Harnessing Supplier Energy: The Next Frontier in Procurement

Procurement can no longer engage suppliers through tactical negotiations focused on cutting margins. Your key suppliers must be immersed in a strategic dialogue focused on long-term creation of mutual value.
Saying that today’s business environment is increasingly complex is an understatement. It does not adequately describe the world’s changing demographics and preferences. People want and need more of everything—products, services, information—faster and through more channels than ever before. Worldwide demand for water, food, and energy is soaring and is already depleting natural resources and putting pressure on preservation and sustainability. Add in more financial volatility from global capital imbalances and geopolitical volatility and you’re talking about real challenges.

So it is no surprise that procurement organizations are becoming more complex and difficult to manage. CXOs expect more from procurement. Procurement must continue to do its “day job” and drive cost reductions while simultaneously becoming more strategic by delivering value beyond cost to the organization (see figure 1). This value is derived from innovation and growth, risk management, capital optimization, as well as speed, agility, sustainability, quality, and service.

Findings in our Assessment of Excellence in Procurement (AEP) study support this broader and more strategic mandate. The study is built on an extensive database, a 20-year compilation of leading practices in procurement across 500+ leading organizations around the world. From the data, we know that leading procurement organizations worldwide are finding ways to deliver on both the fundamental cost expectations from procurement (finding and getting the value) while also driving long-term, sustained benefits (keeping and growing the value). Leading procurement organizations have expanded the traditional view of procurement, moving beyond its role as a transaction center between the organization and its suppliers, to the role of strategic partner and steward for the organization. They no longer simply engage suppliers through tactical negotiations focused on cutting margins. Rather, they leverage and engage key suppliers in a strategic dialogue focused on long-term creation of mutual value. These leaders are fully unleashing supplier resources and energy and, as such, consistently appear in the upper echelons of our AEP study.

Figure 1

CEO expectations of the procurement organization

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<td>Value beyond cost reduction</td>
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<td>Innovation and growth</td>
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<td>2.1</td>
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<td>Risk management</td>
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<td>2.8</td>
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<td>Value chain optimization</td>
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<td>Sustainability</td>
<td>1.3x</td>
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Source: A.T. Kearney analysis
Much like marketing leaders have tapped into “customer energy” to help shape the brand promise, procurement is tapping into “supplier energy” to improve and sustain their longer-term competitive advantage.

What is Supplier Energy?

Broadly defined, supplier energy is the ability to identify and access the vast resources of the supply base—resources that can be channeled for longer-term competitive advantage. It is the level of expertise, resources, and capacity that suppliers put forward to help buyers achieve their broader strategic objectives. Procurement is the interface between the organization and the outside supply base that unleashes and channels this energy potential. It augments supplier energy and energizes its internal capabilities.

Yet many procurement organizations continue to struggle, for all the usual reasons, either because they do not have a seat at the table and are driven by savings or are still too tactical and lack the tools and skills to engage deeper with the business. Even companies with established supplier relationship management (SRM) programs often fail to capitalize on supplier energy or to create what we call a TrueSRM program (see figure 2).

TrueSRM complements sourcing and grows value; it has two major components:

- **Foundational.** Work with all suppliers, managing performance to ensure compliance to regulatory requirements and sustain benefits from sourcing
- **Strategic.** Work with select suppliers, collaborating to change behaviors in order to seek competitive advantage (SRM is a big part of this component)

For those procurement organizations that want to lead the way, we have four lessons to share with you. Each one advances the capabilities and effectiveness of the procurement function to the next level to meet new and more sophisticated business imperatives.

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**Figure 2**

**Procurement value realization over time**

- **Cost reduction**
- **Competitive advantage**
- **Strategic SRM**
  - Unlock competitive advantage
- **Foundational SRM**
  - Retain expected benefits by complying with negotiated agreements
  - Potential lost benefits and risk exposure

Source: A.T. Kearney analysis
Lesson 1: Go Beyond Cost Reduction to Address a Broader Set of Business Objectives

Procurement’s traditional focus on cost reduction is a barrier to unleashing supplier energy. Measuring and “incentivizing” procurement primarily on the basis of cost benefits—and particularly with a short-term horizon—undercuts the ability to engage differently with the supply base and tap into supplier energy. Why would a supplier invest resources, capital, and ideas to support a customer’s agenda if the relationship is short-lived and the supplier is squeezed on margins each year?

