

Making Supplier Relationships Work

A.T. Kearney offers nine ways to interact with your suppliers, identifying formulas that characterize true supplier relationship management. Each one gets to the heart of what makes the most effective supplier relationships tick.



We rely on suppliers for a wide range of products and services that allow us to succeed, yet we know surprisingly little about these relationships or how to fully harness them. Some believe these relationships are all about cutting costs. Others think they are the sum of every category management initiative ever tried. We have a different view. We believe that suppliers, and our relationships with them, are an area yet to be fully explored or exploited. At a recent A.T. Kearney Executive Roundtable, 50 chief procurement officers (CPOs) from major U.S. and global corporations conceded that managing suppliers effectively is one of their biggest challenges, and that they are not currently prepared to address it.

SRM is not new. What is new is **recognizing what characterizes a supplier in relation to your business objectives.**

A team of A.T. Kearney partners is spearheading an initiative to fill this void. Called the True Supplier Relationship Management (TrueSRM) Project, and funded by leading high-tech players around the world, we have developed a comprehensive approach to managing supplier relationships—comprehensive because it works in all industries. This paper is about our initial findings, which will culminate in a book scheduled for release in 2014.

Getting to the Heart of Supplier Relationships

When we look at supplier relationships, patterns emerge. Regardless of industry, company size, or a dozen other factors, our suppliers tend to fall into distinct camps. There are those in the “critical cluster” that, with some nurturing to the relationship, can contribute to competitive advantage. The “ordinaries” provide needed but common products or services that could be purchased from many other sources. Then there are the “problematics” that have been useful sources of supply but pose serious problems that need to be fixed, or the supplier replaced.

Managing supplier relationships is nothing new, of course. What is new is our system for recognizing what characterizes a supplier in relation to a company’s unique business objectives (see sidebar: Where Suppliers Fall on the Performance-Relationship Curve on page 7). What is the core nature of the relationship? How can it better serve our company’s success? What do suppliers themselves want? And how do we communicate with them about where they stand now and where we want them to be in the future? This last point is especially pertinent because supplier relationships are rarely structured in a way that guides internal conversations and planning, or communicates in practicable terms.

This is the premise that drove the TrueSRM project team to develop nine ways to interact with suppliers—identifying individual formulas or models that together characterize true supplier relationship management (see figure 1 on page 3). Each model gets to the heart of what makes the most common and effective supplier relationships tick, while establishing expectations for what each relationship is capable of and laying the groundwork for mutual success. While there is no substitute for classic sourcing, our approach to supplier relationship management is to identify and support those relationships that pose the greatest return on investment.

Let’s explore the nine supplier relationship models in detail.

