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Manage Your Suppliers as a Resource

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Jonathan Byrnes says you should invite your best suppliers to suggest innovative ways to develop new customer-supplier business efficiencies.

by Jonathan Byrnes

Several years ago, I visited Camco, GE's appliance manufacturing and distribution business unit in Canada. Camco was the site of one of the earliest, most successful, make-to-order manufacturing systems in the world. Through insight and innovation, Camco's managers developed a manufacturing process that was widely followed.

I recall the manager of the manufacturing unit telling me that their suppliers were one of their most valuable resources, but they had not realized it until they engaged them in the new system. To the surprise of Camco's managers, many of their most important suppliers quickly adopted the make-to-order system in their own businesses, significantly compressing cycle time throughout the channel, and offered powerful new process innovations that helped Camco in its own business.

This discussion came to mind recently when I met with the purchasing group of a major equipment manufacturer. They had identified a number of opportunities to coordinate with their suppliers in mutually beneficial ways. They felt stuck, however, because they did not have the resources to develop these initiatives to the point where they could engage the suppliers in the many opportunities they identified.

During the course of the meeting, the purchasing group came to realize that they were not using their suppliers as a resource. Instead, they were tacitly assuming that they would have to create projects to develop ways to instruct the suppliers on how to coordinate with them.

By the end of the meeting, a more powerful alternative became clear. Rather than developing their own intercompany processes for their suppliers, they could manage the suppliers and use them as a resource. This involved focusing their efforts on defining clearly what their needs were, and what flexibility they had in their own internal processes. Then, they could invite their best suppliers to engage with them, having the suppliers suggest innovative ways to develop new customer-supplier business efficiencies.

This equipment manufacturer was a very important account for many of its most significant suppliers. The suppliers had ample resources to devote to improving their operating ties with this important customer. By using these suppliers as a resource, the company gained an opportunity to leverage its limited supplier management resources, and both the company and its suppliers faced new possibilities for huge mutual gain.

Many companies have supplier relationships that are tacitly adversarial. Some have developed supplier management programs which specify expected supplier performance in areas such as on-time deliveries and order-fill rate. These typically involve penalties for deficient performance. But few companies are willing to go through the process of identifying and removing obstacles to efficient joint business processes on both sides of the relationship.

Innovative supplier management, using your suppliers as a resource, allows both companies to move past the traditional adversarial relationship toward a partnership with deep mutual value creation.

Innovative supplier management

In Japan, supplier management is viewed as an essential management function. Suppliers are viewed as the "hidden factory." This perspective is largely missing in all too many companies.

In many companies, the cost of materials and components exceeds the internal value-added through manufacturing or assembly. Yet the fundamental nature of staffing and process improvement for internal projects versus external, supplier-related projects is often hugely different.

Few companies are willing to go through the process of identifying and removing obstacles to efficient joint business processes on both sides of the relationship.

Internal process improvement projects are generally well staffed, and develop knowledge systematically through techniques like process mapping. Supplier management projects, by contrast, tend to be inadequately staffed, somewhat ad hoc, and rife with assumptions rather than systematic knowledge development.

In a few industries, such as those that provide consumer products to major retailers, innovative suppliers have stepped up to the challenge. (See Supply Chain Management in a Wal-Mart World.) These innovative suppliers have even gone a step further, offering different levels of customer integration to different sets of accounts, depending on account importance and account willingness and ability to innovate.

In these sophisticated relationships, the best suppliers implicitly penalize accounts that are stuck in adversarial mode and favor those that are adept at creating win-win relationships. The best suppliers seek situations where they can be managed as a resource, creating innovations that benefit both customer and supplier; they shun situations where supplier management is a one-sided affair.

Key success factors

Three factors are especially important in developing an effective supplier management process: partner selection, relationship-building, and contracting.

Many supplier management projects fail because adequate care is not taken in selecting the right supplier partners. In order for a deep, innovative partnership to develop, five key factors must be present:

- Real new value—this value must be measured, observed by both companies, and fairly divided, a process that is essential to keep the partnership vital, even if the original sponsoring managers exit.
- Complementary specialties and capabilities—there must be a good fit and adequate flexibility that will endure over a considerable period of time.
- Strategic alignment—developing a deep partnership with a major supplier often changes the relationship with competing suppliers, and the converse is true for the supplier.
- Willingness to partner—there must be a lack of internal organizational conflict on both sides of the relationship.
- Ability to implement—both companies need to qualify each other to ensure that they both have the ability to follow through on their intentions over a significant period of time.

All too often, companies actually initiate supplier partnership programs with the first supplier that approaches them, whether the supplier fits and is well-qualified to follow through or not. Partner selection is far too important not to be managed proactively.

Relationship-building requires finesse. Often, it takes a few months to get past festering old issues. A channel map is a key analytical instrument at this stage. It provides a broad view of the customer-supplier product flow patterns, and actual channel performance by tracing the product flow through the channel.

A channel map has three components: (1) a diagram of the information and product flow at each channel stage, including handling, storage, moving, processing, etc.; (2) a quantitative analysis, or representative model, of product accumulation and movement over a typical time period; and (3) rough estimates of the costs at each stage.

With the view that a channel map provides, you and your supplier can identify the biggest obstacles to efficient product flow between the companies. This is important because a few well-designed intercompany process links usually can provide a large portion of the potential benefits.

"Showcase" projects are particularly effective at this stage. These differ from pilot projects in important ways. A showcase offers the opportunity to experiment with a program that is only roughly defined, learning by doing in the process. A pilot project, on the other hand, is designed to "try out" a program that was previously analyzed and approved. Once you develop a working model of a new customer-supplier relationship in showcase mode, it is much easier to sell it into both organizations.

Start small

Often, managers think first of developing supplier innovations with their most important suppliers. This is generally a mistake. The most effective place to start is to work with a relatively small, very capable, innovative supplier for whom your company is an extremely important customer. This situation has the conditions most favorable for creating new innovations that can later be scaled throughout your supplier base. Major suppliers, on the other hand, often are more difficult to work with and innovation is more risky with so much at stake.

Once an innovation is developed, contracting is very important. This is a complex topic, but a few underlying principles provide directional guidance. A good contract will have effective incentives for both parties to continue to deepen the relationship and to find new ways to create mutual value over time. In addition, the contract should have a "migration out" provision that will specify how to restore the status quo if the relationship ends and a new partner needs to be obtained.

Developing an effective contract is as much an art as a science, because a productive relationship should and will evolve in new, mutually-beneficial ways. Effective contracts are liberating, not confining.

Your suppliers can be your most valuable hidden resource. If your supplier management function is adversarial in tone, your suppliers will respond in kind. But, if your supplier management function sets its sights on innovation and value creation, you can find a clear pathway to success.

See you next month.

Jonathan Byrnes is a Senior Lecturer at MIT and President of Jonathan Byrnes & Co., a focused consulting company. He earned a doctorate from Harvard Business School in 1980 and can be reached at jlbyrnes@mit.edu.