Time to Tell Your CPOs to Collaborate with Suppliers

How to create value by collaborating inside and outside the organization
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Over the past 20 years, most companies have used strategic sourcing to restructure their supply bases and reduce costs. At times, the approach not only required confrontational relationships with suppliers—deemed necessary collateral damage in the quest for lower costs—but also enabled some suppliers to become so embedded that they were immune to future competitive sourcing efforts. Indeed, it is not unusual for 20 to 30 percent or more of a company’s external spend to be dominated by these embedded suppliers. Today, reducing costs is no longer enough. Companies want value, and they want their chief procurement officers (CPOs) to deliver it. How can CPOs get the job done? By first identifying and then collaborating with their key suppliers.

Companies face unprecedented global volatility. We see wild fluctuations in prices for agricultural products, petroleum products, and other fundamental building blocks. We see the increasing fragility of globalized networks in the face of catastrophic natural disasters and sudden shifts in macroeconomic or geopolitical forces. We see increasingly empowered and informed consumers, some of them motivated by issues of sustainability. And despite the challenge of addressing these issues in the lingering aftermath of a global recession, we actually expect more from our supply chains. It’s no longer enough to lower costs: Successful companies must seek high-impact performance improvements. According to A.T. Kearney’s latest Assessment of Excellence in Procurement (AEP) study, more senior executives are asking their procurement organizations, and specifically their CPOs, to deliver value well beyond cost reductions. Indeed, the AEP finds that the importance of value creation in procurement is growing twice as fast as the importance of cost reduction (see figure 1 on page 2).

Leading companies understand that creating significant value requires tapping into the energy of their supply base. For example, Procter & Gamble expects more than half of its innovation to come from outside of its own R&D group. Executing this philosophy means putting the CPO in a pivotal position: The CPO must shepherd the company on a quest for value.

Procurement was once a transactional function focused on supply continuity. Strategic sourcing transformed CPOs into credible business contributors. Now, CPOs have the chance to transform again—to use strategic supplier relationship management (SSRM) to deliver something more than cost reduction, something that drives competitive advantage—strategic value. Yet delivering strategic value across the supply chain will require a change in mindset: from confrontational, one-on-one negotiations on cost reduction to collaboration—both internal and external.
Figure 1
Senior executives expect more value from their procurement organizations

Importance of procurement in company efforts
(Average responses)

Source: A.T. Kearney Assessment of Excellence in Procurement Study

Figure 2
Unlocking the next level of value: complement a category focus with a supplier focus

Source: A.T. Kearney analysis
What and Where Is Strategic Value?

Many CPOs have rightly concluded that the key to unlocking the next level of value is to complement their category-focused strategic sourcing efforts with a supplier-focused approach. Figure 2 illustrates models of supplier interaction that form a pyramid because they rely on a solid base in category-driven transactions. With some suppliers, it’s also possible to use strategic sourcing projects to optimize total cost of ownership. An even smaller subset of suppliers deserves SSRM value projects that use more intense supplier cooperation to gain more substantial advantages for a specific business unit or product. Lastly, the top of the pyramid represents those few cross-enterprise relationships that interact across many business units or products and multiple dimensions—you may buy from, sell to, innovate with, and sometimes even compete with these suppliers.

In pursuing more value, companies often start out on the wrong foot. They engage in well-engineered, often multi-year segmentation processes to identify “key” suppliers, the ones worthy of collaboration. Their CPOs keep refining the process in hopes of finding the magic formula that can turn historical procurement data into an index of supplier importance. But these segmentation efforts take precious time away from the more vital tasks of generating value, and they often fail to identify those few suppliers strategically critical to the company’s success. Because supplier importance is determined by strategic value—which is forward-looking—attempting to quantify it with historical data is like trying to drive using only the rear-view mirror.

Instead of segmenting suppliers, CPOs should identify strategic suppliers and value by segmenting business units and product or service offerings. The first step is to prioritize business units or offerings based on their strategic importance, then analyze the value chains in each to determine where value could be created or improved. That will generally point a great big arrow at your strategic suppliers.

Successful segmentation requires a keen understanding of what strategic value truly means. We define strategic value in four dimensions, each informed by the company’s overall business strategy (see figure 3 on page 4):

1. Growth. Strategic value increases when you improve the value proposition for existing customers, or generate sales to new customers or markets. Suppliers can help with that, through innovation, customer service, or other unique characteristics. For example, when you have suppliers that can innovate—and get along well with your internal innovators—you can unlock future growth for both companies.