The Critical Cluster: Relationships to Nurture

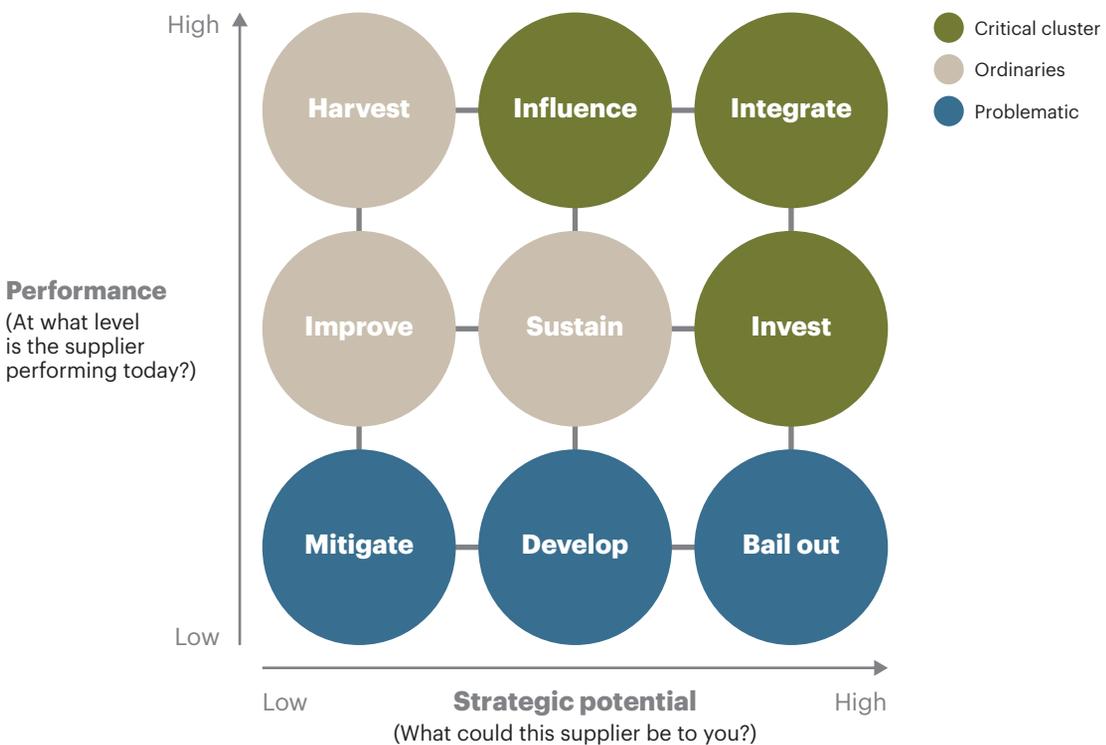
The first under our microscope are suppliers that offer the most promise. Whether vendors that already have a great relationship with you, or clearly could have with a little work, these relationships are the valuable few that are worth time and attention.

Integrate—worthy of commitment

Here the goals of the two organizations are genuinely integrated and they work together as partners. This is a partnership with a capital “P.” Although an often over-used term in business, the true partnership is rare and based on a multi-year, differentiated, and comprehensive relationship between you and your supplier to build an ecosystem that shapes the market. The supplier chosen for this model should be in your sweet spot: Its performance is flawless, and it holds the key to making you a formidable competitor by creating opportunities to grow revenues and profits while jointly shaping or reshaping the industry.¹

When Red Bull introduced its energy drink in 1987, it partnered with Austrian-based Rauch Group, a contract bottler and beverage maker, to be its sole bottler.² In turn, Rauch agreed not to work with any other energy drink company. Such a commitment could have been a risk for both parties, but Red Bull’s product strength and Rauch’s distribution capabilities in 90 countries

Figure 1
Nine supplier interaction models



Source: A.T. Kearney analysis

¹ For more on how to reshape an industry, see “The Strategy Chessboard” at www.atkearney.com

² “F1 investor: Red Bull” at pitpass.com

made for a powerful integrated approach across the two businesses. Today, Red Bull enjoys the largest market share in its category worldwide, selling 5.2 billion units in 2012, and is front and center in sponsoring extreme sports such as Formula 1.

To build and maintain such an involved relationship in the Integrate model requires substantial investment by both parties. Understand that the supplier that commits to this model takes on significant risk. By giving you highly preferential treatment, it could be limiting its own growth potential. Likewise, such concentrated, powerful Integrate relationships suggest that you should have no more than a handful of these suppliers on board.

As with most relationships, **good timing** and **regular communication** are crucial for capitalizing on opportunities.

How to work with Integrate suppliers: A successful relationship with these suppliers thrives on a shared vision and willingness to act as one smoothly running, extended enterprise. The stage can be set by encouraging consistency across your own divisions, functions, and hierarchies in terms of meeting needs, budgets, and timelines with the supplier. This model makes sense only if both parties benefit in terms of profit, revenue, and growth. This means both parties should be mindful of market shifts and how they may affect the other. For example, if your Integrate supplier's competitor offers the same product at a lower price, work with your Integrate supplier to meet this price, perhaps by trimming specifications or improving productivity, and by continually looking for mutual cost reduction opportunities. When each party understands the other's core competencies, duplications can be avoided.

