

Perspectives for Managers

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Super Supplier Collaboration

Does your company collaborate with suppliers? Almost everyone will respond affirmatively to this question, but what does “collaboration” mean? Based on work with many companies, we see that collaboration needs to be more tightly defined, with specific customer-supplier relationships placed in different categories of collaboration. The categories differ with regard to working relationships, performance metrics, inter-firm communications, managerial attitudes, and fundamental objectives. In this article, we will show how a few firms have developed the degree of collaboration, the benefits achieved, the necessary changes in procurement, the imperatives for other parts of the firm, and the implications for the Chief Procurement Officer, the CPO.

The super supplier

Let us start with the ultimate example of collaboration: The super supplier. The fundamental objective for this category of collaboration is set so high that there can be no doubt as to the differences:

- Our firm, working closely with this supplier, will double the value/cost produced through collaborative efforts.

A Concrete Example

Figure 1 illustrates the payoffs that Honda of America achieved over a six year period through a few super-collaborative relationships. During this period, the consumer price index rose 11% and a big competitor was feeling good, as they limited their materials cost increases to only 7% during this period. Through super collaborative relationships, Honda was able to reduce costs by 19%. The overall competitive gain was 26%! The performance of Honda illustrates how efforts made to create and sustain “super

collaborative” relationships can achieve benefits that vastly outweigh typical arms-length customer-supplier relations. Honda achieved significant cost reductions and increased market share through forging linkages with a few key suppliers and cultivating these relationships.

So how did Honda of America achieve these results? Did they “collaborate” with every supplier? No. In far too many cases, we see firms talking about collaboration, supplier partnerships etc., but these are empty words at best – and another form of hard ball negotiation at worst. Building a super supplier relationship requires a great deal of effort – on the parts of both supplier and customer. These relationships are few in number – but focused on those that can make a competitive difference.

Over the last decade, the automotive industry has best illustrated how super supplier relationships can achieve major competitive gains. Specifically, Japanese automakers Honda and Toyota have used super collaborative relationships to surpass Ford and GM. Culturally the Japanese develop supplier relationships in a different way than their Western counterparts. These relationships are based on mutual trust, honesty, integrity, and an objective focus on results.

But in addition to cultural issues and shared values, a super collaborative relationship often includes a dramatic reduction of risk for the supplier – resulting in far better capacity utilization. If a customer essentially buys a portion of the supplier’s capacity, say one shift, the two firms can work together to greatly increase the productivity of that capacity. There need not be any holes in capacity waiting for orders; batch sizes, transport, and synchronized manufacturing can be optimized, etc. The

cultural issues are inevitable – but the payoffs come from highly coordinated activities, with minimal transactions and close coupling of detailed operations in the customer-supplier relationship.

Figure 1 not only illustrates the outcome of a super supplier relationship: it also shows the necessary time it takes to make it a reality. There are no quick fixes in this game, and the mutual trust, honesty, integrity and objective focus on results must be maintained over a long time frame – unimpeded by suboptimal squeezing of key suppliers. The long time frame is also used for a continuing set of process reengineering activities – in both companies, where cost and value are continually enhanced.

It is important to emphasize payoffs to the supplier – as well as to the customer. The super supplier can sell to its dyad partner at cost plus, while selling to competitors at market prices. Classic economics indicate that market price is set by the cost structure of the least competitive supplier still able to stay in the industry. The super supplier, being dramatically more productive, will achieve large profit margins when selling to the competitors of its customer partner.

So how does super collaboration take place? And how does one create/manage super collaboration? We think it is helpful to divide or segment collaboration into four distinct levels. There is often an evolution and choice process for supplier relations to improve. Moving from one level to the next requires definitive changes – that are most profound in the case of super collaboration.

Collaborative segmentation

We see four levels of collaboration between manufacturers and suppliers ranging from no collaboration to very high levels of collaboration, where a manufacturer actively contributes to the success of the supplier and its competitive position. We use the label “super collaborative” relationship for the highest level of collaboration, as the customer is actively helping their supplier to become better than their competition in exchange for preferential treatment.