2. Risk management. In a world of increasingly unpredictable and devastating risks, supplier relationships must include more than routine contingency plans. When you have a rich relationship with a supplier that includes collaboration on approaches to mitigate potential supply disruptions, the potential risks become opportunities to gain advantage over competitors.

3. Value chain optimization. The value chain from raw materials or other inputs to various value-added activities to consumption by the end-user represents a partnership of companies with different advantages and core competencies. Sometimes, tweaking that value chain can benefit all players by allowing them to focus on their strengths. Can you improve innovation cycle times? Can you reduce inventory levels? Are there opportunities for joint ventures to integrate production facilities? Are there competencies that you would be better off acquiring from a supplier, or divesting to that supplier? For example, while some chemical companies build and run terminals to manage their marine shipping, there are ship owners that also
have these capabilities—as a core competency. In such situations, the chemical company may find that outsourcing the terminals will reduce redundancy and benefit all parties.

4. **Structural capabilities.** Depending on your strategy, strategic value can also arise from other dimensions. Reducing costs is good, but sustaining a competitive cost advantage through a privileged supplier relationship is great. Using suppliers to improve your agility, responsiveness, scalability, and even corporate social responsibility also provides strategic value.

Clearly, collaborating with your suppliers can unlock greater strategic value across all of these dimensions. For example, collaborating on innovation can lead to an easier path to transformative growth, while collaborating on risk management plans based on mutual trust will put you at the front of the line in a crisis. When you enter a long-term relationship with a supplier whose philosophies and capabilities you trust, you can work together on initiatives that add up to more than the sum of their parts.

Collaboration does not come cheap, however, so choose your partners carefully, based on the strategic value they can provide. To find that strategic value, start by identifying the businesses, products and services most critical to your corporate strategy. Then work with your internal business partners—including business unit managers, R&D experts and other key players in critical functions—to understand how strategic value can be created. In other words, before a CPO can collaborate externally, he or she must collaborate internally, working across functions to find ways to meet customer needs.

To meet continually changing customer needs—affect ed by mega-trends, such as economic growth in Asia, aging demographics, or the scarcity of key resources and commodities—the CPO must collaborate internally and externally to explore ways to meet these needs with improvements that leverage the entire value chain.

**Getting to Mutual Value**

Traditional strategic sourcing initiatives typically have just one winner: you. In a zero-sum game, you had to beat up, squeeze out, and otherwise

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### Figure 3

**Four dimensions of strategic value**

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Definition</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Growth</strong></td>
<td>Supplier has differentiating capabilities that could enable growth, such as innovation (R&amp;D), customer service, or geographic reach</td>
<td>Collaborate with a supplier’s R&amp;D group to develop a new product</td>
</tr>
<tr>
<td><strong>Risk management</strong></td>
<td>Supplier can collaborate on risk mitigation approaches, turning potential risks into opportunities to gain advantage over competitors</td>
<td>Contract with a supplier to provide redundant manufacturing capacity</td>
</tr>
<tr>
<td><strong>Value chain optimization</strong></td>
<td>Close collaboration with supplier allows for opportunities, from reduced inventory levels and improved forecasting to joint ventures and M&amp;A opportunities</td>
<td>Develop joint venture with a supplier to integrate production facilities</td>
</tr>
<tr>
<td><strong>Structural capabilities</strong></td>
<td>Supplier enables a sustainable competitive cost advantage, or increased flexibility, responsiveness and scalability</td>
<td>Leverage temporary labor supplier to meet changing business needs</td>
</tr>
</tbody>
</table>

*Source: A.T. Kearney analysis*
take advantage of suppliers to get them closer to zero and you closer to the sum. Shifting the focus from cost-cutting to value creation means that for some supplier relationships, that dynamic is going to change. The previous section identified how you can choose the best direction for collaboration—but if you’re only thinking about your own benefits, then you’re not collaborating. The key is identifying win-win situations for you and your suppliers—call it a *mutual value opportunity*. Estimating these opportunities starts by using internal collaboration to complete a value screening process, which takes the following steps:

**Develop a relationship baseline.** Profile your existing relationship with the supplier. This will include its business structure, products and offerings, recent business performance, competitive position, strategic direction, joint commercial flows and other relationship dimensions (such as innovation and joint ventures), relative relationship power, and, importantly, how its culture aligns with yours.

**Identify initial value hypotheses.** What are the potential opportunities and what type and level of value do they bring to both you and the supplier?