Influence—jointly develop new offerings

Suppliers that fit the Influence model deliver nearly perfect products or services. What sets them apart is that they offer the potential for innovation by working with you to jointly develop new products or services. This factor shapes your relationship with them. These suppliers often dominate an industry, as they are the crucial few that a company and its competitors rely on. In turn, they do not favor any one customer, and in the case of monopolistic suppliers, are required by law not to do so. The downside, of course, is that it is nearly impossible to outpace your competition by working with these suppliers. What's more, mismanage this relationship, and you could alienate these suppliers enough that you fall behind competitors that may better handle their relationship with the same supplier.

How to work with Influence suppliers: As with most relationships in life, good timing and regular communication are crucial for capitalizing on opportunities with Influence suppliers. You want to set the expectation up front that it is necessary to have access to their product, technology, process, and innovation roadmaps. Evaluate them for opportunities that you can tap into or even areas that could provide limited exclusivity. Request ongoing feedback on how your company's actions and plans dovetail with theirs for mutual advantage, and then negotiate competitive pricing accordingly. Also, Influence relationships can consume a substantial amount of internal resources, so make the investment pay off by encouraging confidence in each other's plans.

This kind of close working relationship paid off for Transport for London, the U.K. capital's transportation authority, which needed to replace its aging, red, double-decker buses with a modern fleet. In 2010, it chose a design from manufacturer Wrightbus, a global supplier of public transport coaches. Working closely with Heatherwick Studio, the company created a unique design that meets the specific needs of London's ridership, with full wheelchair and pram accessibility, and a hybrid electric and diesel power engine and aluminum frame that make it one of the most environmentally friendly buses in the world. This joint supplier relationship led to a world-class bus fleet and the largest order of hybrid buses in Europe.³

Invest—believe in capability

Does your company have suppliers that offer great ideas and innovations, but then stumble in basic areas, such as providing continuous supply or consistent quality? A great future can be had with these suppliers—as they ultimately could reach Integrate status—but their potential rests on the relationship you build with them now and the extent to which they respond. Ideally, an Invest supplier will aspire to Integrate status and will work with you in building capabilities to achieve this title. Here, we recommend nurturing the relationship by investing time, money, and resources in developing the supplier's capabilities to meet your needs. The best candidates will make capability-building a top priority. Be forewarned, however, that some suppliers may spurn the help, believing that you are attempting to make them “captive” and to cut them off from wider market opportunities.

Clearly define each party's roles and responsibilities to limit confusion.

The Invest model can become widely accepted in an industry. In aerospace, for example, it is common for customers and suppliers to participate in new projects via risk and revenue sharing partnerships, where both contribute to development costs and share in the returns.

Examples can be found in the automotive industry as well. SGL Group recognized the valuable opportunity that working with BMW presented when the automaker approached it for developing lightweight carbon fiber-reinforced plastics for use in its new i3 electric car. The companies co-invested in a state-of-the-art factory in Moses Lake, Washington, to produce body components that reduce the weight of the new electric car by 550 to 770 pounds, compensating for its battery's weight. Indeed, this joint venture is expected to set a precedent for use of carbon fiber in mass-produced vehicles, a milestone for the automotive industry.⁴

How to work with Invest suppliers: Striking the right balance between nurturing these suppliers, engendering their trust, and overcoming fears of being captured is key. A transparent business case that both parties buy into will help alleviate supplier hesitancy. It should present a compelling return on investment, both for you and the supplier. It is crucial to stick to commitments with these suppliers to reduce their risks and thereby deepen their commitment to you. Given the close cooperation that the model calls for, it also is important to clearly define each party's roles and responsibilities to limit confusion over terms of engagement.

³ “London's Hybrid Double-Decker Bus Officially Unveiled,” Inhabitat, 17 May 2010.

⁴ “New Carbon Fiber Plant to be Built in Moses Lake, Washington,” SGL Group press release, 06 April 2010.

The Ordinaries: Leave Well Enough Alone

While suppliers that fall into this camp are generally more numerous, don't let their average status fool you. There is strength in numbers here. As the number of ordinary suppliers in your fold increases, a keen understanding of what makes these relationships tick, and a simple set of tools for maintaining or incrementally improving their performance, can have sizeable positive results.

