

2.4.2. VMI Contract between vendor and buyer

VMI relationship is established usually between partners who have been doing business for some time already. This means that there already exists a trade contract covering terms and conditions of business, possibly a quality agreement and other supplementing agreements. When VMI is implemented, it is necessary to either replace the existing contract or produce a comprehensive VMI appendix to the current contract.

So when product range for VMI is identified (see chapter 2.3.1), volumes and delivery schedules are determined (see chapter 2.3.3), and clear goals defined (chapter 2.4.1), all these agreements should be put into a formal accord. In the VMI agreement, common goals can be agreed, as well as responsibilities and rights clearly allocated.

Both parties must be aware that organisational and IT adjustments are required in order to implement the new purchasing method. As VMI agreements are private contracts, they are not regulated by any legal code nor is there any codified structure to conform to. Zammori et al⁹ have researched standard VMI agreements, and while their work focused mainly on vendor-manufacturer consignment VMI, it is still useful with modifications. Based on research and practice, it can be said that a VMI agreement (usually as an appendix to existing trade contract) should include six major chapters (see Figure 17).

1. Objective and terms of agreement	<input type="checkbox"/>
2. Service level agreement (SLA), including KPIs	<input type="checkbox"/>
3. Agreed assortment and promotions	<input type="checkbox"/>
4. Delivery terms	<input type="checkbox"/>
5. Information exchange	<input type="checkbox"/>
6. Miscellaneous	<input type="checkbox"/>

Figure 17. VMI contract between buyer and vendor

Explanation of VMI contract chapters

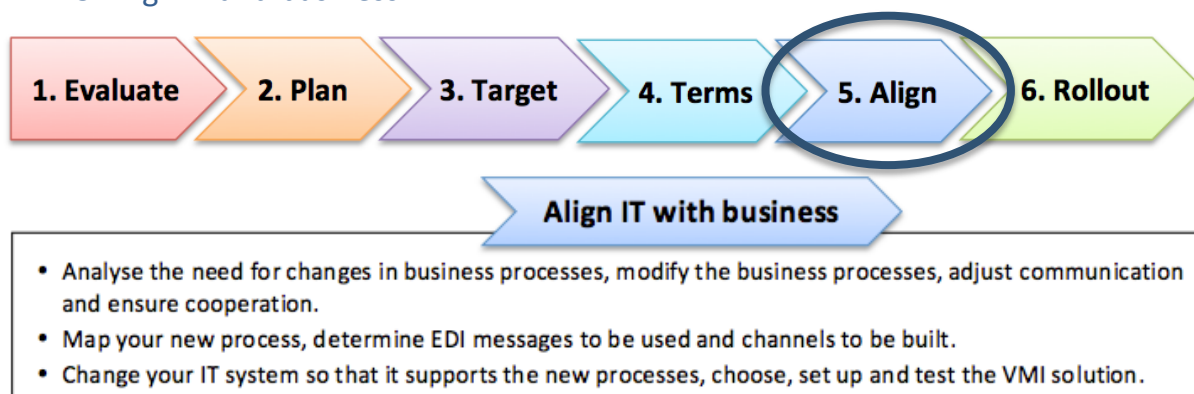
1. **Objective and terms of agreement.** In first chapter, the scope of the agreement (Vendor Managed Inventory) and the willingness of both parties to undertake a relationship based on trust is underlined. The service performed by the vendor and the information released by the customer to support it are defined. Additionally, the start and duration of the agreement is specified.
2. **Service Level Agreement (SLA) and KPIs.** In this chapter, the buyer and the vendor commit themselves to attain a predetermined level of performance. This chapter defines the service which is expected to be supplied by both the customer and the vendor and includes a list of key performance indicators (KPIs) used to quantify and to assess the achieved level of performance. KPIs shall be tied in with penalties and/or benefits and parties must define the controlling system. Handling of service level problems, especially out-of-stock situations, is covered.
3. **Agreed assortment and promotions.** Third chapter covers the frequency of assortment reviews, describes handling of changes in assortments (if those issues are not covered in main trade contract) and specifies VMI-related specifics in promotions handling.
4. **Delivery terms.** In fourth chapter, delivery slots are defined. Delivery information exchange, emergency deliveries, handling of problems, and labelling standards are covered.
5. **Information exchange.** In this chapter, the EDI channels as well as a backup strategy described. All EDI messages are listed with their content, sender and frequency. Product master data attributes listed and explained. Necessary information is given about VMI locations (warehouses, shops).
6. **Miscellaneous.** In the last chapter, most important is the list of contacts for important team members on both sides. Other important legal considerations are covered here: confidentiality, terms of termination of contract and solving of disputes.

⁹ Zammori, Franceso, Braglia, Marcello and Frosolini, Marco 2009. A Standard Agreement for Vendor Managed Inventory. *Strategic Outsourcing: An International Journal*. Vol. 2, no. 2. pp. 165-186.

A comprehensive sample VMI contract can be found in Appendix X.

It is important to study existing contracts in detail prior to signing the agreement and for the parties to discuss all aspects. Consensus is required on the most important points to avoid entering into additional obligations via the VMI agreement. If the wording of the same contractual points differs in the various agreements, it is advisable to adjust these points in the new agreement to be signed, or expressly stipulate this in an additional agreement to the VMI contract. This procedure provides clarity in terms of the legal basis and helps to focus on the amount of debt and damages in the event of a dispute. In particular, how to handle exceptions and solve problems in the new collaboration should be covered.

2.5. Align IT and business



2.5.1. Internal and external business process changes

When product range for VMI identified, volumes and delivery schedules determined, internal process should be reviewed and modified to support the new replenishment strategy. It is advisable to:

- Share experiences with other vendors and business partners who have implemented the vendor managed inventory model.
- Describe target processes and develop a process structure which meets future requirements.
- Identify the required process changes and IT investments in hardware / software.

A buyer implementing VMI will see that many processes have to be changed. There is a research by Reitner et al. (2012) describing those changes in detail. Here we show a simplified version of their work.

Table 8. VMI impact on buyer procurement processes.