Supply & Demand Chain Executive
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Turning Supply Relationships into Valuable Partnerships

By Larraine Segil

Companies that manage complex supply relationships as though they were partnerships reap mutual benefits instead of harmful competition for both parties. Here are the fundamentals of how you can get started, too.

Managing supplier relationships effectively will generate real value for purchasers and suppliers alike. The idea is not that the parties like each other, but rather that well managed relationships increase benefit to all concerned. In its recent study 'Negotiating and Managing Key Supplier Relationships," the consulting firm Vantage Partners found that when supply relationships are managed in a proactive, systematic way, using repeatable processes and tools, all parties can derive quantitative and qualitative benefits with increased mutual gain. This is in sharp contrast to the normal buyer/supplier relationship, which is based on price negotiations and pressure to reduce costs — an approach that often short-changes value when suppliers fight hard to get the contract and then perform with low quality or delays, at times even pushing one of the parties into financial hardship.

Many organizations now have groups that are charged with the job of corporate sourcing and procurement. Their mandate is to create additional value and drive competitive advantage by ensuring effective management of the company's supplier relationships. Does this mean that the role of the sourcing and procurement group is to call all their suppliers and ask for a 10 percent cut across the board? While some automobile manufacturers have done that, the result has been that the top-tier suppliers pressurized the next tier of suppliers, many of which went out of business as a result.

Other companies have chosen an alternate route. They have begun to realize that more collaborative, systematically managed relationships with suppliers can drive increased innovation, improved productivity and reduced administrative costs. The dilemma that many of these internal corporate groups face, however, is that they possess little experience in managing complex, interdependent business relationships. With little knowledge of industry best practices and a lack of direct experience, these groups face the challenge of finding proven methods to add to their existing skill sets so that they can effectively manage supplier relationships.

Even those corporate sourcing and procurement groups that already have deep expertise in managing key supplier relationships typically need to address the reality that their company as a whole lacks comparable experience, knowledge and skill. This means that many people in multiple groups and divisions will touch and interact with the supplier base without the tools, skills and knowledge to do so in a relationship-focused (rather than price-focused) way. Sadly, few corporate sourcing groups have the resources or span of control to ensure the effective management of supplier relationships across the organization. To do this would require transferring skills and tools to a much broader set of individuals within the organization who have significant interactions with suppliers. And, unless the organization buys into the idea of relationship management with suppliers being of added value, that is not going to happen.

There are different management tools available for all parties that enable the creation of more value in supplier relationships. Often, using the approach of market segmentation and relationship-tiering based on differing value and strategic impacts can establish management expectations and supplier performance, which in turn, enable more effective outcomes. This may mean, in some cases, creating a highly integrated relationship with a supplier, while in another, managing a commodity supplier electronically and at arms length. Each of these different approaches to relationship management has a role to play across the chain of suppliers, which support the activities of companies in a complex economic environment in which cost saving is paramount.

When suppliers and customers manage their relationships by looking at sources of value — strategic, operational, financial and relationship — the conversation changes. Suppliers can then position themselves strategically as those who bring knowledge and expertise, business process innovation, and new strategic business ideas; operationally as increasing cycle time and diminishing product defect rates; financially with goals of reducing operating costs and making purchasers more profitable if possible; and with relationship goals that enable surfacing and resolving conflicts early through joint problem solving.

For example, one aerospace company was in a dilemma. Its normal way of doing business was to negotiate fixed-price contracts, which assumed that they could make more products at a lower cost than they had ever done before. The CEO commented on his company's progression from having a price-focused to a relationship-focused outlook: "To gain market share, we signed these onerous fixed-price contracts. Therefore, we went to our suppliers. In the old days, we would have beaten them up, threatened not to renew our contracts, and generally said that they had to solve the problem we created for ourselves. Having changed to a partnering mentality, we went in a very different direction."

The CEO said that his company explained the situation it had created, and then asked its suppliers if they had any ideas. "They said our parts were unnecessarily complicated, and with a few simple changes, we would both save more than 25 percent. It saved our bacon," he commented. The irony, he explained: "They said they'd been trying to talk to us about this idea for three years, but kept getting told that we weren't interested in hearing from them how to run our business."

This is not an atypical example. All too often suppliers have a very clear vision of what it would take to improve the logistics that surround the product or services that they provide. In addition, just as often, entrenched management considers the supplier group as an unavoidable bureaucracy rather than a valued partner.