Harvest—highly productive but still need cultivating

Harvest represents a well-functioning position for both parties. The company receives just the type of products or services it needs. They're nearly perfect, in fact, and support the company's competitiveness. For you and the supplier, this relationship is virtually hassle-free and ties up few resources. It may seem to function on its own, and that's exactly where both parties need to focus. Complacency should be the red flag here. Great performance could be mistaken for a great partnership, so we recommend not using the term "partner" loosely, because it can lead to assumptions that nothing needs to be changed. Low investment of resources can communicate that you don't overtly value this relationship, and if the supplier falters, it could be dropped. The Harvest supplier's vulnerability, then, and the absence of discussion about maintaining performance, can create tension that negatively influences interactions between the parties.

The challenge with the "ordinaries" is **striking a balance between investment and return on the relationship.**

How to work with Harvest suppliers: Harvest relationships will be fruitful as long as two things remain constant. First, the supplier should maintain its performance. Be sure the company understands that it is "on the team" because of its strong performance, not because of a relationship with you. Communicating to a Harvest supplier that it is a partner supplier is a mistake. Second, be sure to provide the supplier with everything it needs to continue delivering at the current level. As long as these incentives require little of your own additional time or resources, this continues to be a true Harvest relationship. If the supplier's situation changes, or there is any hesitation to invest in maintaining the relationship, then there are specific steps to take, which we discuss shortly.

Sustain—drive for continuous improvement

You probably work with a number of Sustain suppliers. Their performance is average but aspects of this type of relationship place it above that of most suppliers, usually because you need these relationships to endure. They do not need major fixes or warrant significant investment. However, incremental improvement to capture more value and move performance toward world-class levels is usually beneficial.

How to work with Sustain suppliers: The challenge is to strike the right balance between investment and return from this relationship. When these suppliers recognize what you value about working with them, they will be less likely to become complacent and allow their performance to slip or present less desirable commercial terms to you. Always treat the Sustain supplier fairly

Where Suppliers Fall on the Performance-Strategic Potential Curve

While supplier relationship management (SRM) as a concept and term is common, a universal definition is not. The TrueSRM Project team began by defining SRM.⁵

At its heart, SRM:

- Drives supplier behavior
- Encompasses the relationship between two enterprises
- Enables a company to capitalize on its size by coordinating across divisions, functions, and hierarchies

Next, we tested workable frameworks with clients to differentiate supplier interactions, focusing on current performance and the future strategic potential of the relationship (see figure). The two axes are defined as:

- **Performance.** Current performance is measured by output over time (such as percentage of orders delivered in full on time), cost (such as savings compared to the previous quarter), and quality (including failure rate). Capabilities are gauged on performance in engineering, procurement, manufacturing, supply chain management, sales, marketing, and finance. In practice, supplier performance is often gauged with a mix of output and input factors.
- **Strategic potential.** Characterized as the future strategic potential of a supplier, this value cannot be measured objectively. It requires considering the uniqueness of the products or services provided (a monopolistic supplier will, by nature,

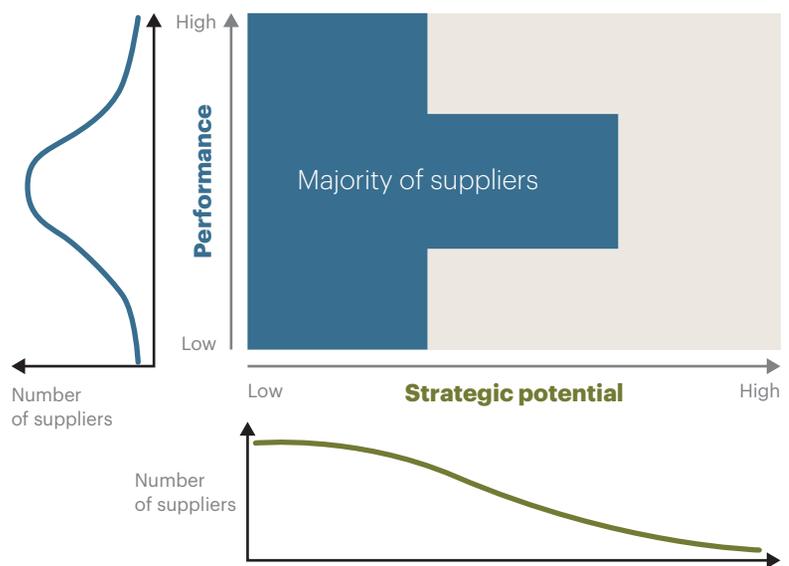
have a relatively high strategic potential, for example); the size of the business with this supplier (a supplier that is important across all divisions will have a higher value than others); the “business” potential (the supplier might have something crucial to a company’s ability to realize its future plans); and the supplier’s attitude (honesty and reliability score high).

