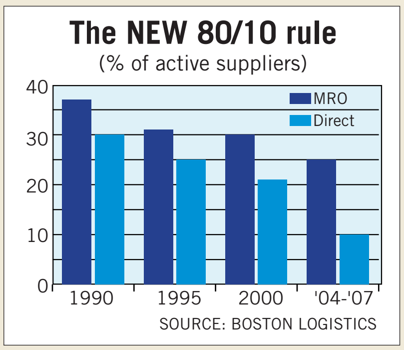
The new economics of partnering

Companies have been consolidating their supplier base for more than 15 years. But, if you think they're done tightening that core group, guess again—it's still their top priority. Chief procurement officers and other supply chain executives still rank supplier rationalization first of 13 supply chain strategies they intend to emphasize over the next four years.

A recent study by the Boston Logistics Group found that supply-chain execs rated supplier rationalization, global sourcing, and purchasing councils at the high end of their priorities, and group purchasing, p-cards, and auctions at the low end.

One of the most notable findings: The new economics of partnering are redefining the business processes, systems, and skill sets of procurement organizations today. That is, companies are shifting from value-based strategies to scale-based strategies—particularly supplier rationalization and centralization of procurement activities—in order to drive production and distribution economies. Tools based on competition—such as RFQs (requests for quotes)—are declining in emphasis.



The average percent of active suppliers that account for 80% of the spend in both MRO and direct has decreased by about 25%.

Megatrends

It's the megatrends in our business environment that are driving this trend. The 1990s brought a bubble of mergers and acquisitions, and then 2001 brought 9/11 and the subsequent recession. As a result, companies in growth modes are using centralized purchasing to digest recent mergers and acquisitions, while companies facing negative margins and shrinkage are focusing on fewer, partner-type suppliers to obtain more spend per supplier and maintain their purchasing power. These are different circumstances than in the 1990s, when many companies were deeply involved in quality-related programs such as value engineering, total quality, and business process reengineering.

Since 1990, the average number of active suppliers accounting for 80% of the spend has decreased by about 25%. Most manufacturers have gone through supplier rationalizations that have taken them from, say, 42 suppliers to 10. Now the question is how much to centralize? Assuming there is adequate competition and it is operationally possible, should buyers consolidate to three suppliers, or two, or one? The 80/20 rule is no longer the rule. Now, 80/10 may be more accurate—if you have 100 suppliers, 80% of your business should be with 10 or fewer of them.

Usually the top two to three suppliers end up with about 50% of the spend. This permits economies of scale and economies of scope, and helps generate the level of intimacy that's needed with your core suppliers.

Yet consolidation of this magnitude is much easier said than done. Tremendous changes underlie hyper-consolidation. Moving up the partnership chain involves major changes in expectations, communications styles, time and energy spent in planning and monitoring the business. Higher-level contacts are often involved in both the buying and the supplier organizations. Most organizations' suppliers are currently transactional or preferred suppliers. With partners, there is more emphasis on integrating processes and systems, forming long-term agreements, and collaborating on joint supply chain strategies. This requires a high degree of trust, systems integration to reduce transactions costs, and a joint accountability for project management and deliverables.

When it comes to technology, most companies will tell you that the actual use of auctions, portals, and electronic forms of cataloging, ordering, and transferring data and funds lags way behind the hype. While CPOs were more aggressive regarding auctions than the other respondents, respondents in general berated them, rating them last on the list and saying they will rely on them less than the traditional approaches over the next four years. Large companies, however, are investing heavily in e-procurement, especially transactional purchasing systems such as electronic catalogs, electronic requisitioning/approvals, electronic ordering, and spend visibility, because of the large overhead cost-reduction opportunity inherent in their high-transaction volumes.

Survey by the numbers

The Boston Logistics survey of 120 supply chain executives was designed to determine where the focus of strategic sourcing and supply chain executives has been since the tech boom crashed. More than 20% of the respondents were from Global 1,000 companies. More than 60% were vice presidents or directors of procurement, with more than half of those, corporate officers.

The survey included companies ranging in size from under $50 million to more than $20 billion;the average company had $4 billion in annual sales. Overall, the study included $236 billion of sourceable expenditure—roughly 2.5% of U.S. GDP. It covered 16 industry groups and commodity categories.

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