Combative

This is the classic purchasing approach: Procurement uses “combative-negotiations” to get results. The main emphasis is on playing hard-ball with the suppliers to bring

down prices or leverage vendors. This style is common in procurement organizations, and always the best source for a quick fix: just demand lower prices – and let the suppliers cope with the consequences. But the combative approach means that suppliers have no incentive to increase value/cost. Innovative ideas are not likely to be shared with those customers perceived as solely interested in price-cutting. The bottom line: combative negotiation can help achieve competitive costs, which avoid competitive disadvantage, but rarely brings competitive advantage.

But let us be clear: combative negotiation is not to be abandoned as a method for procurement. In fact, for many purchased items it is a good way to proceed. Such items are not critical to the customer, and the customer is not the major customer for the supplier. So why not try to get the best deal? Our message is that this approach needs to apply to a carefully chosen supplier segment.

But be careful of measurements: if “price-take-down” is the only measure that Procurement is being graded on, combative negotiation will become the default approach, used with all suppliers.

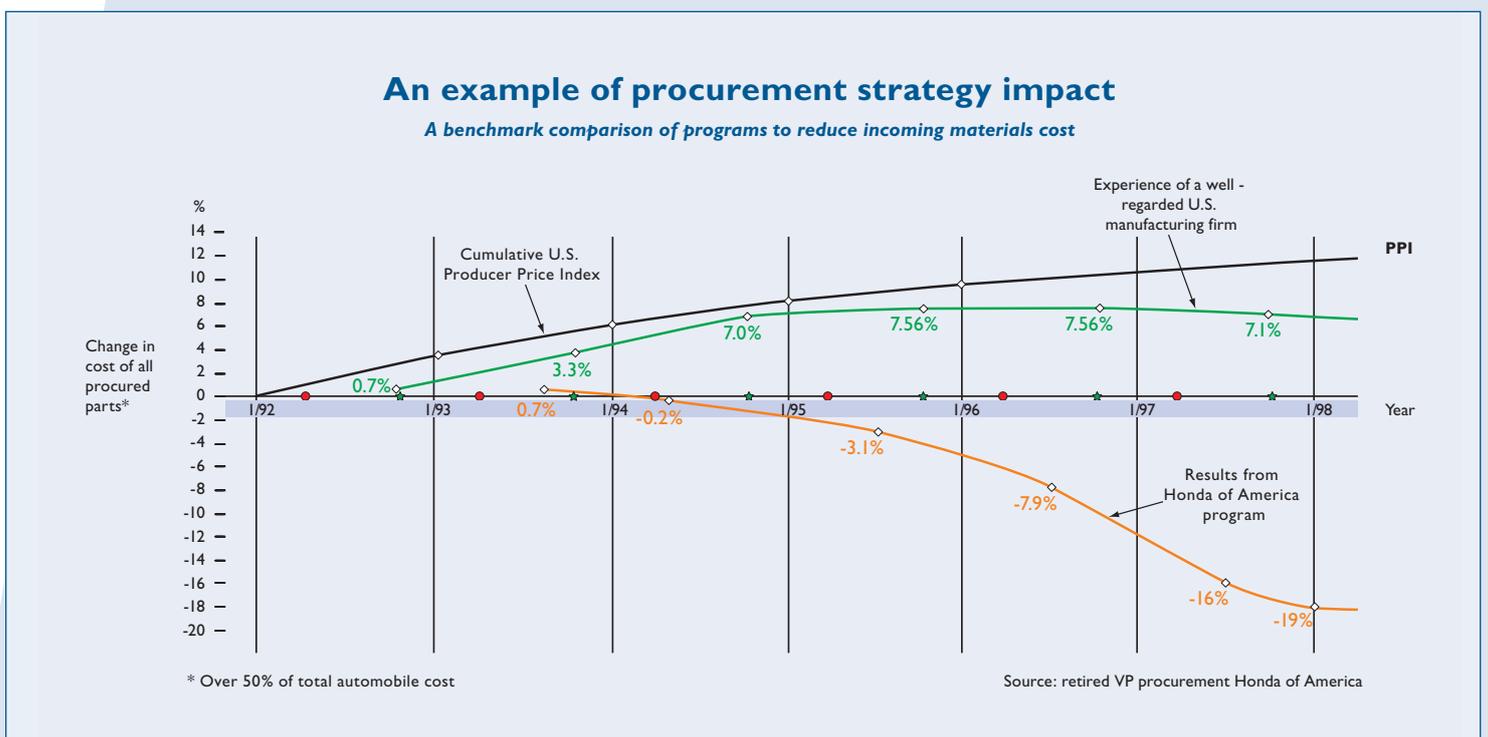


Figure 1: Illustrates the impact a “super collaborative” relationship had for Honda of America.

We see it as critical to not let all supplier relationships become combative, and indeed to carefully select those that are to receive different treatment.

Cooperative

Many procurement relationships are cooperative with each side striving for supply-chain cooperation. These relationships typically exist as an ongoing joint business exchange for goods and services, but they rarely go beyond mutually acceptable working terms. Shared costs in the supply-chain relationship are discussed and understood. The customer works with the supplier to reduce these costs, manage inventories and overall quality control. In addition, sales, response and transaction data are shared so that each party can operate effectively and efficiently.

