

Call it SAIM or VMI; But Call it Win-Win for Both Partners

The payoff of vendor-managed inventory agreements assures that the process isn't just another trend.

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Over the years there have been many fads in the wholesale distribution industry. Some have affected operational structures, some have changed technology, and some have altered processes. The one area that has not seen many fads or trends is inventory management. Sure, there have been numerous attempts to automate the process completely, and sometimes automation works without a hitch.

But often human intervention is required to manipulate purchase orders to match minimum order quantities, discounted pricing, or the available capital allocated for inventory replenishment. Manufacturers and distributors have battled the challenge of replenishment since the beginning of time, each trying to make the process absolutely correct the first time. Distributors are challenged to replenish inventory in a way that meets requirements established by manufacturers. Manufacturers, meanwhile, strive to meet the replenishment needs of their distributors in an error-free and timely basis.

However, due to ever-changing customer demands placed on distributors and manufacturers, the replenishment cycle often hiccups, and thus the finger pointing begins. With the advent of vendor-managed inventory, there is hope that the hiccups will go away and the finger pointing will stop. VMI is a win-win situation for everyone in the channel. Vendor-managed inventory, in its simplest form, allows the manufacturer to replenish the distributor based on product usage and stock level information fed to them by the distributor. Sounds too simple? Well, there are a number of things that need to happen up front before VMI can be implemented.

First, there needs to be a trusting relationship between the distributor and the vendor. The manufacturer trusts the distributor to feed them accurate information on a timely basis. Manufacturers use this information to develop production and shipping schedules. The distributor trusts the manufacturer to use the information correctly to re-supply them with the necessary quantities to meet customer demands.

The distributor must be assured that the quantities they receive are always correct and will arrive on time. The distributor must also trust that the "confidential" information they share with the manufacturer is kept confidential relative to the marketplace and competitors. If any element of the relationship is missing or breaks down, VMI can become a nightmare instead of a dream come true.

Manufacturers win because they develop close relationships with key distributors to get their products into the marketplace. They also win because they can schedule their work load to match customer demands, thus gaining internal cost efficiencies in every aspect of their operation.

Distributors win because they can be assured that the products covered in the VMI agreement will always be delivered on a timely basis, in the right quantities, and at the right cost. Distributors will obviously work harder to get the manufacturer's products into the marketplace because they are gaining efficiencies of scale by reducing errors, costs and backorders--while increasing customer satisfaction.

Along with the trust factor, there are a number of other key elements that make VMI a win-win situation. Paramount to the success of VMI is the use of technology, namely electronic data interchange. EDI is the vehicle used to transmit stock levels and usage rates from the distributor to the manufacturer. The manufacturer uses EDI to inform the distributor of shipping schedules, lead times, quantities shipped, product verification and invoicing. Without EDI, or a direct computer-to-computer

interface between the manufacturer and the distributor, VMI is impossible.

Since the intent of VMI is to provide cost savings and efficiencies to both the distributor and manufacturer, technology is the key to realizing those efficiencies.

Depending on what systems are used and how the agreement is structured, data can be transmitted between the distributor and the manufacturer several times a day. Some of the most successful VMI relationships necessitate that the EDI transaction set formats and the EDI networks be identical in nature. Some manufacturers have even developed complete EDI transaction set formats that are required to be used by their VMI distributors.

On the surface this may sound harsh, but it actually makes good economic sense. The process eliminates the possibility of errors occurring in the EDI translations and cost efficiencies can be gained by using the same value-added network providers. With so much “confidential” and “mission critical” information being exchanged, there is no room for errors.

VMI’s Payoff Is High. While some distributors may be squeamish about letting their vendors manage their inventory, the distributor receives the greatest benefit from a VMI relationship. In most distribution operations, there is at least one full-time buyer or purchasing manager whose responsibility is to identify what products should be carried in inventory, analyze usage rates, manage cycle counting, manage stock levels, and use the computer and their instinct to decide when and how much to order. With their vendors each year, the pressure can be immense.

A small mistake here and another mistake there may not seem like a big deal, until you add up all the dollars involved over a year. Now, let’s multiply those “little mistakes” by the number of buyers, the number of products, and in some cases, the number of branches. The result may be devastating to the distributor, since the most common reason most distributors fail is “mismanagement of assets.” With inventory being a distributor’s largest asset, VMI makes even more sense when implemented and managed correctly.

