Vendor Managed Inventory

Applies to:

SCM 4.1 onwards For more information, visit the Supply Chain Management homepage.

Summary:

In the times when businesses are facing a stringent competition the need to retain customers is of utmost importance. The usage of technology helps them in staying ahead of their competitors. This article gives an overview of the Vendor Managed Inventory (VMI) process which is an application of EDI (Electronic Data Interchange) technology. It also discusses the benefits of this process from both customer and supplier perspective.

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Introduction

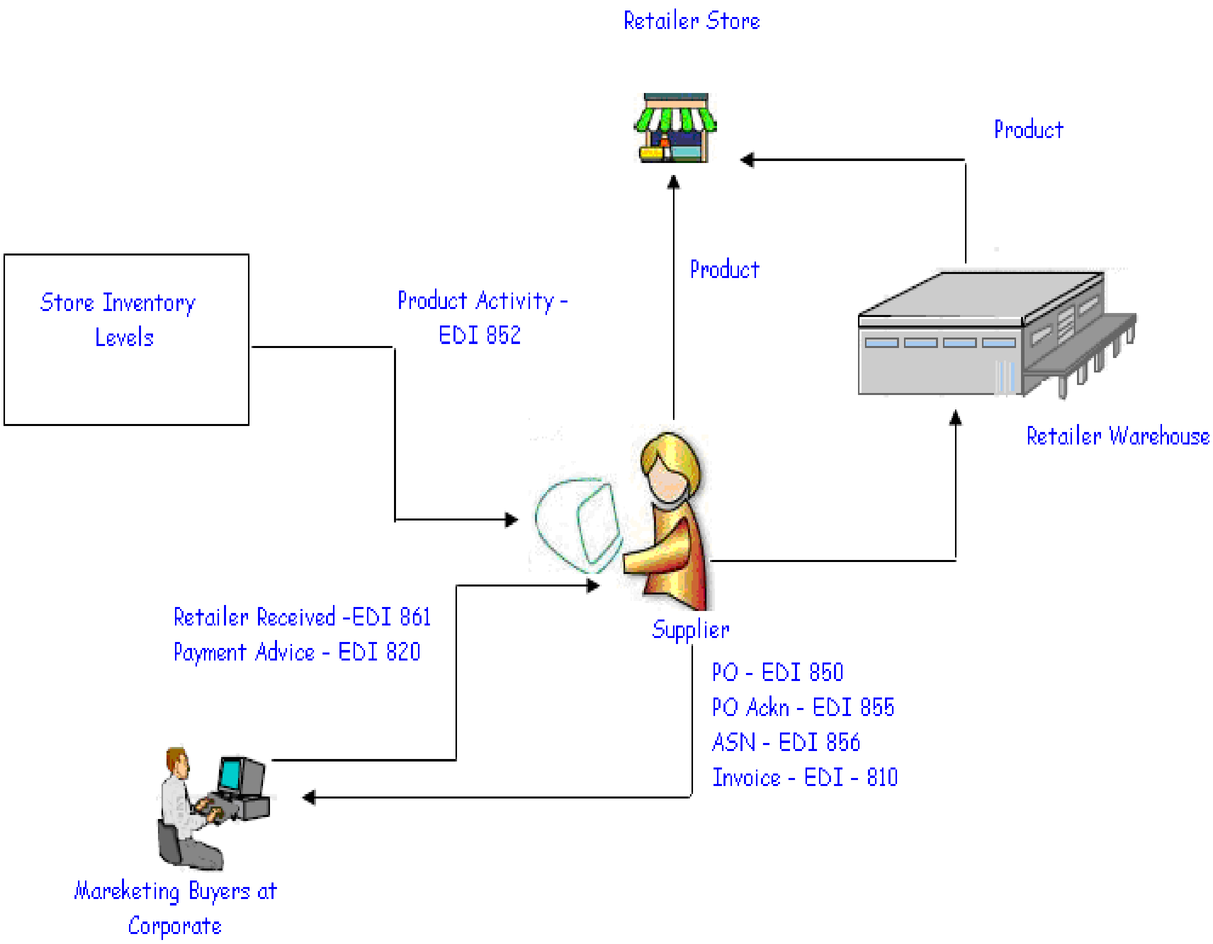
In the present rapidly changing business world customers demand a high level of professionalism through higher performance and efficient delivery. In order to stay one step ahead of competition and retain customer's, businesses need to employ new technology.

The concept of Electronic Data Interchange (EDI) has gained importance since the mid 1960's when industries realized that fast processing of information is fundamental in order to remain competitive in the business world. The need to avoid delays, inconsistencies and high costs in business operations increased the usage of EDI concept in many industries.