By contrast, Kansas City, Mo.-based Butler Manufacturing Co. delivers its construction services for multiple-site customers on a collaborative supplier basis. The company serves many Fortune 500 companies including retailers, manufacturers and distributors. These alliances work for Butler and for its customers. Butler looks at the entire enterprise, the whole construction project or program, and the customer's needs from building concept to move-in and start-up. It shares information and value all along the value chain, and everyone benefits.

This 100-year-old market leader has the most loyal customers who return repeatedly to their partner, Butler Manufacturing, to help them roll out huge chains of stores and warehouses. This process delivers benefits over the alternative of consistently relying on the lowest-cost material supplier. Butler Manufacturing said it has found that managing its customer/supplier activities with relationship management capabilities can leverage benefits, which in traditional supply relationships seem unimaginable.

The Opportunity Cost of Changing Suppliers

When looking at the value of a supplier, you must also look at the opportunity cost of not working with that supplier. Two elements should make up the evaluation of the opportunity cost of changing a supplier relationship: the strategic value of the supplier relationship for that buyer and the replacement cost of finding and training a new supplier to do business with the organization.

Strategic and replacement questions could include whether or not the parts those suppliers sell your company highly customized to your particular business. Has the supplier already learned much of the knowledge that they need to understand your business and serve you competently? How easy would it be to replace them in the marketplace? Your answers to these questions will enable you to categorize the suppliers into to four different types of relationships:

Commodity relationship: Suppliers that are easy to replace, do not need time or training to come up to speed and are less integrated relationships.

Custom relationship: These are suppliers that are difficult to replace because they have to tool their plants or train their people to specifically be of value to your company.

Collaborative relationship: This group contains suppliers that are strategically important, but not that difficult to replace.

Strategic supplier relationship: These are suppliers requiring the most relationship management attention and resources because they have critical importance to your company in a number of ways. They are the most strategically important and costly-to-replace relationships.

Changing the Way Things are Done

In "Negotiating and Managing Key Supplier Relationships," Vantage Partners did research on the benefits of managing supplier relationships with the application of relationship management processes and metrics, and the results were supportive of this approach. For example, almost 80 percent of respondents said that strong working relationships with suppliers generated 25 percent or more quantitative value. Procurement professionals also stated that they could improve their company's bottom line by a savings of $43 million annually through the application of strategic relationship management tools and processes to key supplier relationships.

The study proved that sourcing and procurement executives are seeing the real benefits of the time and resources invested in relationship management. Supply chain management can be so strategic that the innovation developed by the relationship could affect an entire industry.

Consider the integration of a major consumer products company with its major customer, a mega-chain of retailers. In this classic supplier/customer integration example, the retailer gave its supplier, the consumer products company, access to its supplier management processes and asked for help. The consumer products company spent huge resources and time analyzing and designing a supplier management system that integrates customer purchases and store inventory management to its manufacturing, ordering and shipping processes. In this way, they created a nearly seamless system that allows integration between their customer and themselves, two separate entities. This has worked so well that the retailer asked its supplier to help it integrate this new approach as a supply-chain management system for other suppliers. That retailer now has one of the most intimate and detailed supplier management systems, which leaves little room for inefficiency and contributes to its cost savings and overall customer promise.

Contrast a major automobile manufacturer's relationship with its tier-one suppliers. In the past, this manufacturer had approached its suppliers with a Japanese Keiretsu mentality, presenting its suppliers with issues and concerns, and asking for collaboration, customization, integration and a long-term relationship. In short, the manufacturer said to its suppliers, "Work with us to save us all money," which is the approach of mutual gain that we have seen to be so successful in negotiations.

Unfortunately, in later years, this same manufacturer demanded across-the-board price cuts from its suppliers, creating some untenable situations that have resulted in some suppliers going out of business, and in other situations, ineffective actions and performance from existing and unhappy suppliers.

Taking the approach that says, "If you win, I lose, so that every inch I yield to you is an inch I must give up," represents a zero-sum game. However, when customers and suppliers approach their negotiation from the point of view of, "Along as I am better off, even if you are much better off than I am, we are both still winning," there is joint gain, rather than win-lose.

Managing complex supply relationships as if they were partnerships creates a collaboration that can transmute supplier concerns and margin issues to the more collaborative discussions of customer constraints and investment issues. When a company can see the supplier relationship as a partnership, this ultimately positions both parties as joint investors in human and knowledge capital for value. Together the possibility then exists for mutual benefit, rather than an unbalanced, untrusting and competitive relationship. Managing a supplier relationship as if it were collaboration rather than a "bid" gives way to quality enhancement, rather than suppliers who resentfully cut corners trying to squeeze profit out of a reluctant customer. It requires a strategy, a commitment from senior management, transparency of costs and margins, and longer-term contracts.

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