It is important for procurement to make fact-based rather than anecdotal decisions. One way to accomplish this is by developing supply-award scenarios to assess trade-offs that are determined across a multidimensional, balanced scorecard. The scorecard is tailored for each company based on its competitive environment and strategic imperatives. A good balanced scorecard has a few metrics that are common to an industry, such as marketing. For example, a global branded food company’s scorecard will likely emphasize product quality, innovation, supply risk, sustainability, supplier diversity, and long-term cost management (see figure 3).

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### Figure 3
**Sample scorecard for global branded food company**

#### Changing growth imperatives
- **Changing demographics and consumption**
- **Innovation to counter commoditization**

#### Increased demand for sustainability
- **Depleting natural resources**
- **Focus on sustainable product design**

#### Higher levels of risk
- **Elevated financial volatility and risk**
- **Rising raw material costs and volatility**

#### Tighter regulation
- **Changing role of government**
- **Increased regulation**

#### Continual cost pressures
- **New paradigms in product design and manufacturing**
- **Realignment of global supply chain**

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**Balanced scorecard dimensions**
- **Growth and innovation**
- **Operation excellence and speed**
- **Risk**
- **Capital optimization**
- **Long-term cost advantage**
- **Doing well by doing good**

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*Source: A.T. Kearney analysis*
An automaker is most likely to focus on speed to market, innovation, quality, capital optimization, and competitive cost advantage.

By using a scorecard, the procurement organization demonstrates that it understands the broader business imperatives and can act as a steward of co-creation, providing supply solutions to functional and business leaders. This is far better than procurement “taking” these imperatives as an input at the end of the process when degrees of freedom are limited.

Lesson 2: Create an Integrated Operating Model to Unleash Supplier Energy

Nearly every leading procurement organization has holistic, integrated capabilities deeply embedded within the team. Competencies are built across business planning, long-term category management strategy, strategic sourcing, foundational SRM, and strategic SRM.

By comparison, typical procurement organizations tend to emphasize strategic sourcing, with little to no focus on SRM. Even if some initial steps have been taken, such as appointing an SRM champion, this is not enough to fully unleash supplier energy. Releasing supplier energy requires a shift from strategic sourcing to a distinct SRM operating model (see figure 4).

**Figure 4**

*Integrated SRM operating model*

Group suppliers into interaction clusters to focus on those with the most potential

Actively manage the supplier portfolio—identifying alternatives and halting poor performance—to best suit the business needs

Establish an integral enabling structure: governance, decision support (tools), people and culture, and organizational structure

Give preferential treatment to priority suppliers to build trusted relationships as the basis for value generation

Manage performance to ensure value is delivered, leakage is prevented, and relationships are improved across the entire supplier portfolio

Source: A.T. Kearney analysis
Prioritized suppliers receive special treatment, with the aim of building relationships based on trust as the basis for generating long-term value.

Here is how it works: Business requirements are the starting point, used to determine which spend categories are essential and have the biggest potential impact on your long-term competitive advantage and which dimensions of the balanced scorecard—sustainability, supplier risk management, customer service, costs—are essential. Within these spend categories, qualified suppliers are grouped into clusters, which helps focus on those with the highest value potential (more to come on this later). Prioritized suppliers receive special treatment, with the aim of building relationships based on trust as the basis for generating long-term value. Performance management is employed to monitor the value delivered, minimize value leakage, and improve relationships across the entire supplier portfolio. Throughout, the supplier portfolio is actively managed to identify alternatives and discontinue poor performers as necessary. The sidebar, “Building an SRM Organization,” offers more detail on setting up an SRM operating model.

Building an SRM Organization

A recent client example will help illustrate the ins and outs of establishing a TrueSRM organization. The client, a global manufacturer of branded food products, had a critical supplier of a key ingredient. The CEO was convinced that building a more collaborative relationship with this supplier would unleash all new levels of supplier energy. We confirmed that this supplier was indeed a good match and set out to identify leaders and executive sponsors, define roles, and share expectations.

