us.”

The main thing this technology service provider offered was a low-cost solution for both the vendor and the retailer. As mentioned earlier, a traditional EDI system would present a tremendous financial burden to both parties, but just the opposite was true for the option provided by SPS Commerce.

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SPS Commerce actually provided five components to make the process extremely attractive.

1. As a third party provider or ASP, it hosted the technology for the communication between the vendor and West Marine. This meant that West Marine did not have to invest in additional, specialized technology for this initiative. This was a dramatic difference of the $150,000 to $200,000 anticipated for a traditional EDI system.

2. West Marine provided initial communication about the program to the trading partners; however, SPS Commerce followed up with detailed information to reduce the implementation and enablement burden for the vendors.

3. Testing and certification for vendors who already had a solution was the responsibility of the third party technology provider. Again, much of the burden was removed from West Marine.

4. Training of the vendors for the new system was the responsibility of SPS Commerce. When EDI was initially contemplated in the late 1990s, potential training expenses was a major impediment from moving forward.

5. SPS Commerce provided the necessary customer support.

The Goal

As a result of this potential solution, West Marine established a rather aggressive goal for 2001/2002. At the beginning, the company had approximately 1200 vendors. Of these 1200 partners, probably 700 received such a small number of invoices that they were of little concern. But the remaining approximately 500 received over $25,000 in invoices each year. The goal by the end of 2002 was to have 90% of the invoices exchanged electronically.

This was an aggressive goal because West Marine's supply chain had to service both regular store inventories and special orders. One goal was to increase the direct vendor-to-store shipments by approximately 100% by the end of 2002 and approximately another 15% during the subsequent year. In addition, approximately the same amount of business was done in special orders as direct-to-store business. These orders require special attention because they are unique, "one order at a time" rather than periodic replenishment.

Another unique goal was to gain more control of the Vendor Managed Inventory (VMI) system used for approximately $5 to 6 million in fishing tackle and batteries. The company stocks many different sizes and styles of these items so in the past the vendor would check the stock at the individual stores and maintain an inventory level for West Marine. But little control existed for this system. The new approach was to have the vendor count the inventory on a periodic basis and send a P.O. to West Marine. This provided much more control and visibility of the VMI. However, it would have required too much paper work and have been too slow without the appropriate technology. As a result of the new technology and VMI approach, tackle and batteries would each become one SKU.

Each of these processes represents an indirect goal. The real goal is to reduce inventory and handling costs while increasing the fill rate at the same time that the company increases the total number of stores. These cost reductions should occur due to less inventory shrinkage, improved use of labor, fewer routine errors and faster cycle time. At the same time, improved fill rates should increase sales.

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Because of the nature of West Marine's business, the fill rate was extremely important. As a specialty retailer of recreational boating supplies, it is in a highly cyclical business. The high season begins in April with the peak hitting on the 4th of July. Its customers have high in-stock expectations and West Marine has high expectations for itself. A stock-out may mean a lost sale because in a short, cyclical season, the customer may not return. Larry Smith, Senior Vice President for Planning and Replenishment best summarized the importance of fill rate when he said, "We are not just talking about the expense side of the equation. We are talking sales opportunities." He calculated that a 1% in-stock increase would increase comparable sales by 5%. The goal was to increase the in-stock level to 96%—an extremely high figure for a specialty retailer with over 50,000 products.

The Approach

The "Trading Partner Enablement Program" was introduced in 2001 by sending letters to 400 vendors. This letter stated, "The Internet now provides a relatively low cost and widely accessible alternative. Our first step down this mutual savings path will be to require electronic transmission of purchase order and invoice information." The letter went on to say that the transactions required would be Purchase Orders (850), Purchase Order Change (860), Purchase Order Acknowledgement (855), Advanced Ship Notice (856) and Carton Labels (128) as well as Invoice (810). It is important to note that the letter mentioned a penalty if compliance was not met; however, the penalty was not stressed.

