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# UNIT 13 SOURCING

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## Objectives

After reading this unit, you should be able to:

- describe the significance of sourcing as a function of retailing;
- explain the process of sourcing in a stepwise manner;
- explain various factors which influence the sourcing strategy of a retailer;
- explain the factors affecting international sourcing decisions; and
- understand the finer points of sourcing negotiation.

## Structure

- 13.1 Introduction
- 13.2 The Sourcing Process
- 13.3 Factors Affecting International Sourcing Decisions
- 13.4 Factors Influencing Negotiations for Sourcing Merchandise
- 13.5 Vendor Relationship Marketing
- 13.6 Warehousing/stocking of Merchandise
- 13.7 How Much to Order and When?
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- 13.9 Impact of Life Cycle on Sourcing
- 13.10 Allocating Merchandise to Stores
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- 13.12 Critical Analysis of the Vendors
- 13.13 Summary
- 13.14 Key Words
- 13.15 Self Assessment Questions
- 13.16 Further Readings

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## 13.1 INTRODUCTION

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When you enter a retail store to buy a commodity all the commodities displayed on the shelf have come from more than a dozen or 20 suppliers. The number of suppliers can be even more. Thus you see that at any given point of time a retailer negotiates purchase of various goods and services with many vendor. Merchandise sourcing is a complex and tedious process. The golden rule of sourcing is to buy quality merchandise at the reasonable price and then sell it 14) the customer at the reasonable profit. Without proper planning and strategy a retailer cannot be successful in this critical function of retailing. Therefore it is essential to understand the significance of sourcing of goods.



## 13.2 THE SOURCING PROCESS

Sourcing is a process involving several steps:

### Determining the Categories

The retailer must first determine the categories in his store. Each category may have distinct features and therefore different points of attention from buying point of view. Categories in a bicycle store can be men's bicycles, ladies bicycle, sports and health bicycles and kids bicycle. However, you must realise that different categories of bicycles may not need so many vendors as is needed for grocery stores. Diverse categories of a supermarket or departmental store need many vendors to supply the required products. .

### Using Internet to Gather Data Regarding Categories in Demand

Although it is still not prevalent in India it is worth mentioning that it may become a reality in the near future. While conducting search for categories a retail outlet may definitely like to delve into the net for information. However, when we are looking onto the Internet for such information our search will be of a different type. Retailers generally post information about the prospective products/ categories on the various search engines like Yahoo, Google, etc and gauge the number of inquiries by the web surfers. On the other hand the merchandisers may' also put up information regarding such categories at various chat sites and take part in the interest amongst the customers who visit that site. Based on the feedback gathered a retailer can take decision in this regard.

### Identifying the Vendors or Sources of Supply

Very often, we find retailer sourcing certain categories from the authorised dealers. For instance in a supermarket, products like detergent bars, cigarettes, and similar products may be procured from authorised dealers of the respective brands. As a retailer depending upon your turnover you may also like to procure it directly from the manufacturer. On the other hand products like food grains and other edibles may be sourced from either the whole seller or directly from the food grain mandi. Coming to apparels a retailer may look into various sources of supply.

Retailers like Wal-Mart are going for global sourcing of their products. International sourcing is an area still new for India although some players have been doing it for quite a number of years. While going for International sourcing the retailer has to be very sure about the rules and regulations of foreign trade, issues related to foreign currency and transport. As a retailer once you decide to source merchandise internationally you should be confident about the credibility of the supplier and the expected return on investment.

It is worthwhile for the retailer to go through the financial statements of the various vendors. This will help in ascertaining the financial worth of the vendors. It also helps the retailer study and visualise the financial position of all the individual vendors.

### Activity 1

Make a visit to a small retail outlet and a large multibrand store in your city/ location. Try and make a study on their sourcing process.

