



Vendor-Managed Inventory: Truck Parts Supplier SKF Peels Out With SaaS

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Sustained vendor-managed inventory (VMI) successes are hard to find. Despite its well-quantified financial impact among those that perform it well, the AMR Benchmark Analytix service finds that fewer than half of all brand owners practice buy-side VMI, and fewer than 5% apply VMI as their primary component-inventory planning method.

The relative dearth of VMI deployments flies in the face of the exceptional financial benefits of so-called joint value creation, in which supplier and customer share inventory risk and visibility reward to lower the total amount of inventory required to achieve exceptional end-customer service.

But our interview with Craig Young, director of e-commerce and VMI evangelist for leading truck parts supplier **SKF**, leaves us with optimism that VMI best practices may indeed be within closer reach of the cross-industry mainstream.

We showcase the positive results of Mr. Young's efforts, sharing insights into how he and SKF have combined active customer outreach with software-as-a-service (SaaS) deployment methods to bring collaborative VMI to the automotive aftermarket. The roots of Mr. Young's recent successes can be found in the financial opportunities at stake for his distribution accounts.

AMR Benchmark Analytix data indicates companies that practice VMI with their suppliers hold 25% less materials inventory on 6% lower total supply chain costs.

Given how much stands to be gained from VMI, the money left on the table due to companies' adherence to antiquated, arm's-length inventory planning methods is staggering. To help, Mr. Young offers some of his own answers to the following:

- Why, despite the clear benefits, has VMI uptake been so slow in his industry?
- How is SaaS helping to remove at least one of the two major barriers to VMI growth?
- What tangible dollar gain has SKF been able to help its customers realize with VMI?

The twin potholes: trust and technology

Trust

It almost goes without saying that trust must be the foundation of any collaborative planning initiative. But the problem with much of the VMI how-to literature is that it describes trust as a requirement that sits right alongside technical software functionality, as if trust is something we can buy from a vending machine. Of course, if it were that simple, trust would not be such a scarce commodity, the way it is among and between vehicle assemblers, distributors, and parts component suppliers like SKF.

Mr. Young claims that the main obstacle to establishing trust with his customers has been the relative shortage of visionaries within his customer base that are naturally inclined to risk the pursuit of more productive commercial models. He states, "When you're trying a new process, it's critical to have a customer that brings an attitude of partnership, that will work with you to make the new process successful. The strategic thinkers are out there, but historically they have been hard to find."

Technology

The other significant barrier to VMI deployment, particularly at points furthest upstream in the supply chain, has been the absence of IT sophistication and the resources needed to bring VMI to scale. In our study of automotive spending (see "Automotive and Heavy Equipment Budget Outlook for 2007: Reducing Time to Market and Increasing Market Share"), AMR Research finds 60% of companies that take on VMI also have to confront nontrivial levels of software customization.

Yet most lower tier suppliers and their low-margin distribution partners don't have the resources to buy, let alone customize, sophisticated tools for automating collaborative business processes. Adds Mr. Young, "Even if they had the cash, they don't have the internal capability."

SaaS puts VMI in the fast lane

SKF has long held that the best way to overcome financial and administrative obstacles is to outsource setup and

maintenance of VMI programs to a third-party specialist. To that end, SKF in 1997 engaged **Datalliance**, a turnkey VMI SaaS hub.

Datalliance provides the following:

- Data translation and error alerts when formats or taxonomies are incompatible
- Data staging tables
- Order recommendations
- Performance and problem reporting
- Order points and order quantity policy recommendations, with overrides

Depending on the metric that most concerns the customer (such as inventory turns versus fill rate versus profitability), SKF and Datalliance tune the optimization method used to set reorder points.

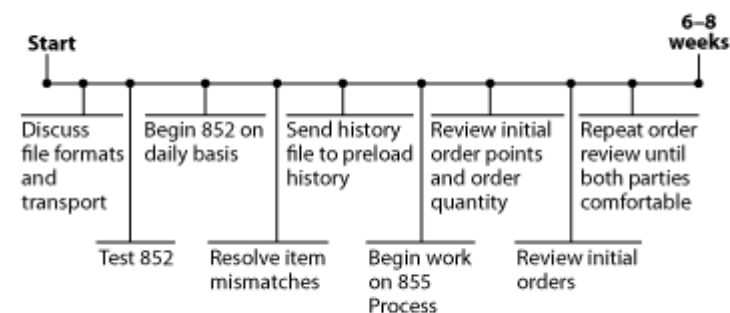
At initial program setup, the analysis generally starts with a detailed query of hundreds of line items and a simulation of alternate approaches. It then finishes with a prescription for a blended set of optimization techniques.

