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A Converge White Paper

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Recovering Value from Surplus Inventory

- What is Surplus Inventory
- Causes of Surplus
- Risks Associated with Surplus
- Solving Surplus Problems
- Surplus Remarketing Partner

Unexpected Changes.
Reliable Results.

What is Surplus Inventory?

In the electronic components industry, a surplus market is a situation in which supply of a particular type of commodity, such as DRAM memory, exceeds demand from buyers. A surplus market can be a widespread phenomenon as well, with general oversaturation of unneeded components. Either application can also be referred to as a “surplus” or “buyer’s” market.

One of the main characteristics of a surplus market for a specific product is a sudden drop in the value of the product. In addition, lead times for delivery are significantly shorter than usual.

The definition of “surplus inventory” in itself has changed over the last ten years. Formerly, electronic components were considered to be surplus after they had been in inventory for at least six to twelve months. Now, due to the rapidly changing pace of modern technology, parts can be considered surplus after they have been in inventory for only three months. At that point, the owner must rush to “move” the surplus inventory before the parts become obsolete. With new technology continuously being introduced, the velocity of turning surplus electronic components into recovered value is critical.

Causes of Surplus Inventory

There are several predominant factors that can cause a particular electronic component to oversaturate the market.

Inaccurate forecasting. Very often, inaccurate analyst forecasts cause companies to buy more inventory than they actually end up needing. For example, DDR3 SDRAM was forecasted by most industry analysts to be in large shortage during the second half of 2010. This was a new type of memory for desktops and notebooks. Following the forecast models, manufacturers bought vast amounts of DDR3 to avoid having to shut down production lines when the potential shortage hit. What happened, however, was the complete opposite of what was predicted. Greece declared bankruptcy in early 2010, and other European countries started to admit financial turmoil as well. These world events threw off



the estimates on the number of computers that were going to be sold in the European community. This resulted in the major computer manufacturers reducing their output by nearly 40 percent.

In the end, manufacturers were left with millions of dollars of DDR3 SDRAM components in inventory that they had no use for. The result was a widespread surplus situation in which the value of the inventory significantly dropped. Global DRAM revenues declined to \$8.64 billion in the fourth quarter of 2010, down 20% from \$10.78 billion in the third quarter, according to DRAMeXchange.¹

Late cancellation of current product lines. If a product line is unexpectedly cancelled after manufacturers have already ordered the parts needed to make that product, surplus inventory can result.

Seasonal lows. Demand for certain products can vary greatly with the seasons. The Christmas shopping season, for example, can lead manufacturers to buy a large number of components needed to make a popular item. If the item doesn’t sell as well as expected, manufacturers may be left with significant surplus after the holiday buying season is over.

Risks Associated with Surplus

There are substantial financial risks for any company that finds itself with surplus inventory in a surplus market. A manufacturer could lose millions of dollars, depending on the volume of surplus inventory it owns and the original purchase price of the components. The original purchase price is also known as the “established cost.” Ninety-nine percent of the time, the company will not be getting that entire established cost amount back.

It is possible to find a buyer for surplus parts in a saturated market with the help of an expert with vast market knowledge and global connections. The owner of the inventory must understand that the resale price probably will be less than the original price, but that it is better to recover some of the loss on surplus inventory than to sit on it indefinitely. The longer a company waits to remarket surplus inventory, the more recovery value it will potentially lose.

$$\frac{\text{Established cost of surplus inventory} - \text{Recovered value}}{\text{Total loss from surplus inventory}}$$

Solving Surplus Problems

Independent electronic component distributors offer critical solutions in a complex, fast-moving supply chain – purchasing excess inventory, responding to shortages, balancing demand and bringing flexibility to the marketplace. Neither OEMs nor ODMs could function without them. Yet, by serving in the role of “middleman,” the distributor takes on the additional job of protecting manufacturers by stopping counterfeit and substandard parts before they make it into the supply chain and, eventually, into the hands of consumers. If you are dealing with a distributor that does not have a rigorous Quality Management Program, you are putting your company’s reputation on the line with every transaction.

When choosing an independent electronic component distributor, be sure to choose one with a world-class Quality Management Program. And ask to see the details. Anyone



CONVERGE®

Solving Surplus

- Outright buy
- Consignment
- Demand Opportunity

can procure a part. Only quality-driven distributors can guarantee parts that protect their customers and the manufacturers that they represent.

A reputable independent distributor mitigates risk and expense in a surplus market by helping manufacturers recover value from surplus inventory. There are several different ways in which to do this:

Outright buy programs. The independent distributor purchases the surplus and obsolete inventory directly from the manufacturer and remarkets it through its global sales channels.

Consignment programs. The independent distributor partners with the manufacturer to take “consignment” of surplus inventory. In other words, the manufacturer consigns its surplus inventory to the distribution partner without having to do any of the legwork. The distributor then remarkets the materials through its global sales channels, with proceeds returned through a mutually agreed upon shared revenue program.

Demand opportunity. The independent distributor provides the quickest time to market while the manufacturer maintains possession of its inventory throughout the sales process, consigning parts on an as-needed basis.

No matter which solution is used, timing is a vital part of the remarketing process. When it comes to surplus inventory, the company that goes to market with a specific type of component first is likely to see a better value return than the companies that remarket the same component in the days that follow.

What to Look for in a Surplus Remarketing Partner

When looking for an independent distributor to help you with the sale of surplus inventory on the open market, there are several key qualities that you should check for:

Size. Independent distributors come in many shapes and sizes. The bigger the company, the more traders and “tribal knowledge” you will have working to your advantage. Size does matter when it comes to recovering the most value for your inventory.

Commodity managers. Generally speaking, commodity managers go hand in hand with size. A small, independent distributor will probably not have experts who are solely dedicated to studying one particular commodity’s global activities; larger ones probably will. Commodity managers devote their time to assembling complete market intelligence around one or two specific commodities, and can provide a wealth of in-depth market knowledge to the traders working on your behalf.

Around-the-clock workforce. We operate in a global economy, not one that ends at 5 p.m. in the time zone that we happen to live in. When it is 5 p.m. here, the workday is just beginning somewhere else in the world. A global independent distributor will have traders and/or commodity managers working around the clock in different regions of the world, which enables them to find a solution for your surplus parts in as little time as possible. In addition, because an independent distributor with an around-the-clock workforce never stops working, it never misses a beat when it comes

Surplus Partner

- Size
- Commodity Managers
- 24/7 Workforce

to knowing about world events that may affect the market.

The need to remarket surplus inventory will always exist, whether there is a surplus market or a stable market. Despite the best-laid plans, manufacturers will end up with more parts than they need for the current demand of their products. It is simply the cost of doing business in an unpredictable world. The good news is that solutions do exist to help mitigate surplus inventory costs, no matter which market currently prevails. By partnering with an independent distributor you trust, your company will be better prepared to handle any surplus market challenges that come along.

About Converge

Converge is the premier global supply chain partner for technology-driven companies. We provide solutions that increase your bottom line and reduce your risk in electronic components distribution.



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¹ CBR Staff Writer. “Global DRAM Revenues Decline to \$8.64bn in Q4 2010: Bedford.” Computer Business Review. 22 Feb. 2011. Web. 04 Mar. 2011. <<http://storage.cbronline.com/news/global-dram-revenues-decline-to-864-in-q4-2010-bedford-220211>>.