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## 13.3 FACTO AFFECTING INTERNATIONAL SOURCING DECISIONS

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### Country of Origin

Once upon a time electronic goods were sold more prominently with the Made in Japan Sign. Off late, issues related to country of origin have become very important. Swiss watches are very popular among the customers as they are marked of technology and style. Chinese products are supposed to be very cheap but very low in durability. There are many such issues which are constantly discussed in the marketplace by the retailers, customers as well as the vendors. While sourcing international products retailer must always keep in mind the reputation of the country of origin as well as the costs involved and expected perception by the customers.

### Foreign Currency Fluctuations

While making global sourcing decisions a retailer has to be cautious about the foreign currency fluctuations. This is one aspect which makes the product expensive or cheap depending upon the fluctuation in the market. Moreover it will be in the interest of the retailer to enter-into a deal wherein he is supposed to pay at a fixed rate of currency exchange.

### Taxes

There are a host of taxes levied on export and import of products which makes the product expensive or reasonable depending upon the laws of the land. With the introduction of GATT there is an effort to prevent double taxation. However this exists in various forms in different countries depending upon the laws of the respective governments. Moreover with the incoming of the WTO it still remains to be seen what will be the scenario five years from now.

### Comparative Evaluation and Selection of the Suppliers/sources of Supply

Once we have identified the vendors/sources of supply the next step is the critical one to evaluate and select the suppliers.

While short listing vendors and eventual selection, one must look into the following checklist:

- 1) How much reliable is the supplier. Here point to be considered is his consistency
- 2) Price being offered
- 3) Delivery lead time
- 4) Additional services provided by the supplier like credit, free transportation etc.
- 5) Honesty, ethics of the supplier
- 6) Possibility of having a long term relationship
- 7) Financially strength of the supplier
- 8) Risk involved, if any in dealing with the supplier.

The prime consideration -in selecting the supplier is the fact that the products supplied by the vendor will be able to satisfy the needs of the customers.



### Merchandise Examination

Since the customer is ever demanding and makes efforts to get the best quality, the retailer must be cautious. While comparing various sources of merchandise one must always evaluate the quality of merchandise. A retailer should always remember that even if a single unit of bad quality product goes to the customer and is detected by him than he may face a big loss. He will not only lose one customer but many due to negative word of mouth publicity.

### Price Negotiation

In any business money saved means money earned. Therefore every retailer would like to say the least for the merchandise so that he can earn maximum profit. Depending upon the bargaining capacity of the retailer the financial terms and conditions of the merchandise supply is agreed upon. At all points of time a retailer would like to avail as many discounts as possible. Discounts can be of various types like:

**Trade Discount:** This is the reduction in price of the product of supply by the manufacturer. Such discounts are generally given to the wholesalers or retailers.

**Volume Discounts:** Based on the quantum per case made by the retailer discounts are given on the total amount of purchase. Such discounts are given by the manufacturer to boost their sale on an annualised basis. However one should remember that these discounts are given only if specific amount of purchase of goods is done within a specified period of time.

**Cash Discount:** Although such discounts are available in a very small percentage of businesses it is worth mentioning. A specific percentage of reduction is done if the retailer makes the payment within the stipulated time.

**Off-season Discount:** To boost sales of products when there is little and no demand for the product such discount is offered. It is offered as an incentive to the retailer for supporting the manufacturer.

**Promotional Discount:** Depending upon the policy of the manufacturer of fixed percentage of purchase amount of the retailer (from the specific manufacturer) is given as a promotional discount. This discount is actually an amount given to the retailer for promotion of that specific manufacturers plan. This amount comes very handy even for the manufacturer, since certain salient features of the promotional schemes can be laid down as stipulated by the manufacturer. Such promotional schemes have been explained, as schemes jointly financed by retailers and manufacturers. Please refer to unit 11 of this course.

Each retailer tries to reduce the cost of his investment in merchandise. Secondly he would also like to have easy terms and conditions for his convenience. Beside this any retailer would like to have the supplier support for early delivery of order, order cancellation and replacement of defective goods. A retailer always expects discounts, gifts, schemes etc from the supplier. This is an important stage of the sourcing process for the retailer.

