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TECHNICAL REPORT NO. 1239

April 1998

**VELOCITY MANUFACTURING
COMPANY SUPPLIER
PARTNERSHIP PROPOSAL**

By

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VENDOR C, INC.
"Your Quality Machining Blank Supplier"

MEMORANDUM

TO: John Price, Purchasing Manager, Velocity Manufacturing
FROM: Charles Strait, VP Sales, North American Operations
DATE: June 17, 1998
SUBJECT: Supplier Partnership and JIT II

On several occasions over the past three year, you have encouraged me to discount the prices on the machining blanks that we sell to you at Velocity so that we might align with your 4-2-2% Vendor Partnership Program and thereby achieve the status of Primary Vendor. I understand from the attached competitor price sheets and profit margin analysis which you provided to me that our prices this year averaged 8% higher than those charged by your "preferred" supplier, and that an 8% increase in the cost of machining blanks would make your products unprofitable. Since the business that you could give to us would represent a 20% increase in our current volume and would allow us to restart our second shift operations, I have taken the price demands that you have made quite seriously.

Specifically, at your request, I have brought your proposal to the attention of the management committee here at Vendor C. After a careful

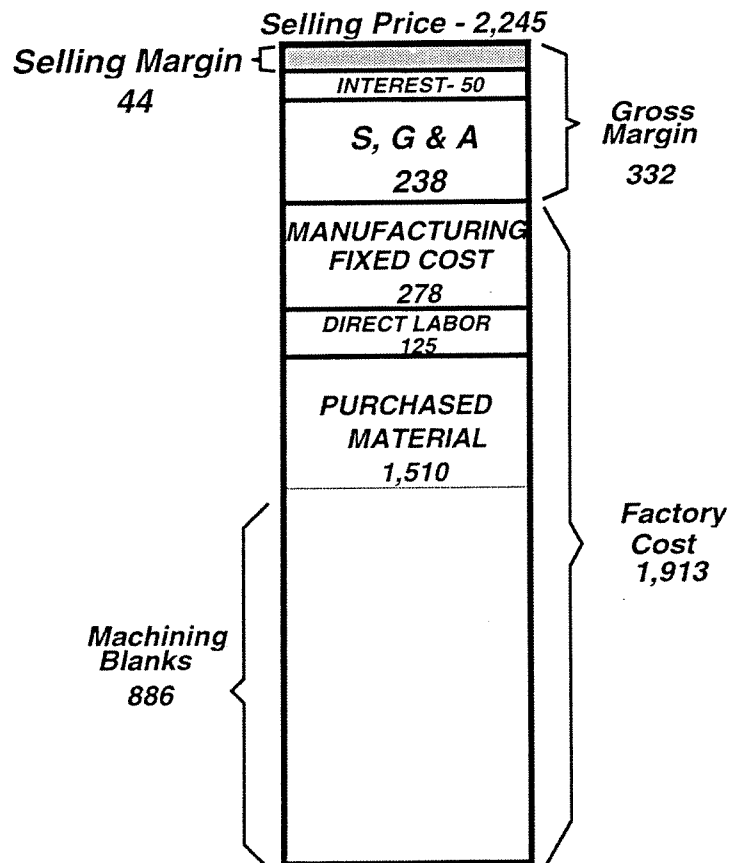
analysis of our operating expenses and our business strategy, the management team has concluded that:

1. from a shareholder perspective, we can not afford to discount our prices while maintaining the quality and service level commitments that we have made to our current customer base,
2. from a current customer perspective, the prices that we charge are considered fair in light of the quality and availability of our product, the speed and reliability of our delivery, and the nature of our support services ranging from JIT point-of-use delivery to new product engineering support,
3. from a prospective customer perspective such as yours, a detailed analysis of all costs and expenses which accrue from your current use of Vendor A's machining blanks will show either that we represent a "somewhat higher price, but lowest total cost" opportunity for you, or that we are simply the wrong supplier for your needs. (Attachment 2 a check list of indirect costs associated with the use of materials which are sometimes overlooked. We would be delighted to help with such an analysis for machining blanks at Velocity).

I must, therefore, respectfully decline the opportunity to become the Preferred Vendor of machining blanks to Velocity under the terms that you propose. I would, however, welcome an opportunity to meet at your convenience to discuss ways in which we might work together to reduce your total material expenses. I will look forward to seeing you at some point in the future and to discussing my ideas with you in greater detail at that time.

| Material | Vendor | Price (\$) |
|---------------|--------|------------|
| Red Blanks | *A | \$184.00 |
| | B | \$193.20 |
| | C | \$196.90 |
| Blue Blanks | *A | \$220.80 |
| | B | \$234.00 |
| | C | \$238.50 |
| Orange Blanks | *A | \$294.40 |
| | C | \$338.60 |
| Yellow Blanks | *A | \$257.60 |
| | B | \$273.10 |
| | C | \$278.20 |
| White Blanks | *A | \$276.00 |
| | B | \$292.60 |
| | C | \$300.00 |
| Pink Blanks | *A | \$368.00 |
| | C | \$415.80 |

*Primary Vendor

Velocity's Vendor Pricing Data**Velocity's Profit Margin Analysis**

Indirect Costs Of Poor Quality Suppliers

inventory management
open order tracking
accounts payable administration
supplier surveillance
receiving inspection
component acceptance testing
material return and claim processing
cycle stock investment
safety stock investment
product rework
production capacity loss
scrap material
manufacturing expediting
integrated product inspection
transportation expediting
warranty service
product liability