Partnerships

Partnerships make up a small percentage of the customer-supplier relationships. The emphasis is on creating mutual benefit rather than trying to gain control of the relationship or focus on price reductions. This extends the cooperative relationship, attempting to maximize overall value of the relationship. Through collaboration, each party aids the other in developing and/or leveraging their joint intellectual property – maximizing the value of the relationship. A partnership can support increased productivity and joint product development – unlike a cooperative relationship that focuses primarily on price and transactional costs. A partnership takes time to develop and must have continuous and honest communication, so that each partner will commit to long-term goals. There are fewer price-based negotiations but greater emphasis on jointly prospecting for new competencies, ideas and technologies that would enhance the joint relationship and the customer product portfolio.

Super Collaborative

Although we have here used the terms “super collaborative” and “super supplier” interchangeably, the former term is the correct choice. It is not about suppliers becoming some form of Goliath – it means both firms truly collaborating. Some manufacturers invest in procurement engineering and benchmarking to

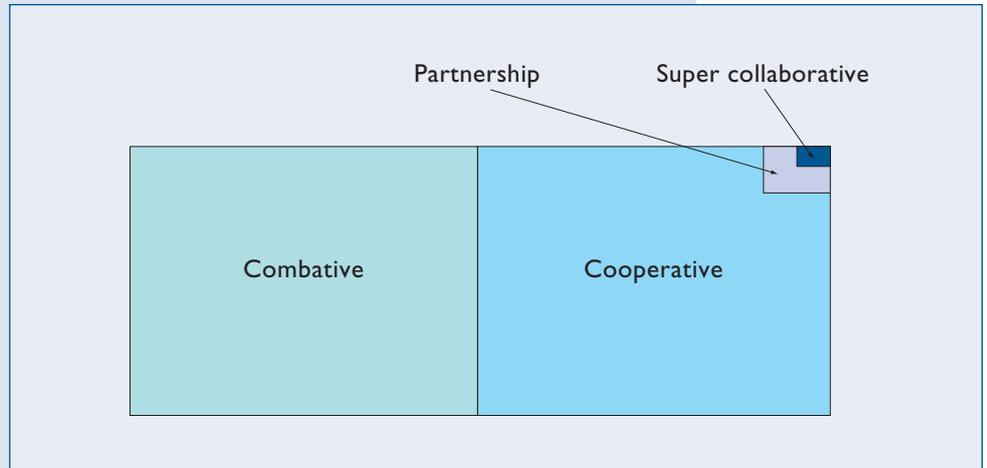


Figure 2: Typical Mix of Collaborative Relationship

create “should cost” or “absolute best cost” models. These models, and the procurement engineering knowledge used to build them, may be used to obtain better prices, but with limited value if used in a combative fashion. Instead, if the results of the absolute best-cost models (i.e. the best practices) are implemented by the super supplier, the result is the best cost – profitably. Correctly managed, the supplier gains significant competitive advantage by adopting unbiased competitive intelligence, insights, and engineering expertise, and using it against their competition. The challenge is to ensure that, like Honda, this also creates competitive advantage for the buyer.