All the terms and conditions are discussed and finalised at this stage. The latest in the Indian arena in the field of merchandise buying is the trend known as slotting allowance. This is the allowance paid by the supplier to the retailer to put his brand in few of the prime slots of the store. With more and more brands hitting the shelves everyday the store shelf is shrinking. Thus the slotting allowances have become a relevant outcome of the present retail boom.

### Executing the Purchase

Concluding the Purchase is very important for the retailer. He has got several options at his disposal. However, it also depends upon the bargaining capacity of the supplier vis-à-vis the retailer. At times when the supplier's brand is very



strong with a loyal customer base then this indispensability does not leave any option with the retailer than to just acquire it. There have been instances where despite very low or negligible margins as well as tough terms for payment the retailer is forced to stock the specific brand. Here the rationale is very simple when customers come in they come with multiple requirements. If they get their choicest brand in one of the products they are motivated to stay longer and in due course purchase something more.

While finalising the purchase some essential aspects of the deal are to be kept in mind. The Retailer has to decide when to take the title of the goods. He has to negotiate the credit period. He also has to mount pressure at this time for old grievances if any to be redressed.

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### 13.4 FACTORS INFLUENCING NEGOTIATION FOR SOURCING MERCHANDISE

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Certain factors need to be kept in mind by the retailer before entering into negotiation with the vendor.

**Complete Information:** A retailer or merchandise buyer should have complete information about the vendor. It is necessary for the buyer to have complete historical information about their relationship with the vendor. This at any point becomes a strong bargaining aspect.

Situation analysis of a product is to assess the ground realities in the market. Each vendor has an image in the market, which makes his products sell to the ultimate customer.

Target setting is another important issue for the retailer. While negotiating he has to keep in mind various aspects of the contract such as terms and conditions of payment, freight, transportation, delivery, terms for goods return etc. Based on his past experience a retailer while sourcing merchandise especially while negotiating with the vendor should have specific goals in his mind. This helps them to make the best deal as well as have satisfaction regarding quality of the goods, delivery in time and assurance of redressal of grievances.

Deadlines are very important while negotiating with the vendor. Deadline regarding delivery of product as well as making payments should be clarified and confirmed at the time of negotiation. A clear deadline confirmed and acknowledged by both the parties removes any chances of misunderstanding and conflict between the two parties. This is more in the interest of the retailer since any misunderstanding on such issues definitely will be loss incurring for the retailer.

No assumptions must be made by the retailer regarding any terms and conditions of sourcing at the time of negotiation. Each and every aspect of the contract should be discussed, clarified, confirmed and put in writing and duly signed by both the parties. This removes any doubt or misconception in the minds of any of the parties.

Never spoil relationships-even if the retailer is unable to reach the deal with the vendor he must not under any circumstances, spoil relationships with the vendor. It can just be possible that due to conditions of the contract or price points the vendor refuses to agree and sell merchandise to the retailer. However it is in the interest of the retailer that he patiently waits for the next time to reach the deal with the vendor. In today's market everybody has become so short sighted that relationship has taken the backseat. However, it is worth mentioning that business or no business there should not be any adverse effect on the business relationship. A retailer or any businessman for that matter of fact should not burn bridges which at times become lifeline for the same individual.




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## 13.5 VENDOR RELATIONSHIP MARKETING

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Retailers and vendors share a common cause. Both of them are interested in the merchandise to sell both are benefited once the customers purchase their merchandise. Practically seeing the relationship you will find that both share the same concerns. It is in the interests of both the supplier and the retailer that they work as a team.

The retailer is in a position to share vital consumer information with the vendor. On the other hand the vendor can forward valuable assistance in terms of credit, timely delivery as well as general information of the market. At any given point of time the manufacturer does not have accurate information of the market demand in comparison to the retailer. A retailer's sales forecasts can be much more effective in a manufacturer's production planning and control than forecasts prepared on the basis of manufacturer's experience. Thus sharing of information can prove to be a boon for both the concerned parties stop.

