

# Consignment stock

The fourth in a series of articles about operations management, written and meticulously reviewed by IOM members – experts in their respective fields, and with the addition of well researched references both in print and on the web.



## CONSIGNMENT STOCK

The stock of goods at an external customer's site that is still the property of the supplier. Payment for these goods is only made to the supplier when they are sold or used by the external customer.

## ALSO KNOWN AS

Consignment stock is closely related to Vendor Managed Inventory (VMI).

## PURPOSE

Consignment stock arrangements are usually put in place to assure continuity of supply to the customer or to reduce the customer's working capital or both. While much of the benefit is to the customer, the supplier also benefits because the customer is tied to his product, he does not have to hold stock, and has more freedom in choosing when to manufacture or procure additional supplies to replenish the consignment stock.

## KEY FUNCTIONS AND FEATURES

Consignment stock is managed by the customer. This is the main difference from Vendor Managed Inventory. The customer draws from and replenishes the stock at will, but should inform the supplier of all stock movements since the stock still belongs to the supplier. The customer makes specific arrangements with the supplier to inform him of remaining stock, usually monthly, so that the customer can be invoiced for usage. Usually the supplier physically checks

stocks (with the customer) quarterly or half yearly and any discrepancies are invoiced as usages.

An agreement should be in place between customer and supplier to cover discontinuation of the supply contract. Customer and supplier generally exchange information about expected future usage and about reorder points and reorder quantities.

There are implications for inventory management systems, material planning systems and financial systems. The stock is managed as if it were the customer's property, but title is transferred only when a specific transaction (such as an issue to manufacturing) occurs. Similarly, the supplier must be able to record, plan for and account for consignment stock although it is being managed by another party. Both of these requirements can be difficult to satisfy.

## BENEFITS AND RISKS

### Advantages to the Supplier

- The customer is a 'captive market'
- Supply can be made at convenient, regular intervals (so production and delivery costs can be reduced)
- Panic buying by the customer is eliminated.

### Advantages to the Customer

- Confidence in availability of items
- No need to plan supply
- Reduction in inventory value and improved cash flow
- Purchasing does not need to be involved in replenishment

Consignment stocks may not reduce significantly the overall cost to the

supply chain. They transfer some of the costs one stage back in the chain i.e. to the supplier. Their main advantage over a conventional supply partnership is that the goods are in place at the customer's site.

## Risks

Consignment stocks do have several disadvantages:

- The overall inventory may be increased due to suppliers sales people negotiating inflated stockholdings and to duplicated inventories
- The only pressure to reduce inventory is indirect
- Customers can use it as an excuse for not planning purchases, and therefore some stock will eventually become obsolete
- Suppliers are likely to extra costs by carrying out stock audits on customer's premises.
- A very high quality of stock rotation and record accuracy is required to be maintained by the customer's employees when dealing with the suppliers' inventory.

## INDUSTRY SPECIFICS

Consignment stock is extensively used in many industries, especially automotive.

## RELATED TOPICS

See also: Vendor Managed Inventory

Reorder Point  
Inventory Management  
Financial Systems  
Business Systems:  
Specification

## REFERENCES AND SOURCES OF ADDITIONAL INFORMATION

Wild, Tony. "Consignment Stocks - An Opportunity?" Control Vol 24 No 10 (December 1998 / January 1999)