**Align with internal partners.** Vet and prioritize partnership opportunities with internal stakeholders by assessing their value to the organization.

Again, before collaborating with suppliers, CPOs must first collaborate within the organization. This alone may be new territory for some. But creating value requires tearing down the walls of the procurement organization to gain an enterprise-wide view of the supplier relationship. Two factors are at work here. First, the procurement organization cannot be expected to shift overnight away from its traditional focus on cost-cutting, and outside perspectives will aid in that shift. Second, strategic value is created across the entire enterprise—and indeed the entire value chain—so it is vital to take an enterprise-wide view on how to create that value and which opportunities to pursue with suppliers.

Recently, a client of ours applied this value-screening process to seven strategic suppliers. The company developed 37 win-win hypotheses, spanning all four dimensions of value, valued at $70 million (see figure 4). The value-screening process established the business case for collaboration. With this business case, the CPO was able to demonstrate the type and levels of strategic value, and identify the suppliers with whom to collaborate.

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**Figure 4**

The value-screening process identified 37 win-win hypotheses worth $70 million

<table>
<thead>
<tr>
<th>Level of value</th>
<th>Corporate enterprise</th>
<th>Business unit 1</th>
<th>Business unit 2</th>
<th>Business unit 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>High (more than $5 million)</td>
<td>☒ ☒</td>
<td>☒ ☒</td>
<td>☒ ☒</td>
<td>☒ ☒</td>
</tr>
<tr>
<td>Medium ($500,000 to $5 million)</td>
<td>☐ ☐ ☐ ☐ ☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Low (less than $500,000)</td>
<td>☐ ☐ ☐</td>
<td>☐ ☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

*Source: A.T. Kearney analysis*
Sure, we collaborate with suppliers, you may be saying. My CPO was just telling me a story last week…. Indeed, many companies have examples of successful supplier collaboration—but often these are mere anecdotes, one-time success stories derived from unique circumstances, or even freak accidents, not the results of a structured approach to identifying opportunities. To drive strategic value creation systematically, your procurement organization needs to develop a key competency in supplier collaboration.

Fortunately, many of the competencies developed for strategic sourcing are also applicable to SSRM. Indeed, the first step for CPOs is to lead the function through an understanding of how a collaborative approach compares and contrasts with traditional sourcing (see figure 5). What happens when you move from transactional to relationship-based philosophies? Which traditional strategic sourcing success principles can help you in the move? Many CPOs, for example, enforce the use of deep analytics to inform the process before engaging a supplier. Good. The analytics are important in developing a structured approach to identify value creation opportunities.

Turning supplier collaboration into a core competency will not be easy. But when properly structured as an initiative to develop a key capability, it will not be insurmountable (no more so than developing strategic sourcing capabilities was 20 years ago). There are tried-and-true ways to establish this competency, requiring consideration of three core elements:

1. **Form value creation teams.** Value creation teams follow a flexible but repeatable “value commitment management process” for creating mutual opportunities to create value (see figure 6). Each team, comprising the appropriate internal stakeholders, begins with a value segmentation and screening of potential partners, followed by defining objectives and strategy, including development of a plan for engaging suppliers and sharing the benefits. The next step is engaging suppliers, seeking deeper insights through more integrated work, followed by a joint commitment,

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**Figure 5**
Comparing sourcing to collaborative relationship management

<table>
<thead>
<tr>
<th><strong>Exploit buying power—existing competency for most companies</strong></th>
<th><strong>Create an advantage—new capability for most companies</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sourcing</strong></td>
<td><strong>Relationship management</strong></td>
</tr>
<tr>
<td>• Focus on categories</td>
<td>• Focus on relationships and trust</td>
</tr>
<tr>
<td>• Fixate on unit price and cost savings</td>
<td>• Advance value creation from growth, risk management,</td>
</tr>
<tr>
<td>• Promote a competitive atmosphere</td>
<td>value chain optimization and structural capabilities</td>
</tr>
<tr>
<td>• Focus on the short-term projects and events</td>
<td>• Promote a collaborative atmosphere</td>
</tr>
<tr>
<td>• Use RFPs, auctions, negotiations and one-way communications</td>
<td>• Focus on a long-term horizon, driven by programs</td>
</tr>
<tr>
<td>• Employ cost-focused analytics</td>
<td>• Use workshops, two-way communications, structured</td>
</tr>
<tr>
<td></td>
<td>feedback, performance management and recognition</td>
</tr>
<tr>
<td></td>
<td>programs</td>
</tr>
<tr>
<td></td>
<td>• Employ analytics focused on building relationships</td>
</tr>
<tr>
<td></td>
<td>and creating value beyond cost reductions</td>
</tr>
</tbody>
</table>