In a real-world case, the distribution of suppliers across these two axes is not flat. As illustrated in the figure below, suppliers will be spread across the performance axis in a bell curve or normal distribution. The majority will have average performance. Across the

strategic potential axis, the distribution will lean toward the left. The majority of suppliers will be in mature relationships with the company and will not be the source of exceptional events in the foreseeable future. There will be, however, a few suppliers that have a very high strategic potential.

Looking at the overall picture, a pattern begins to emerge. Most suppliers will be center left in the portfolio, all of them with average performance and in mature, strategic relationships. A limited number of suppliers will reside in the “interesting areas” of the corners of the portfolio. This tendency immediately leads to the question of how to interact with these suppliers.

Figure
Distribution of suppliers by performance and potential



Source: A.T. Kearney analysis

⁵ Category management, while related to SRM, focuses on the best approaches for managing a portfolio of purchased goods or services.

while not tying up disproportionate resources. The relationship is likely to be relatively arms-length, with the supplier needing to compete for additional business. However, take care in this respect. Market and performance changes can cause shifts in the relationship. Remaining sufficiently close to the supplier will help you understand this dynamic and act accordingly.

Improve—address the shortcomings

The majority of your suppliers are likely to fit here. They perform at a level similar to that of a Sustain supplier, with equivalent shortcomings. The key difference is that should they fail—especially repeatedly—you would be more likely to replace them than a faltering Sustain supplier. The Improve relationship can feel unstable for you and the supplier as a result. Instead, turn the unknowns into opportunities by helping the Improve supplier to raise performance and move toward Harvest status.

How to work with Improve suppliers: As long as Improve suppliers do not warrant major investment of time and other resources, having them address their shortcomings is preferable to replacing them. Clearly communicate how they need to perform more effectively and be straightforward about their future strategic potential. Otherwise, these suppliers will lack a true understanding of the situation and fail to improve, leading to the more laborious task for you of replacing them.

The Problematics: Time for Serious Fixes

Rather than rue the day you hired certain suppliers that have become problematic, take a closer look at what has gone wrong and learn from everyone's mistakes. Indeed, this is the time to contain the damage. It's also a great opportunity to repair relationships that warrant the investment, or at least keep the lines of communication open should you both go your separate ways but later find that things look better.

Mitigate—disengage on good terms

Sometimes, it just doesn't work out. A supplier has significant ongoing issues with delivery, cost, or quality and it's time to look for a more promising source. The risks and consequences of doing this need to be mitigated. Relationships that reach the Mitigate stage are easy to transition out of when the failing supplier is small or the business simply structured. But when there are multiple lines of business, numerous product segments, or big outsourcing agreements with a long-term supplier, replacement becomes a challenge. Paradoxically, the quality of this relationship—even though it is ending—is one of the most important supplier interactions to maintain at a level of openness and clarity while you are still working together.

How to work with Mitigate suppliers: Start with a transition plan to avoid misunderstandings and even disasters. Your supplier should fulfill all remaining business obligations and articulate steps for handing off the business to a new supplier. Large suppliers should have done this preparatory work as part of ongoing risk management.