You must appreciate that both the retailer and the manufacturer have their individual interests. Therefore, when we speak about the vendor retailer relationship we have to be a bit cautious. It measures the possible information sharing by one of the parties this time with an intention to make the other party more inclined towards the offer of the first party. Therefore, whenever we are looking into this sort of relationship there have to be some touchstones. These touchstones are mutual faith, common interest, selfless communication, and sincerity towards developing the relationship.

### Activity 2

Visit any retail outlet in your location and try to study the strategic importance of vendor management.

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## 13.6 WAREHOUSING /STOCKING OF MERCHANDISE

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This is the last step in the sourcing of merchandise process. Receiving the merchandise and then stocking is perhaps one of the critical functions of sourcing. This involves various tasks such a receiving the goods, checking the invoice, matching the goods received with goods ordered list, adding the goods received to stocks. Finally making payment and planning for its entry in the store. At this point it is the duty of the retailer to seriously check for damaged goods, unordered goods and any deficient goods (ordered but not delivered). Since generally payments' are not made in advance the retailer has a better chance of getting his fresh grievance redressed early. In case the retailer has a chain of stores then-stocking becomes much more critical as it precedes distribution to various stores in different quantities and may by at different times too.

In store merchandise handling is an important issue which must be dealt with a lot of care and caution. Here the a retailer has to be cautious about the quality and quantity of merchandise delivered vis-à-vis the order. Chances of losses



involving of delivery of lesser merchandise as charged for looms large. There are chances of embezzlement of existing stocks by collusion between the vendor and store staff. Such embezzlements can take place if the staff a successful and very tactfully passing some part of existing merchandise in the store as of old and damaged merchandise through the mode of conveyance used by the vendor to deliver the goods.

### **13.7 HOW MUCH TO ORDER AND WHEN?**

A retailer should always develop a mechanism in this regard, since this is a critical issue. So the focus should be on the following:

- 1) Average current demand for individual items. Also called SKU (stock keeping unit)
- 2) Future SKU demand discounting seasonal and fashion trend variations
- 3) For optimum restocking what sort of ordering policy or rules would suffice.

In order to take these three decisions we need to get some vital information for which we need to have the following:

- 1) Inventory Report ⇒ This describes each SKU and summarises the inventory position.

An inventory report gives vital information from the retailer's point of view. A retailer based on' this information can calculate how much of specific merchandise should be purchased to meet customer demands for a relevant period. It also gives vital indication regarding shrinkage if any as well as the movement in the market. Based on the inventory report a retailer can always take necessary steps to clear stocks before they reach alarming levels. Moreover, it also gives a clear picture as to what sort of assortment should the retailer order for as well as, how much of each constituent of the assortment of the ordered, so as to meet the demand.

Product Availability Report => This indicates that in a month on an average how much the product was available when required by the customer.

This report enables the retailer to understand the vital statistics regarding availability of products in the store. One of the most critical factors for the success of any store is the availability of a product as and when demanded by the customer. However, at times it is just possible that a specific product is not available in the specific size or denomination as required by the customer. Going through this report a retailer can very well apprised himself/herself about the trends in the market and consumer preferences. For instance, if a supermarket owner finds that 100 gms pack of Parle G biscuits were not available for a considerable number of times, an indication is given by these data. In this data is code related with the inventory report data regarding the same brand of biscuits, a vital clue can be derived as to which pack size is not moving vis-à-vis the hundred grams pack.

- 2) Reordering level => It is the amount of inventory below which the availability should not go down. At this point order is placed with the supplier.

Each supplier takes a particular time before the specific merchandise is delivered to the store. On the other hand every retailer has his limitation of space and money. Based on these two considerations retailer can fix the level of stock which, once reaches an order, of that merchandise will automatically be placed with the supplier. This is known as the reordering level. One more consideration



here can be the inventory turnover of the retailer. Therefore, reordering level for the same merchandise can be different for different retailers even if they are based in the same city or maybe in the same area.