Source: A.T. Kearney analysis
Figure 6
The value-commitment management process

<table>
<thead>
<tr>
<th>Perform segmentation and value screen</th>
<th>Identify objectives and strategy</th>
<th>Develop a supplier engagement strategy</th>
<th>Establish joint commitment and review plan</th>
<th>Gauge mutual value capture</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Select key partners</td>
<td>• Establish future-state scenarios across all dimensions</td>
<td>• Iterate hypotheses using partner insights</td>
<td>• Define supplier interaction model</td>
<td></td>
</tr>
<tr>
<td>• Assess current value using a holistic baseline</td>
<td>• Define and test hypotheses</td>
<td>• Integrate and align communications</td>
<td>• Establish joint team</td>
<td></td>
</tr>
<tr>
<td>• Identify additional value hypotheses</td>
<td>• Identify initial targets and timing</td>
<td>• Establish joint team and plan</td>
<td>• Develop value roadmap, including action plans, key dependencies, and risk identification and mitigation</td>
<td></td>
</tr>
<tr>
<td>• Test with internal partners</td>
<td>• Align internal stakeholders</td>
<td>• Prepare and endorse business case</td>
<td>• Conduct periodic executive reviews</td>
<td></td>
</tr>
<tr>
<td>• Define SSRM* project type</td>
<td>• Develop plan to engage suppliers and share benefits</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*SSRM stands for strategic supplier relationship management.
*Source: A.T. Kearney analysis

Figure 7
Transformation roadmap to develop an SSRM* capability

<table>
<thead>
<tr>
<th>Phase 0</th>
<th>Phase 1</th>
<th>Phase 2</th>
<th>Phase 3 and onward</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 to 3 months</td>
<td>5 to 6 months</td>
<td>5 to 6 months</td>
<td>Wave 2: Form joint value capture teams</td>
</tr>
</tbody>
</table>

Form value creation teams
- Wave 1: Form value commitment teams
- Segment and screen for value
- Develop supplier interaction models
- Design organization and talent management
- Create foundational SRM** capability
- Establish transformation management office
- Develop performance metrics
- Facilitate training and knowledge transfer

*SSRM stands for strategic supplier relationship management.
**SRM is supplier relationship management
*Source: A.T. Kearney analysis
in which a joint team develops a roadmap and business case, with periodic executive reviews.

2. Establish foundational processes. These processes guide the value-creation teams so they can devote their creativity to the work, rather than the procedures to accomplish it. These processes should include cross-enterprise governance models (to encourage supplier interaction), organizational redesign (making necessary changes), and protocols for measuring and sharing value.

3. Manage the transformation. Transformation management ensures that the investment in various capabilities pays dividends. Goals include talent management (because the skill sets for collaboration differ from those needed in sourcing), knowledge transfer, performance measurement, communications management, and an active transformation management office.

A typical transformation roadmap for designing, initiating and sustaining an SSRM capability will span two to three years, addressing multiple waves of suppliers (see figure 7 on page 7).

Now is the Time
Now is the time to push your CPO to become a strategic contributor to your team, accountable for tapping the supply base’s energy to help achieve your company’s strategic objectives. Obviously, these objectives go well beyond cost reductions. As key industries continue to consolidate, the first-mover advantage of learning to collaborate with winning suppliers will be crucial to success. The CEO’s job here is to understand and articulate the vision—and task the CPO with specific strategic objectives over the next two to three years. These objectives may include:

- **Growth.** Create incremental revenue growth
- **Risk.** Demonstrate a significant reduction in enterprise risk, covering all potential relevant risk categories such as brand, catastrophes and commodity pricing
- **Value chain.** Optimize the value chain around the corporation’s core, differentiating capabilities, using supplier relationships to maximize benefits for all involved
- **Structural capabilities.** Demonstrate advances in select areas, such as a sustainable competitive cost advantage, improved agility or responsiveness, gains in corporate social responsibility, or other structural capabilities essential to the future strategy.

Clearly, the objectives will vary depending on your strategy, position, and industry. The suppliers you collaborate with, and the results you achieve, will also be unique. What must not vary, however, is the philosophy of collaboration. In the past few decades, the procurement function has grown from a function of lesser importance to one important enough to have a chief officer. The next step in the quest for value creation is collaboration. And the time to take that step is now.
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