



Supply Chain Management Best Practices



Is Vendor Managed Inventory Right for your Business?

"The most commonly touted benefit [of VMI] is usually better inventory turns."-Jason Bader



What is Vendor Managed Inventory (VMI)?

The thought of someone else managing the replenishment of inventory, at no cost to you, sounds like a pretty good plan. Those inventory planners and buyers are pretty expensive folks. Not as expensive as sales reps, but they do add a nickel or two to the payroll. Beyond the payroll expense, figuring out what to buy can be three parts art and one part science. A friend of mine once suggested that purchasing inventory in a distribution company is “a thousand little decisions done right each day”. No disrespect, but it sounds like someone was trying to justify his existence. All kidding aside – replenishment is a challenge we would all rather do without.

In order to prepare for this article, I solicited the opinions of several distribution experts. In addition, I surveyed and interviewed many distributors who currently participate in VMI relationships. This is a culmination of what they told me.

Vendor Managed Inventory, or VMI, comes in many different forms and relationships. Essentially, inventory levels are managed by the preceding link in the supply chain. Some VMI relationships constitute the manufacturer managing inventory levels in their distributor customers. Some distributors manage the inventory levels of their customers. For the purposes of this article, I have focused my attention on the manufacturer – distributor relationship from the perspective of the distributor.

There are a couple of different ways to develop a VMI relationship. A manufacturer can use a proprietary system that analyzes your transactional data in order to recommend orders. The greatest challenge with these types of systems is getting the data into a common format. Many participants said this was the greatest challenge in the whole process. Another option is to go through a VMI service provider. Several participants indicated that this was a much easier way to go because the data translation, between manufacturer and distributor, was handled by the provider.

In this relationship, the service provider fee is typically covered by the manufacturer so there is very little downside to a distributor. It was also noted, by those who had used both a service provider and a proprietary system, that the service provider was more adept at understanding inventory replenishment in a distributorship. As we all know, manufacturing and distribution are two very different animals.

The Benefits:

The most commonly suggested benefit derived from VMI was the ability to return products without the usual hassle. One person I spoke with described a complete

change of demeanor by their rep with regard to returns. Prior to entering into the relationship, the rep would be very reluctant to accept returns even though the distributor was well within the stated policies. It was always a hassle to get a return authorization signed. After they entered into a VMI relationship, the rep almost welcomed the return transaction. According to this distributor, that made the program worth its weight in gold. My suspicion is that it had something to do with how it affected that rep's sales commission, but you didn't hear it from me.

The most commonly touted benefit is usually better inventory turns. A liberal return policy will help this a great deal. The fact that you don't have to make freight minimums anymore is another huge factor. Most manufacturers dispense with the normal freight minimums for VMI customers. This really helps when you need to do non-stock specials or have high volatility. Can you achieve solid inventory turns without VMI? Sure, but it makes it a lot easier when the supplier is a partner in achieving mutually agreed upon goals.

From a customer service standpoint, many participants suggested that they experienced fewer stockouts and better overall flow of material. One participant shared that he was always the victim of shortages due to product allocation. After VMI, those shortages disappeared. Although the manufacturer never publicly stated it, he believed that his company was now given priority status on products subject to allocation. Some people believe that this is a reward for helping a manufacturer to plan better. Although there is a possibility for a manufacturer to use your data to improve their production, it is fairly unlikely. Your business would have to be a significant portion of their overall volume in order to move production planning.

Cash flow improvements are a distinct possibility. Some manufacturer's offer incentives for VMI customers. These could come in the form of rebates or special payment terms. They should. Much of the benefit occurs at the manufacturer level. Let's face it, once you go on VMI with a supplier, they make it very difficult for competitive products to earn a seat at your table.

Many people believe that there is a potential labor reduction by entering into a VMI relationship. Unfortunately, this is not often the case. VMI is not a "set it and forget it" type of program. You still have to watch and approve the orders as they are generated. Many participants suggested that they still have to tweak orders on a regular basis. I guess this is a good segue into the challenges of this type of program.

The Potential Challenges:

As I mentioned above, data translation is one of the biggest challenges to any VMI relationship. The two partner systems have to be able to communicate. I can walk around the country and find many different item codes for the exact same product. Many people overcome this challenge by using the UPC code as a common denominator. This requires the distributor to enter this field in their master item records. Not a very difficult task, but a significant time consideration. VMI service providers can really help smooth out this translation.

Reporting can also be a real challenge. First, the distributor has to be able to create a transactional report that accumulates usage. Second, the manufacturer must be able to assimilate this report into their system and populate the proper fields. Any time 2 databases try to communicate, bits can get lost in translation.

One participant suggested that they had difficulty with rapid changes in sales usage. As sales picked up, the system always seemed to be in catch up mode. Highly volatile item can be difficult to predict. When the replenishment recommendation is one step removed from the distributor, the challenge is magnified.

Overstocking of material has always been one of the biggest fears around VMI. Once you hand the reins over to the manufacturer, look out. Here come the 40' trailers. While some participants experienced overstocking in the beginning of the relationship, simple adjustments leveled off the optimistic flow of inventory. Holding partners to some specific performance metrics will help offset this challenge.

On the opposite side of the spectrum, some distributors experienced problems with programs that tried to manage the inventory too tight. Setting up unrealistic parameters, such as 8 or more annual turns, caused inventory shortages in many key products. This is why inventory turn goals must always be balanced with customer fulfillment goals.

The Advice:

The best recommendation I heard was: Make sure that you have a good relationship with a supplier before you even consider entering into a VMI program. Several participants agreed that you should only attempt this type of program with someone you have been involved with for a long time. It should be a trusted partner with a track record of successful VMI implementations. If they are not doing a great job for you now, VMI will not necessarily make them better.

Before you sign on the dotted line, make sure to establish clear performance metrics. Set realistic goals for inventory turns. Make sure to balance it with a clear expectation on customer service fill rates. Define what you consider dead stock. Believe me, there are many different answers to the date of death. Make sure you agree on what constitutes surplus stock. If you don't, you might be shopping for a new warehouse.

Take time to plan out a VMI implementation. It takes a while to get things right. Start with a small sample size and work up to more complicated lines. You need to build confidence within your purchasing team. This may be seen as a threat to their job. Be sensitive to this and manage the fear of change. It should be noted that a vast majority of the distributors I spoke to had fewer than 5 VMI relationships. Nobody is losing their job over this one.

Before you head down the trail, get advice from your industry peers. Most of you work with the same vendors. Ask for recommendations and references. Make sure that you check out service providers before agreeing to sign on with a manufacturer. Many of them have exclusive relationships with a particular provider. According to the participants I spoke with, there can be a vast difference between companies. If they think "fill rate" refers to the speed at which beer flows from a tap, you might want to look elsewhere.

Is VMI right for you? I hope that I have given you plenty of information to chew on. Only you know the right answer for your situation. I can only answer this question like any good consultant – it depends. Good luck.

About the Author:

We hope you found this article of value. We have many additional articles on our website and we also can partner with your company if there is a need to explore other supply chain management technology solutions. We can consult with you to give solid guidance on strategies and systems that have led to success from our vast industry experience. We look forward to hearing from you. Our contact information is below.



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