About the same time, West Marine approached the National Marine Manufacturers Association (NMMA) about the possibility of having one web-based system as an industry standard. This would allow all the marine manufacturers and vendors to use one system so the vendors would have a minimal investment. West Marine was able to suggest one web-based system for the industry because it is the largest specialty marine products retailer. When the industry decided to use this technology as the standard, it was a major boost to vendor adoption.

Section 4: Costs and Benefits

Vendor-customer transactions require two partners; accordingly, the costs and benefits should be analyzed from both partners' perspectives. Too frequently the customer may have the attitude that because we are the customer and paying for the product, we should not be overly concerned about the vendor. But this is certainly not the best or prevalent way of thinking: the customer must understand the vendor's perspective. Therefore, the vendor's side of the equation is considered first.

Vendor Costs and Benefits

Vendor costs are minimal and directly related to the rate of usage. And usage represents business. The only technology requirements for the vendor are the PC, browser and printer for the UCC 128 labels. This represents an extremely low technology investment even for the smallest business. For vendors who already have their own solution in place, a one-time testing and certification fee is incurred to verify data integrity prior to being connected to West Marine. For vendors subscribing to the hosted web service, the monthly fee may be as low as $25 or up to $250 depending on the number of transactions. The cost-benefit relationship is easy to see. The set-up fee and monthly fee are low; meanwhile, the fee per transaction is minimal and is in effect only when business is transacted. As one vendor said, "This is certainly a small cost for doing business...and the more it costs, the more business we have."

The greatest cost may be intangible—change. This represents a new way of doing business and may initially be seen as an inconvenience. Even though SPS Commerce makes training and customer service available, the fact remains that it is a new process that may represent a burden to the vendor. Part of the burden is that the vendor must enter data into the system that can be tedious for an advanced ship notice (ASN). It forces the vendor to be more systematic. They must know what quantity is in what carton. And they must place the UCC 128 label on the carton. Of course, increased accuracy and accountability may seem like a benefit, but at the time it is a burden. Unfortunately, any new system requires a learning curve.

Several benefits are immediately available to the vendor. First, customers receive the invoices much quicker, and this translates to receiving cash much sooner. West Marine believes that the date of the invoice is the date on which it is received. This date should be earlier now so the cash-to-cash cycle for the vendor is shortened.

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Another benefit is improved P.O./shipment matches. After this technology was implemented, the matches were in the high 90s for EDI transactions compared to the mid 50s for non-electronic communications. Research indicates that for every one hundred times that a human touches a paper transaction of some kind, at least one error can be expected. And this number increases dramatically as the complexity increases, so a complex P.O. with various sizes, colors, and other dimensions would naturally result in errors.

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Prior to this Web EDI initiative by West Marine, the company employed two full-time employees to verify matches between shipments and P.O. and determine appropriate penalties. As accuracy increases, these employees will not be needed to perform these functions so West Marine is able to reduce labor costs. But the vendor also gains because penalties are eliminated. In addition, the vendor also decreases labor costs necessary for re-shipments.

A third way that this West Marine initiative benefited its vendors is that they could use the same technology with several major customers. As previously mentioned, West Marine worked with the National Marine Manufacturers Association to make SPS Commerce's system the industry standard. This benefited the vendors as they could use one economical system rather than investing in multiple technology platforms.

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West Marine Costs and Benefits

Employees in any company may resist process changes and the same could be expected at West Marine. Some of the employees will benefit from the process changes and appreciate them while others will not see the benefit. It is largely a matter of a person's function and perspective within the company. But the actual hardware and software change is another matter as the benefit is more obvious to the supplier. According to John Fawcett, Senior Director, Software Development for West Marine, "It's easier to implement web-based EDI than traditional EDI because the supplier only needs a PC, browser and Internet access."