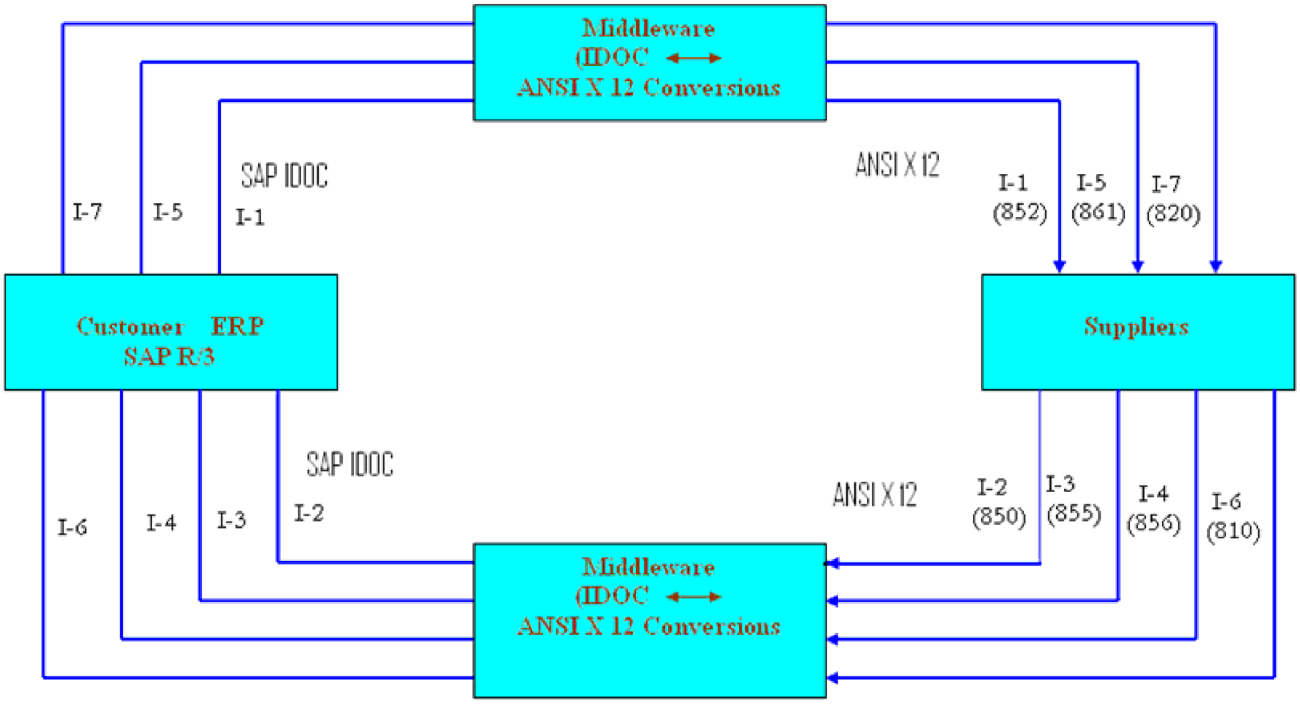
Vendor Managed Inventory (VMI) operates on the concept of EDI. The process which was once considered only as an experiment has now become the preferred way of doing business. VMI augments the supply chain performance by increasing the sales figures, providing improved customer service, reducing an overall inventory in supply chain and stabilizing the supplier's production. The success of this process is primarily associated with the information exchange between the trading partners.

VMI Procurement Process

Customer provides the product activity information to the supplier which would help him in accessing the customer's inventory levels and the demand for that product. This would in turn help suppliers in forecasting consumer's demand and create Purchase Orders accordingly. Once the Purchase orders are created the supplier sends a shipment notice before shipping the product to the customer. Soon after this he sends the invoice. The customer does an invoice matching and handles payment through their account payable systems.



Supplier EDI Architecture



The main purpose of SAP/EDI interface is to allow the business transactions to be exchanged with the supplier there by eliminating the need for manual paper work. EDI architecture is divided into seven interfaces.

Product Activity – (I-1)

Product activity gives information about the inventory level at the customers end and also the demand for the product. This information is sent by the customer to their entire supplier's on a regular basis. Standard (#852) only transmits a "Change" since previous transmission.

Purchase Order – (I-2)

Vendor Managed Inventory is a backward replenishment model where the supplier creates Purchase Orders and the information is communicated to the customer. Purchase order (# 850) is created based on established inventory levels and demand information.

Purchase Order Acknowledgement – (I-3)

PO Acknowledgement will be received from Suppliers via EDI (# 855) and is updated in SAP. This is to confirm PO details from the original PO.

Advance Ship Notice (ASN) – (I-4)

ASN lists the contents of the goods shipped with additional information like product description, physical characteristics and type of packaging etc. This is sent by the supplier and is known as the EDI 856 document.

Receipt Advice – (I-5)

This is a notification sent by the customer to the supplier which mainly communicates the receipt of shipment. This SAP IDOC is converted into EDI format (# 861) by the Middleware.

PO based invoices – (I-6)

The EDI 810 document is sent by the supplier claiming the payment for the goods/services supplied to the customer. The supplier uses Bill of Lading (BOL) or ASN as the reference information.

Payment Advice – (I-7)

This is sent by the customer to the supplier and it has payer (customer) and payee (Supplier) information, including bank, sellers invoice ID, billed and paid amount. The SAP IDOC format is converted into EDI 820 document by the middle ware.

Benefits of VMI

The concept of VMI brings benefits to both customers and suppliers. These benefits mainly depend upon the efficiency of operations between the customer and the supplier.

Customer Benefits

1. Customers only have to supervise the stocks instead of drawing up a detailed analysis for the placing of orders. In this way they will have more time for other purchasing activities.
2. Customers need not have to maintain huge stocks as the uncertainty due to variability in the supplier’s period of delivery will drop.
3. Reduce in the number of stock outs as the supplier will have better insight into the customers business.
4. Enhanced customer satisfaction as they find the right product at right time will help in increasing their sales figures.
5. The cost incurred in forecasting and purchasing activities are reduced as the responsibility is shifted from the customer to the supplier.

Supplier Benefits

1. Supplier has the complete knowledge about the consumption patterns of a product which helps in making better forecasts relating to future consumption. This in turn helps in maintaining accurate stock levels there by reducing general emergency stocks with the supplier.
2. The supplier and customer relationship gets strengthened because of the setting up of electronic links.
3. High cost of implementation will increase the threshold limit for the customer to change the supplier.
4. As the supplier forecasts and creates orders mistakes which would often lead to return are reduced.

Related Content

White paper on VMI

Everything you need to know about VMI

Evolution of VMI concept.

What is VMI

VMI- A Processual Approach

For more information, visit the Supply Chain Management homepage.

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