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IS CONSIGNMENT REALLY A GOOD THING?

Lately, everyone I know has been loving consignment inventory. (Everyone understands consignment inventory, right? Person A holds something from Person B. Once the use it/sell it, then Person A buys it from B. One metaphor is consignment furniture shops in the U.S. The retailer and supplier make some money each when the product sells). On every side of the story, people are jumping into consignment relationships with both feet. But is consignment really a good thing?

If you are a customer of someone who provides consignment inventory—*their* inventory—as a part of your business arrangement, then its happy days for you, right? No inventory hanging around in your balance sheet, yet the stuff is still sitting at your place. In most cases, you can even determine how big a pile you want. High availability, reduced costs, sounds great!

What about the supplier? Most suppliers will tell you that it is a good thing for them too. They provide an added service to their customer. The justification is usually that the customer operations rely on the supplier's material and thus consignment provides a natural solution. The supplier gets into a deeper partnership with the customer, hoping to secure business. Long term customer stability is every supplier's dream.

Unfortunately, like most things, consignment arrangements can have a dark side. This dark side of consignment is that it can be a buffer of inventory that lets supply chain professionals take their eye off the ball. This produces sloppiness, and the lack of process discipline and monitoring can have some dire consequences for both parties.

First, there are Sarbanes-Oxley regulations that come into play. Yes, the legislation is alive and well—if you think otherwise, just mention the word "SOX" or even "socks" near your CFO and see if she jumps. Sarbanes-Oxley is very particular about whose inventory is whose to prevent things such as trade loading and quarter-end shenanigans. If that consignment level reaches a certain point under some circumstances, that can convert automatically to customer inventory. The new adage of consignment: you forecast it, you bought it. God forbid that the inventory becomes obsolete and is written-off. You think a million dollar write-off between trading partners should be an issue? How about a multi-million dollar argument? The point is: consignment inventory has to be managed tightly.

Second, that buffer of inventory does not come for free. Here's an example: A client had about 70 percent of customers in one division on some type of consignment relationship. However, the customer service metric was delivery to the customer site. In the case of consignment, they made sure every replenishment to this buffer stock was perfect. What did that mean to that company? It was if that inventory did not exist at all! The poor folks there struggled to meet every customer replenishment order that came in. Urgent or mundane, that order had to be filled NOW. Overtime, parts expediting, addition shipment costs, just to refill the consignment. One key point did beg a question: Where did the extra cost go? The answer: right back to the customer in the form of price increases.

In the end the question is still whether consignment inventory is a good thing or not. Well, despite this contrarian piece, it can often be helpful and a benefit to both parties. Positioning inventory close to use is necessary to insure high availability. Suppliers who offer this as a service can help their customers. But buyer-beware: consignment inventory, like all other inventory, can easily take a wrong turn. Added costs and lost relationships are almost inevitable. Hawkeye's advice: apply consignment only as necessary and watch it closely if you do.