- 3) Order quantity => This is very subjective. It's based on the frequency of consumption and delivery lead time.

Once again, order quantity is based on the four factors namely

- frequency of sale and inventory turnover level
- storage capacity
- capacity of the retailer to block funds in the specific merchandise
- anticipation if any, for shortage of the specific merchandise

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### **13.8 SHRINKAGE**

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It is the reduction in inventory caused by shoplifting, misplacement or damaging of merchandise. Such shrinkages can be measured by comparing purchase records with available inventory physically in the store. Depending on the shrinkage decision to source merchandise is influenced (quantity wise)

Shrinkage through customer and employee theft has become an alarming problem for the majority of retailers. Stealing of merchandise from stock area as well as receiving area is common steps should be taken to minimise such happenings. A visual surveillance in such cases has been very helpful and has been prominently found in majority of the stores nowadays. A retailer has to realise that the cost of shoplifting reduces the profit in the bottom line of the organisation. Costs of shoplifting can always make the difference between the retailer earning high profits and a marginally profitable retailer. RFID has been successfully installed in the stores commonly in the West. However in India it has still not become a common phenomenon due to the exorbitant costs involved. More information about this technological product has been covered in unit 20 of this course.

When we are discussing shrinkage, we must not forget the scope of shrinkage in transit. There have been instances that goods have disappeared while the goods were in transit in small quantities to avoid recognition in the first instance by the retailer. Here the pilferage can be between the vendor and the transporter as well as any third party and the transporter. To avoid such thefts the retailer must go for only credible transport agencies. Moreover it is important that the vendor also shares responsibility in this regard. This however has to be communicated to the vendor at the time of executing the contract of purchase.

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### **13.9 IMPACT OF LIFE CYCLE ON SOURCING**

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While sourcing merchandise the buyer is sure about his decision regarding the quantum of purchase. This confidence of the decision comes from the experience the buyer has. This is due to the fact that most of the product categories generally follow the typical life cycle of a category. However variations in the life cycle stages can take place due to seasonal changes fad or fashion

Speaking about that it is generally a short-term spurt in sales due to change in reference. However, fashion exists for a much longer duration and is much more predictable than fad.

Therefore, whenever a retailer is planning for sourcing his merchandise he must take into consideration the prospect of changes in the preferences, lifestyle of the



target customers before deciding on specific categories as well as assortment and quantities to be purchased.

It is worth understanding that all these factors of fashion and preferences will not affect the demand of staple merchandise. Stable/basic merchandise has got a continuous and consistent demand. It may just be possible however, that demand or some of the staple brands of merchandise declined over a period of time. For example a couple of decades back in majority of the households it was a tradition to buy wheat in large quantities and then ground to flour in small quantities on a monthly basis or maximum quarterly basis. This has over a period of time changed as there has been the growth in preference for ready-made flour. Interestingly this has not led to growth in demand for ready-made flour in branded packets. This may be due to the fact of a very high price differential from the flour ground from neighbourhood based flour mills.

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### **13.10 ALLOCATING MERCHANDISE TO STORES**

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After the merchandise is received, the next main task is to allocate the products to different stores belonging to the same chain (Assuming a chain store). While allocating merchandise to different stores retailer generally uses the historical sales information. However it is very important to pay due attention to the current supply and demand situation so as to maintain proper inventory situation. The retailer also has to keep in mind the geographic and, demographic factors influencing each of the stores. It means that due to the concentration of specific community or people of specific region in a particular area demand for the specific category type of products rises in a specific season or month due to some festival or custom. Therefore demand for that specific category of products will be more in that particular store than the other members of the chain. One factor which plays an important role while allocating merchandise is the generation of percentage of total sales. It works like this - in case a retail chain has 10 stores in a particular area and demand for a product has suddenly risen across in all the areas. In such a case the demand for a particular product will dramatically rise however with the limited supplies the retailer has to take a decision regarding allocation of merchandise. Decision here will be taken on the basis of percentage of sales generated by individual stores. The store generating maximum amount of sales will have the authority to demand the same percentage of the product.