The SRM operating model was designed to cut through horizontal reporting lines to involve the “right” level of executive decision makers and to ensure that the partnership management team was fully aligned with the overall corporate culture.

Knowing that communication is always essential to success, we moved quickly to set up a transparent partnership management structure and a calendar of regular program management activities, including weekly updates for the working team, quarterly steering committee meetings, and yearly executive sponsor meetings. At the outset, both companies agreed on objectives along a balanced scorecard—cost, innovation, sustainability, growth—along with shared program management and performance management tracking tools such as flash- and benefits-tracking reports.

An important component in the SRM organization was a qualitative feedback mechanism and an agreed upon format to escalate key issues and concerns as necessary. At the same time, all attention was on finding and dedicating the right core and extended team members. We wanted teams with the right mix of right-brain, left-brain skillsets, for all the obvious reasons and because getting the skills mix right was essential to getting the right organizational attitude. After all, a true partnership depends on people embracing a new attitude toward change and a new organizational mindset. The entire effort must never be perceived as just another sourcing effort that will eventually fall off the radar screen.
An SRM enabling structure is also essential to building supplier energy as it ensures governance, provides decision support (tools), and maintains people, culture, and the organizational structure (see figure 5).

Lesson 3: Develop SRM Skillsets Beyond Traditional Procurement Skills

Unleashing supplier energy involves working in a fundamentally new way. It requires different proficiencies and abilities beyond traditional procurement skills—from business acumen and aptitude to problem-solving. In this way, procurement is better able to collaborate with functional stakeholders and suppliers to develop new solutions. For example, engaging a brand manager to consolidate agencies often calls for the right vocabulary (to balance brand impact and efficiency) and a keen understanding of organizational dynamics and emotional intelligence.

Clearly then, winning the war for talent is critical to fully leveraging supplier energy—requiring taking more proactive and aggressive steps to recruit, develop, and retain top talent with both left-brain and right-brain skillsets (see figure 6 on page 8). A typical procurement professional has most of the prerequisite left-brain skills: he or she is analytical, logical, precise, organized. A right-brain person, by contrast, is creative, imaginative, conceptual, and business savvy. These people are not typically recruited by procurement organizations.

Yet to unleash supplier energy, right-brain people have to be part of the mix. Procurement needs left-brain thinkers to deploy advanced analytics and right-brain thinkers to engage on supplier energy, effectively lead cross-functional teams, and embed communication and change management into the process.

Note: SRM is supplier relationship management.
Source: A.T. Kearney analysis
Two skill areas are particularly important:

**Analytical (left brain).** Advanced analytical tools have enabled a step-change in quantifying constraints and multivariable optimization. The focus has shifted from compressing supplier margins through traditional tendering to collaborating with suppliers to uncover new supply combinations and explore “white space” opportunities. By articulating their areas of strengths and sources of competitive advantage, suppliers are exploring new ways of interacting and jointly developing optimal supply scenarios.

The latest breakthrough is the depth with which larger scale new analytical tools enable collaboration at a level of insight never before possible. A combination of a formula-based request-for-solution with open fields for conditional bidding invites suppliers to fully unleash their energy and develop creative solutions—pulling multiple value levers across pricing structure, product specifications, ordering structure, and bundling scenarios. Advanced statistical analysis, multivariable predictive modeling, scenarios, and constraints-based optimization are core capabilities necessary to fully unleash supplier energy.

**Business savvy (right brain).** The average procurement organization focuses on optimizing what and how a spend category is procured, within the constraints of existing internal processes. A leading procurement organization goes deeper to challenge existing processes and requirements, map behaviors, and provide strategic governance—doing so in full collaboration with internal stakeholders and suppliers. Procurement leaders look at their internal processes from an end-to-end perspective: Why is a spend category bought and how could it be substituted? How is it used internally, from end-to-end? What drives demand and specifications? Who is involved in the process? And they understand the amount of energy a good supplier must unleash to identify opportunities for deeper and more durable value creation.
Lesson 4: Segment Suppliers Based on Performance and Future Potential

Many SRM programs, while well-intentioned, fail because they are too broad in their definition of strategic suppliers. Our research shows that companies often take a process-based approach to supplier segmentation. This approach can take six months or longer, is usually overly complicated, and results in too many “strategic” suppliers (at least one per spend category) with unclear prioritization across spend categories.

