Focus on the right suppliers


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According to a major study of sourcing executives, the trend toward supplier consolidation is increasing in intensity and is characterized by the "80/10 rule" (see Jan. 13, page 64). Out of 13 supply chain tools, Chief Procurement Officers selected supplier consolidation and the centralization of purchasing organizations as where they will focus the most over the next four years.

Some have chosen that emphasis in order to leverage the purchasing power of multiple new acquisitions; others are using it to restore or increase profitability to acceptable levels following the recent recessionary period. Regardless of the cause, the trend is hard to ignore.

At first blush, supplier consolidation seems easy: send everything out to bid, and award all the business to the two or three suppliers with the lowest prices. However, bid prices are often understated by suppliers because of their strong desire to win the business—and their belief that they can "make-it-up later" or "make-it-up elsewhere." Among their common strategies: cross-subsidization, surcharges, and stretching the specifications ("thinning the paint").

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But, in reality, that doesn't work because suppliers have differing abilities to sustain low prices, depending on their source of competitive advantage, and because they vary widely on non-price dimensions such as service, quality, and flexibility. So the truth is that very few suppliers are suited for the transition from transactional vendor to strategic partner. Strategic suppliers should be screened along non-price dimensions because partnerships mean much more than the "buzzword" programs such as "supplier rationalization" or "supplier consolidation" would imply. They involve rethinking the supply base and realizing latent synergies.

Three tools can be helpful in partner selection and screening: the supplier portfolio matrix, supplier cost benchmarks, and joint target-setting.

Supplier portfolio matrix

Leading companies are increasingly differentiating between transactional suppliers and partner suppliers by a supplier portfolio matrix that segregates suppliers according to their partnership potential and spend. Companies with high partnership potential get an increasing amount of procurement attention and spend, and rise and shift to the right in the matrix over time. Companies with low partnership potential are treated as transactional suppliers, and sink down and to the left over time. To get the benefits of consolidation, the "A" suppliers in the upper right-hand quadrant total no more than 10% of the category spend, and the suppliers in the bottom two quadrants total 90% or more. No suppliers should be in the upper left-hand quadrant.

Supplier cost benchmarks

Cost is a more accurate measure of suppliers' long-term potential competitiveness than bid prices. It is more stable and often a better predictor than price of long-term viability. The local supermarket might offer a sale price the same as Wal-Mart's, but Wal-Mart can maintain that price over time because of its underlying competitive advantages in sourcing and distribution.

In bid and negotiation cycles, and during discussions about cost structures, breakthroughs are found that can lead to true partnerships. These benchmarks can be used in conjunction with company-specific cost analyses to help get to "win-win" in negotiations.

Joint target-setting framework

Once potential partners are identified, joint goals and targets should be set as part of the negotiation process. If you don't have a clear set of targets for each "A" supplier that is acknowledged by your organization and theirs, then you haven't made the transition to a strategic supplier portfolio. Though every organization and every relationship has its particular goals, strategic relationships should have a shared vision, explicit goals, and performance indicators that frequently or even continuously monitor the basic areas:

- Cost (e.g., $/unit)
- Quality (e.g., cost of nonconformance)
- Flexibility (e.g., time to respond to a 20% demand spike)
- Delivery (e.g., % on-time and complete)
- Service (e.g., time to successful resolution of issues).

Where are you on the path toward partnership? Are you focusing on the right suppliers? Boston Logistics Group is now conducting the 2004-2005 version of its study, which will assess the performance improvements that companies are achieving through scale-based strategies, especially through hyper-consolidation. It will examine the extent of supplier consolidation and benchmark key metrics associated with partnering and other strategies. To get a free copy of the feedback report, download the confidential one-page survey at www.bostonlogistics.com or e-mail djacoby@bostonlogistics.com. A summary of last year's 62-page report is also available on the site.