During the transition, be sure to have a window into the Mitigate supplier's inner workings, much like the transparent back of a pocket watch. Ask the supplier to update you on every aspect of the phasing-out of the product life cycle for all categories and lines of business. Understand their interdependencies and how they affect your business. Some of the processes and services may not be obvious, so it is wise to conduct an in-depth assessment. Develop

scenarios and business cases, including war gaming, which can help anticipate supplier reactions and generate valuable input. An exit strategy crafted by top management and key stakeholders and then communicated to everyone will help control communications and extinguish conflicting messages before they flare up.

Finally, avoid characterizing the Mitigate relationship as permanent. Maintaining bridges via a positive relationship could enable a fresh start should conditions change. After all, this supplier has gained valuable insights into your business that could prove useful in the future.

Develop—invent the ideal source

For competitive advantage and operational benefits where none exists right now, consider building a Develop relationship with a supplier whose current performance is poor and needs to be addressed. This should be a hand-selected vendor with lots of potential for working closely with you to identify opportunities across its value chain and yours. Reach out to your in-house cross-functional teams to identify viable candidates that are currently not ready for prime time but have the potential to become star suppliers. There are numerous examples of Develop suppliers that became key sources in well-managed relationships. Consider, for example, the many manufacturers that nurture low-cost country suppliers, providing technology or engineering assistance to get them up to speed as component suppliers.

The Bail Out supplier relationship should be **brief, rare, and temporary.**

How to work with Develop suppliers: This type of relationship works best with suppliers that see your company as a unique chance for improvement and are willing to execute according to your development plan. They should be open to working with your people across their organization. Start the conversation by presenting a business case and plan that reflect the interests of both parties, including informing the supplier about your volume allocation. The objective is to motivate the supplier to change its setup and processes. We recommend including standards for engineering, manufacturing, and quality, with strong program management oversight. The plan and execution will call for both sides to free up core resources, ideally in a way in which they pair up to manage projects and influence functions. Finally, with both parties aiming for the same goal, monitor performance by cascading MBOs down to every employee level affected by the new relationship.

Bail Out—when stepping in is necessary

A major supplier commits an egregious error or a chronic problem suddenly requires triage. This is the abrupt formation of the Bail Out relationship. The situation can significantly jeopardize business by threatening supply.

The immediate goal is to stabilize the supplier's performance. The long-term goal is to learn from the problem to avoid future Bail Outs with this supplier. It may seem counterintuitive, but this is a relationship that will likely be maintained, particularly with important suppliers. The Bail Out relationship should be brief, rare, and regarded as a temporary step toward improving the overall supplier relationship.

How to work with Bail Out suppliers: Immediate and swift recognition of the Bail Out situation will minimize damage and help save the relationship. By acknowledging the situation's severity and allowing your company to intervene, the supplier sets the stage for crucial next steps. Correcting this situation should be a joint effort. Provide specific guidance and expect the supplier to comply with all instructions, including the expectation that it determine solutions to the problem. Bail Outs will rarely be solved in your company's offices and usually take place completely on the supplier's premises. So, have boots on the ground as soon as possible.

Usually, the Bail Out situation poses challenges that you will not have seen before in quite the same form. For effective and speedy reaction, it is wise to put in place contingency relationships with third-party experts up front. These additional resources can then be leveraged to help solve the problem.

Bail Outs are expensive for everyone. Immediately on the heels of this phase, if there is a strong mutual desire to maintain the relationship, then leverage the recent experience to work together and specify plans to enhance the relationship. Debrief, reexamine systems, and establish a revised working relationship that includes ongoing checks and balances so that future Bail Outs do not occur. Most companies immediately jump to replacing the supplier at this point, which is the wrong approach, because it does not consider the relationship's potential longer-term value.

With these nine supplier interaction models, you and your suppliers can know exactly where you stand and where you should plan to take the relationship in the future.

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The signature of our namesake and founder, Andrew Thomas Kearney, on the cover of this document represents our pledge to live the values he instilled in our firm and uphold his commitment to ensuring “essential rightness” in all that we do.