The customer focus on super collaboration is a commitment from the entire firm and all its functions to create significant competitive advantage for the selected suppliers, in exchange for the suppliers creating significant advantage for their firm. Many classic purchasing behaviors need to be “unlearned.” Figure 2 depicts the distinction between collaboration levels, showing that the segments get smaller and smaller as one moves up: there is only time to work with few suppliers at the super collaboration level.

So what are the implications for the CPO? What does the firm need to do to create more collaborative relationships? How should one start on the road to super collaboration? What are the imperatives in procurement – and in the other parts of the company?

Management implications

Creating a “super collaborative” relationship

It is best to start this journey with only one supplier. Procurement will need to analyze which supplier is best suited for super collaboration, if any, and which could generate the expected benefits if the efforts were successful. Also, with which supplier can mutual trust be generated and reciprocal preferential treatment be obtained? Managers in both firms will have to work diligently to form a relationship that can bear long-term pressure and scrutiny, and create a system of continuous measurement.

The Checklist

The following checklist outlines activities that a firm should have completed prior to starting a “super collaborative” relationship.

- Procurement has a strategy, measures, and a charter for competitive advantage that goes beyond “price-take-down”.
- A buying category has been identified, where a market opportunity exists for a “super collaborative” relationship.
- All functions in both organizations can be committed to the relationship.
- A structure has been established that will continuously evaluate, communicate and improve the “super collaborative” relationship. It will handle the continuous communication and alignment internally, and with the supplier.



“The ultimate goal for each side in the relationship is to create significant competitive advantage as an absolute measure, not a relative one.”

“Super collaborative” relationships require diplomacy, and they will be impossible to create and maintain without a consistent, long-term and collaborative mindset. It will require selecting the appropriate procurement officials who are able to establish this association.

Measuring success

It is essential to have constant focus on objective and fact-based benchmarking, using tools such as the “absolute best cost models” described above. The ultimate goal for each side in the relationship is to create significant competitive advantage as an absolute measure, not a relative one.

Once a super-collaboration relationship is established, the classic metrics associated with traditional suppliers no longer apply. It goes without saying that “super collaboration” must produce outstanding results, as the efforts and investments go beyond those required in any other procurement relationship. Unlike supply-chain cooperation, the relationship’s metrics need to focus not just on the overall improvement of the supply chain or maximizing value creation, but on what competitive advantage has been created through the joint efforts.

“Super collaborative” operations will improve classic productivity measures, but each partner must commit to ever-evolving metrics that exploit gains and valuable learning brought by their counterpart. It is to be expected that the “super collaborative” supplier will use their new competencies in working also with other customers. But «our» interest is in having the supplier be the most effective provider of goods/services to others as well – but for them to pay much higher prices! Of course, there will need to be an open dialogue as to what acquired learning and initiatives can be used with other customers and suppliers. However, setting

strict limitations should be discouraged, as the focus should be on enhancing each others’ market position and creating a mutual competitive advantage.

The Future

If “super collaborative” relationships are yielding such compelling results – why isn’t every manufacturer racing to form them? Simply put, it takes an empowered Procurement function and devoted strategic efforts over a long period of time! These relationships require long-term commitment and focus, and entire organizations must buy in. Most firms have a difficult time committing to internal initiatives, and long-haul external collaborative relationships may be out of their comfort zone. Additionally, relying on Procurement as a broker and facilitator of competitive advantage may be difficult for many firms to accept. Over time, the Procurement function must evolve and be endorsed as a significant part of the firm’s competitive advantage. The CPO will need to ensure his/her staff has the right skills. Correctly done, the commitment and energy invested can provide significant results, which would be impossible for a firm otherwise.

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