Each store has to keep adequate stocks to generate confidence in the customers. It has been generally felt that under stocked stores attract lesser number of customers. Under any circumstances customers must not feel that just because the store is relatively small in size or is not doing well, therefore it is not well stocked. In case the retailer wants to generate sales through a push strategy then he has to obviously keep large quantities of the stock. On the other hand if the strategy is to generate sales through pull strategy then the merchandise is distributed once the demand is generated by the customers at the store level.

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### **13.11 MERCHANDISE PERFORMANCE**

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Merchandise planning process is an ongoing process. Retailers must constantly examine various categories, SKUs, departments, various other aspects of the store- Regarding merchandise a retailer must continuously examine the performance of various merchandise being sourced from multiple vendors. For this a retailer can go for sales analysis whereby, he can compare their actual sales and targeted sales to determine the further strategy. The retailers can also use be complex method of weighing the vendors on a multi attribute basis.




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## 13.12 CRITICAL ANALYSIS OF THE VENDORS

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Since merchandise forms the core of retailing due to the importance given to the sourcing process. It is just possible that for a given product category a retailer is dealing with many vendors. With the given pace of the market as well as changing consumer demands and preferences a retailer has to constantly analyse the performance and critically evaluate in the best interest of the customers and business as a whole. Following are the key areas in which the retailer ought to delve into:

- Standards of quality in the merchandise supplied based on customer feedback
- Comparative study of the facilities/support forwarded by the vendors
- Comparative study of the various discounts given by the vendors
- Total quantum of orders placed within each vendor
- Differences in terms of delivery, price, product quality, any other issues which may have arose in the recent past
- Sales performance of individual merchandise

Such a study is always helpful for the retailer. It not only appries the retailer about the most valuable vendors but also gives indications for future course of action. This helps in strengthening relationship with the deserving vendors and at the same time cautions regarding the ones who do not.

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## 13.13 SUMMARY

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Sourcing is a critical function of retailing. It is at the core of merchandising. This unit initially speaks about the process of sourcing. In this process it is important that we keep a checklist while short listing vendors for procurement. While short listing the quality of merchandise should carry the maximum weight. A retailer should always develop a mechanism based on his business and funds to indicate how much to order and when to order. Shrinkage is one of the risks which all the retailers are facing as of today. Once the merchandise is received the retailer must pay attention to allocating it to the store(s). Sourcing is a large scale purchase decision of a recurring nature. In case of sourcing from international destinations a retailer must be cautious about the country of origin, foreign currency fluctuations and taxes.

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## 13.14 KEY WORDS

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**Country of Origin:** The country, which the merchandise belongs to.

**Reordering Level:** The level of stocks at which the retailer will order for merchandise.

**Shrinkage:** Reduction in stocks due to shoplifting, pilferage etc.

**SKU:** Stock Keeping Unit.

**Sourcing:** The function of purchasing goods from vendors for further selling.



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### 13.15 SELF ASSESSMENT QUESTIONS

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- 1) How collecting information about the merchandise sources is a tedious task?
- 2) How will you explore the possibility of having long term relationship with the vendor?
- 3) What measures can we take to minimise shrinkage?
- 4) What are the main factors which should guide allocation of merchandise to stores in case of a chain of stores?
- 5) With examples explain what points should be kept in mind before entering into a negotiation with the vendor?
- 6) In the unit certain factors have been given regarding sourcing from international destinations. Can you add some more factors which we can keep in mind while sourcing from some specific destinations like Pakistan, Iraq etc.

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### 13.16 FURTHER READINGS

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Sinha Piyush Kumar and Uniyal Dwarika, *Retail Management - An Asian Perspective*, Thomson Learning, Singapore, 2005.