Let’s examine some of the savings gained and hassles eliminated on the distributor side of the VMI agreement. For those products covered under VMI, buyers usually only have to do some monitoring of those items, rather than the detailed analysis required to place cost-

effective purchase orders. This allows the buyer to spend more time focusing on other product lines, helping to ensure that the lowest outgoing cost is achieved through timely replenishment in quantities that meet customer demands, but that do not overflow the shelves in the warehouse.

Once shipments from the VMI vendor begin arriving on a regular basis with a high degree of accuracy, distributors can reduce their costs and efforts in the receiving area by eliminating detailed cross-checking of the purchase order. Since most VMI arrangements allow the distributor to return merchandise to the vendor at no cost and hassle-free, distributors can simply take the shipment from the truck and put it right on the shelves.

This also helps distributors replenish their “available for sale” quantities much faster, thus positively impacting customer service levels. Since many VMI vendors do not require a distributor’s order to be of a minimum size, this also helps the distributor manage surplus stock levels and potential “dead stock” inventory. With many VMI vendors paying the freight on the shipments, this eliminates much of the “add-on” stock some buyers tack on to a purchase order to reach the “freight free” minimums. This can have a great impact on the turnover rates of the distributor by reducing stock levels, yet not negatively impacting service levels.

Some vendors identify premium SKU’s that they guarantee the distributor will receive within 48 to 72 hours. This obviously can have a major impact on customer service levels, particularly for those items that the distributor should never have out of stock. Advanced VMI vendors even identify the distributor’s stocking location on the packages, thus allowing the distributor to put away the product faster and with a higher degree of accuracy. It should be obvious that constant communication between the vendor and the distributor is critical to make this feature work.

Should a shipping error occur, the vendor accepts responsibility and the word of the distributor, and fixes the error in a short time frame. It is the distributor’s responsibility to provide the shipping error feedback and supporting documentation to the vendor within a predetermined period of time. The invoice reconciliation process is nearly eliminated since in most cases the invoice is automatically posted into the distributor’s accounts payable system, with payment schedules determined during the

VMI agreement negotiations. There are a number of wins for the distributor under VMI, many of which eliminate some of the internal costs of operation, increase customer service levels, decrease the distributor's annual cost of carrying inventory, and put additional dollars on the bottom line.

Manufacturers win because their VMI distributors make a commitment to carry a broad breadth of their products. The distributor must agree that the majority of the specific SKU's they distribute will be from the VMI vendor. While that may seem to contradict some of the aforementioned savings in inventory, don't forget that the distributor receives these items in a just-in-time manner, the products shipped have a very high degree of accuracy, there is a very liberal return policy, and the distributor has multiple opportunities to return merchandise to the vendor.

Manufacturers require that all information regarding usage rates and stock levels be 100% accurate from the distributor. It is also the distributor's responsibility to alert the vendor of any major changes in usage rates, or anticipated changes. This includes large one-time sales, adding or losing a large customer, distributor promotions, or protected stock for a distributor's key customer. As you can see, VMI agreements represent a "partnership" that has many advantages. However, just like any partnership, there is not always total bliss and utopia.

Once a VMI agreement is inked, there is a great deal of pressure put on both parties to perform up to the standards outlined. One key ingredient is that the computer systems used by both parties are compatible and able to handle the detailed electronic transfer of information and funds. This may require distributors to invest in upgrading their computer systems to comply with the vendor's incompatible technology standards.

However, with all the potential cost savings available to distributors, upgrading systems should not be a stumbling block in determining if a VMI agreement should be completed. Upgrading computer systems more frequently is a way of life in today's hi-tech environment. Distributors can't afford to be "penny wise and dollar foolish" on this issue. If both the vendor and the distributor develop the trust, the relationship, and the partnership required for VMI to succeed, they will both

realize all the up side advantages that it has to offer.

Entering into a VMI agreement is not something done on a whim. Take the time to research the up sides and the down sides. Only then can you determine if VMI is the winning formula you've been looking for.

For more information on Vendor Managed Inventory please visit www.datalliance.net.