Success comes from a more focused approach—assessing spend categories based on a supplier’s energy potential and then matching the categories to suppliers with the most energy potential. We explore this method in our recent paper, “Making Supplier Relationships Work,” where critical suppliers are identified based on nine distinct supplier interaction models (see figure 7). The right SRM program is then designed for the right suppliers.

The key is to focus procurement’s limited resources on the most important suppliers—the 1 percent that fall into the critical (influence, integrate, and invest) cluster and the problem (mitigate, develop, bail out) cluster. Problem suppliers must be monitored to ensure performance, while critical suppliers require close collaboration to gain competitive advantage. Suppliers in the critical cluster are important for their portfolio, capability, and exclusivity. Let’s take a closer look at what these suppliers bring to the table:

- **Influence**: Tap into supplier technology to jointly develop and launch products and services
  - **Portfolio** defines industry standard and is rarely customized
  - **Capability** is high due to size
  - **Exclusivity** is typically not granted
• **Integrate:** Enter a multiyear exclusive relationship with the objective to shape the market
  — Able to change the rules of the industry across a sizeable **portfolio**
  — **High capability** is a must
  — **Exclusivity** allows game changing moves

• **Invest:** Jointly build competencies and commit resources on both sides
  — **Portfolio** that could become game changing
  — **Capability** gaps limit the potential for game changing moves
  — **Exclusivity** is rarely relevant

Based on our work and research in this area, collaboration that takes place within the critical clusters can generate mutual breakthrough results, from speeding up new product development times by 40 to 60 percent to increasing sales by 10 to 15 percent. Critical cluster companies report reducing supply costs and inventories by 10 to 20 percent, forecast errors by 600 to 900 basis points, and transportation costs by 7 to 15 percent. All of these results are attributed to not only building collaborative partnerships but also managing them correctly.

**Notable success factors include creating win-wins for both organizations.**

We’re often asked if there is a “secret sauce” to managing these partnerships. There isn’t. But there are a few things that successful partnerships have in common. For one, expectations are defined upfront, and opportunities are evaluated before approaching the potential partner. Then, when finally ready to approach, every move, every conversation, every data point demonstrates commitment and a compelling rationale for collaborating. There is also an innate understanding that minds and mindsets will need to change across all management levels, and there is a willingness to invest the time necessary to accomplish this. Other notable success factors include creating win-wins for both organizations, building trust through transparency (establishing data “clean teams” to share detailed information, for example), and defining gain sharing parameters so both partners understand the rules and the benefits early on.

**Pulling the Lever**

If you are interested in unleashing supplier energy but are still not ready to pull the lever, you are not alone. We offer advice to executives in similar situations every day.

We begin with a suggestion—look closely at your procurement operating model. Does it reflect the priorities and new activities required to unleash supplier energy? If the answer is no, maybe, or I don’t know, we can help. The first step is to define the appropriate operating model and get a baseline of your current SRM practices. We then define a vision for the expected value that can be derived from critical suppliers, and prioritize gaps based on voice of the customer, voice of the supplier, and leadership best practices such as those identified in our AEP study. Finally, we hand you a multiyear roadmap that sequences foundational and strategic SRM improvements, the kind that drive value through supplier pilots while building a thoughtful and sustainable capability.
Suppliers are the Solution

The journey to unleash supplier energy takes time. It requires changing how procurement engages and collaborates with the functions and the business, realigning the procurement team, injecting new capabilities, and segmenting your categories and suppliers in a new way. And while everyone will need to be engaged in the effort, it is usually less complex and more self-funding than improvement efforts focused solely on internal resources. Isn’t it time to view your suppliers as the solution to capturing additional, sustainable value and unleashing their energy potential?

Authors

Mike Hales, partner, Chicago
mike.hales@atkearney.com

Matthew Sorenson, principal, Chicago
matthew.sorenson@atkearney.com

Yves Thill, partner, Atlanta
yves.thill@atkearney.com

John Piatek, consultant, Chicago
john.piatek@atkearney.com
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