Once consensus is reached as to the preferred weighting scheme, SKF lets the automated order points take over. Datalliance generally then recalculates order points weekly, running through a set of tests and highlighting order points that fall outside predefined control limits.

To accelerate adoption, SKF picks up the full tab for the Datalliance services subscription. And the ramp is quick: SKF typically takes a new VMI customer from business agreement to software go-live in six to eight weeks. Figure 1 shows a typical implementation timeline.

Our research on 2006 automotive and heavy equipment technology spending indicates that just 10% of companies purchase turnkey SaaS. But anecdotal evidence from companies like SKF suggests that SaaS is such an efficient mechanism for collaborative commerce that we may be witnessing the dissolution of the last of the major technical impediments to wider adoption of VMI best practices.

Figure 1: SKF's standard VMI implementation timeline, with support from Datalliance



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Source: AMR Research, 2006

Results

By demonstrating VMI success with a few early customer pioneers, Mr. Young has armed himself with credible stories to bring to other accounts, those that may at first be more averse to the risk of business process transformation.

SKF now runs VMI with 15 of its major customers and processes almost 100% of its sales volume with those accounts through VMI. Among those deployments, Mr. Young cites the following highly tangible benefits:

For the customer:

- **Administrative cost**—"Because we plan at least as well as the customer," says Mr. Young, "We eliminate over 50% of their planning effort."
- **Inventory cost**—"The reality is we generally plan better than they can." One customer, because it had been overestimating SKF replenishment lead times, was carrying \$1.2M of SKF inventory. Shortly after SKF had set up VMI service for the account, the customer's inventory dropped to just more than \$600K for the same high level of service. Says Mr. Young, "In VMI, the manufacturer has to understand their customers' businesses better than if it's [electronic data interchange] or a phone order. That's where we generated that lead-time insight." Mr. Young states that the national market average is 3.2 inventory turns. He claims to have been able to double that number for most of his major accounts.

For SKF (the supplier), the Datalliance service offloads the cost of the following:

- **Customer communication**—On basic systems and data configuration.
- **Syncing files**—Datalliance maintains a copy of the SKF master inventory file and matches the data against the customer file. The application does the heavy lifting to match SKF part number against customer part number.
- **Managing exceptions**—Datalliance feeds the customer and SKF copies of any exceptions that kick out, according to preconfigured business rules.
- **Building internal VMI planning expertise**—Datalliance has a team of in-house experts that maintain algorithms and train SKF staff based on experience with other VMI implementations.
- **System maintenance**—Once basic file formats are established, the Datalliance system becomes

turnkey.

More important than cost savings, however, is the ability that VMI offers SKF to strengthen relationships with its key accounts. Saving the customer money and offloading the customer's planning effort is the surest way to increase market share, states Mr. Young.

The road to VMI growth

This is not to say that pioneering a new supply chain capability like VMI has not been rough-going. The problem of trust is still very much at the top of Mr. Young's agenda. He continues to promote ceaselessly at various public forums. SKF has even made VMI an explicit part of its sales force's bonus plan. And despite all this effort, fewer than 5% of the more than 1,500 independent wholesale dealers in heavy duty markets have instituted VMI with SKF or any other supplier. "It's still a challenge to find visionaries who understand the potential," he laments.

But Mr. Young also believes he's on the cusp of a true inflection point in the lifecycle of VMI adoption. For the first time, "Customers are approaching us to understand how to start VMI," he says. And the ease of SaaS has made a name for itself among other manufacturers. SKF was the first in its industry to sign up with Datalliance.

Says Mr. Young, "All other manufacturers are on board. Datalliance is close to becoming the VMI standard in the vehicle aftermarket." Now it is just that small matter of finding enough other customers that know the value of taking a risk.