CoVest
Sourcing Network

CATEGORY MANAGEMENT BEST PRACTICES:
Exploring the murky world of manufacturer deviations

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In late 2010, when working with a member to benchmark an IT hardware and software agreement we came to an interesting standstill. With what all accounts have shown to be a much lower margin contract, we could not show savings on the company's existing program, even at cost plus ½%. In the end we found that the existing supplier had put in place deviated pricing with all of the manufacturers without the knowledge of the company. They were just being a good supplier and saving their customer money, right? Yes, it did save them money, but it also ensured that when the company tried to RFP or otherwise move the business they faced a steep uphill battle, especially since they did not know that the deviation existed.

Fast forward to today. In mid-2020 we were able to create, for multiple members, savings in excess of 40% on Facilities Supplies. We were able to achieve these results through the creation of both a more leveraged supply agreement and through the usage of key manufacturer deviations that we have put in place in a category often neglected.

Clearly this is an important concept for anyone delving into the arena of indirect supply management, especially for high SKU count, low volume categories. Let's explore what exactly these deviations are, and how you can use them to your advantage if you have the time and resources to manage indirect spend categories the right way.

What are deviations?

Call them manufacturer deviations, special pricing, or other forms of a special deal; deviations are a discount to industry standard cost. When a distributor negotiates pricing within some categories, they negotiate a "standard cost" upon which all of their pricing is based, unless...

The distributor is required to use the standard cost unless the manufacturer gives them a customer specific allowance. There are a number of reasons that a manufacturer would want to do this; to gain market share, protect sales, or to gain inroads to a new or attractive customer. The important part about these deviations is that the end customer may or may not have knowledge of their existence, and the discounts can be significant. We will get back to that point in a minute, first let's talk about figuring out whether the deviations exist or not.

Do I have deviations in place?

It is our view that these manufacturer deviations are the property of the customer. It is, after all, based upon the attractiveness of selling you products that they were enacted in the first place. You should be able to find out whether they exist. Unfortunately, not all distributors and manufacturers share our view.

Why not? First, they may not be sharing them with you, at least not completely. They may pass on only a small portion of the deviation, just enough to retain your business, and retain the remainder. Secondly, if you ever plan to try to move the business, not knowing is valuable for the existing distributor. New distributors are unlikely to be able to compete on price if they are unaware of or cannot get the same deviation. Manufacturers may be reluctant to grant the same deviation to a new distributor seeking the customer's business, thinking best to support the current supplier who already has the business.

What are the effects of deviations?

The primary effect is lowering the price that your distributor pays for your company's sales. Whether they pass on some or all of that deviation is a black box unless you take control. It is common to see 5 – 10% deviations, but it is not exceptionally rare to see 20% and higher. That is right, without a change in your distributor's margins you could be paying 20% less for some items. If you have a cost plus arrangement with a supplier, this is where defining cost is important. Especially in areas surrounding IT, it is common to define cost as standard cost, where the supplier retains the deviation as a rebate which they receive directly from the manufacturer at the end of the year separately from the transaction.

Deviations therefore have a very negative influence on supplier portability. If there is a deviation in place the existing supplier/distributor has a huge advantage. That begs the question, would a manufacturer be willing to "share" that deviation with another supplier? If you push them hard enough they will, because they do not want to lose the sales, but it is not always easy. Sometimes a given manufacturer may be required to notify the current distributor that you are asking to share the deviation, which puts the distributor on watch that you are shopping for a new partner. Often, though, it can be accomplished without this occurring. The important point is though, that the release of the deviations to all suppliers must occur to create a level playing field among distributors if you are going through an RFP or other business consideration process.

Where are deviations common?

Deviations are common in SKU intensive categories where the manufacturer holds the ultimate pricing power and where competition is limited, but still exists. Categories include, but are not limited to, certain areas of Office Supplies, MRO (industrial supplies, facilities supplies, bearings and power transmission, and electrical supplies, to name a few), and IT (hardware, peripherals, servers , tablets, headsets).

How do I identify deviations and take control?

There are three stages of managing your manufacturer deviations:

Identify: Identifying the existence of deviations can be a more difficult process than you might imagine. It starts with looking at the spend profile for a category and contacting the manufacturers from whom you purchase (whether through a distributor or directly). A strong distributor will help you through this process, but finding the right person to talk to at each manufacturer can be time consuming. Identifying the deviation will help you ensure that you are getting the biggest financial benefit possible from their existence.

Manage: Build a direct relationship with these key manufacturers. They can help you do more than just manage deviations, they can also help you navigate your way through product alterations, ensuring the right usage of their products, and help with understanding what to do with new products that they offer.

Control: Integrate the manufacturer deviation process into both the category RFP process and the category management of existing contracts routinely to drive larger deviations in exchange for consolidation.

What is the end result of taking control of my deviations?

Ultimately both savings and better control over product selection can be achieved through working with manufacturers. In addition, manufacturers may have additional insights into how best to utilize their products and can help you figure out the best products to use for your company. CoVest members have enjoyed many of these relationships, some longstanding and some new, and the significant savings attached to those contracts. Perhaps your company should as well. We aggregate spend across multiple companies to create a more substantial potential customer base to manufacturers that decide to partner with CoVest. This has allowed CoVest to partner with more manufacturers on our members' behalf than they likely could individually. This takes managing deviations to a new level, but at the very least this is an important component of any solid sourcing plan for indirect categories.

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