Another cost is the labor involved in the total conversion. In addition to technology adjustments required for the SPS Commerce-West Marine interface, it was necessary to assure accurate communication with vendors. As new vendors began to use the system, it would not be unusual to have them call West Marine with any number of little concerns. However, according to Gary Maxey, IS Application Manager, who had been through a major EDI implementation with another retailer, "We are mostly involved with typical implementation issues that you would normally expect to take up 99% of the time. But they are generally rather minor." He indicated that quite a few customizations were required for the application but this was only to be expected.

From the initiative's beginning, Mr. Maxey and others directly involved with the effort tracked the number of hours spent on the project. Although it was difficult to determine the precise number of hours directly dedicated to this application, West Marine was generally not too concerned because the cost was so low compared to the benefits. Also, the direct costs were minor because no special technology was required and the vendors were responsible for the certification and testing fees.

On the other side of the cost-benefit ratio, West Marine's CIO, David Schenk, summarized the benefits when he said, "Supply chain visibility has numerous direct and indirect benefits. Some are just more obvious than others." Improvements can be identified at each step of the process. First, the vendor gets the order more quickly. Second, the customer knows exactly when the vendor receives the order and, if necessary, it is known immediately if an alternate vendor needs to be identified. This is particularly important for special orders. In the past, a long cycle time at this stage could result in a lost order. In the case of West Marine this could be a $1,000 item. Third, an accurate, advanced ship notice is received. Finally, an accurate shipment is received that matches the P.O. with UCC 128 labels, and the invoice can be paid more rapidly."

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As is the case with the vendor, several benefits are difficult to track. Savings in simple things such as postage should be considered along with the labor involved whenever someone touches a piece of paper. Also, the error rate along with the cost of the related corrections must be considered.

An interesting note is made by John Fawcett, the Senior Director, Software Development who believed that 75% of the benefits lie in an improved process and the other 25% in inventory process. Meanwhile, as noted earlier, Mr. Smith, the Senior Vice President for Planning and Replenishment, believes that it was the other way around. Most of the improvement would be seen in improved sales. The point is that it may be a matter of perspective as benefits occur in improved processes and increased sales.

Section 5: Considerations When Selecting a Hosted Service Provider

Is this too good to be true? It sounds as if both the customer, in this case West Marine, and the vendor benefit. Small costs are involved, but the benefits are large. Although it appears almost too good to be true, West Marine admits that it faces several risks. First, a critical supplier could resist the new process and the customer may have little power to do anything about it. However, so far this has not happened. Second, SPS Commerce could have a technology interruption or “shut down.” Even a 12-hour delay could be disastrous for West Marine. If West Marine was forced to return to a process based on fax or e-mail, lost sales could result. West Marine will monitor SPS Commerce technology developments closely even though it is confident that the technology is on a solid foundation.

The third risk is that SPS Commerce could rapidly acquire additional business and not be able to manage the increased customer support requirements. Again, West Marine will monitor SPS Commerce’s infrastructure closely to assure that it grows with an increased customer base. Finally, SPS Commerce could attempt a large price increase that would put pressure on the vendor’s ability to comply. However, West Marine believes that the current rates are extremely easy for the vendors to manage and market dynamics would prevent any radical increases.

What are West Marine’s next steps? Not all vendors are currently using SPS Commerce technology. The goal is to obtain 100% compliance. This may be a little unrealistic because a few small, special order vendors may always fail to comply. However, a vendor adoption rate in the mid 90% range seems reasonable.

Section 6: Summary and Future Plans

Efforts to improve collaboration between the customer and vendor are also on the horizon. This process will allow joint sales and P.O. forecasts to be communicated to the vendors. Aggregate orders will be easier. Also, as the system gets more fully utilized, it will be easier to provide vendor performance feedback. Each of these items goes hand-in-hand with continually improving the vendor-to-store supply chain as well as the fill rate for special orders.

Mr. Schenk, the CIO, provides a good summary, "This is a major process improvement." Simply stated, it is a process improvement that provides easily observed benefits for both the vendors and the customer.

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