

Case 2: Managing suppliers at FaastLane Ltd

FaastLane Ltd manufactures motorbikes and is located in Brisbane. More than 70 per cent of the cost of the company's motorbikes consists of material and components, which are purchased from Australian suppliers.

About three years ago, FaastLane introduced a comprehensive supplier evaluation system to monitor the performance of its suppliers. Each supplier was given a three-year contract that guaranteed large orders as long as it performed according to FaastLane's strict requirements. Each supplier's performance was measured by considering its adherence to delivery schedules (FaastLane works on a just-in-time (JIT) system), accuracy of orders delivered, number of components rejected on delivery, and its achievements in reducing its production costs (and, therefore, its material and component prices) over the contract period. Performance in all of these areas will determine whether FaastLane renews the supplier's contract or offers the contract to another supplier. The suppliers are aware that there are many alternative component suppliers who would be eager to enter into a long-term contract with FaastLane.

After holding discussions with the purchasing manager, as part of the review process, the financial controller has conducted a study to determine the full cost of dealing with suppliers. While the company uses a series of non-financial performance measures to measure most aspects of supplier performance, the financial controller believes that the calculation of the total cost of ownership will provide an additional perspective to viewing supplier performance. For the most recent year, the following supplier-related activities and costs have been identified:

Activity	Total Cost (\$)	No. of Activities
Order components from supplier	1,080,000	3,600 orders
Receive order	5,400,000	6,000 deliveries
Return reject components to supplier	23,100	33 returns
Receive late deliveries	156,000	78 late deliveries
Production downtime due to late delivery	1,440,000	480 hours
Production downtime due to defective material	2,160,000	1,800 hours
Process invoice and pay supplier	630,000	1,800 invoices
Dispute invoiced amount	24,000	30 disputes
Quality audit of suppliers	300,000	6 audits

FaastLane obtains its exhaust systems from a four suppliers, the two most important of which are I-Pot Exhausts and Chroma Manufacturers.

Last year, FaastLane purchased 3,000 units from Chroma Manufacturers at \$200 per unit, and 5,000 units from I-Pot Exhausts at \$190 per unit. Both suppliers provide an identical component.

The analysis revealed that last year the following activities related to the two key suppliers:

Activity	I-Pot Exhausts	Chroma Manufacturers
Order components from supplier	130 orders	90 orders
Receive order	150 deliveries	90 deliveries
Return reject components to supplier	16 returns	15 returns
Receive late deliveries	28 late deliveries	6 late deliveries
Production downtime due to late delivery	45 hours	34 hours
Production downtime due to defective material	29 hours	20 hours
Process invoice and pay supplier	130 invoices	12 invoices
Dispute invoiced amount	3 disputes	1 disputes
Quality audit of suppliers	2 audits	1 audit

Requirements:

1. Prepare a report for management comparing the two suppliers in which you:
 - a. Provide a detailed supplier cost analysis and calculate the supplier performance index (SPI);
 - b. Identify the key drivers of SPI – that is, the factors to which SPI is more responsive to;
 - c. Consider the various criteria used by FaastLane to evaluate suppliers and for each criterion propose two performance measures that the company might use to evaluate suppliers' performance.
 - d. Evaluation of the current situation and advise whether contracts should be renewed with I-Pot Exhausts and Chroma Manufacturers;
2. Drawing on your analysis above, but not limited by it, make a set of appropriately justified recommendations to management regarding ways of managing suppliers that would be beneficial to the company.
3. Discuss how accounting and performance measurement systems may create challenges to supplier management. What recommendations would you make to their design to enable effective supplier management?

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