Metrics Drive Supply Chain Collaboration

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Assessing and ultimately collaborating with suppliers in the supply chain can lead to cost reduction, risk management, and improved performance applications.

Points of Interest

At a glance, here are the main points covered in this article. By reading it, you will learn:

- The importance of selecting the best performance data
- How to develop collaborative relationships
- The benefits of sharing the gains
- How outsourcing drives integration
- That the gains from supplier relationships depend upon continuous improvements at all levels of the supply chain

You could see the excitement in his eyes and hear it in his voice. When the director of supplier development for a major corporation described the new tools his organization was using to assess risks and target opportunities for improvement, it was obvious he was anticipating a dramatic payback for his efforts. Finally, he would be able to determine when the organization was at risk of supply disruption, and when he appealed to a supplier to improve, he could quantify the need and identify the specific area to be addressed.

As any truly progressive supply management organization realizes, tracking supplier performance is vital to minimizing risks of supply disruption, quality and delivery problems, and cost escalation. Knowing which suppliers represent a risk to the customer's business and what specific aspects of the supplier's operations need improvement to reduce those risks or costs is a must for competent supply chain management. While the viewpoint is widely held, only a few organizations are doing much about it.

According to a study by the Aberdeen Group, those enterprises that apply best practices in measuring supplier performance are able to improve performance by about 26 percent. With today's automation tools, Aberdeen suggests capturing as broad a percentage of the supply base as possible because even large numbers of suppliers can be assessed with adequate frequency to be worthwhile. Frequent reporting of obvious parameters such as quality and delivery performance across all sites and business units is essential. Other key metrics that should be tracked include leadtime and cycle time, systemwide inventories, and supplier-initiated improvements. Whenever possible, measurements should focus on elements of total cost of ownership (TCO) as in the case of those above.

In addition to mitigating risks of supply disruption and lowering total costs, there are a number of other benefits from measuring and analyzing supplier performance.

1. Allows selection of only the strongest performing suppliers in first and upper tiers
2. Encourages collaborative and more productive relationships with suppliers based on performance gains by both customer and supplier

3. Promotes benefit sharing of lower costs and greater customer satisfaction throughout the supply chain
4. Facilitates the movement toward increased outsourcing by better information availability to customer operations and between purchaser and supplier
5. Creates systemic assessment, joint improvement, improvement tracking, and gain sharing throughout the chain

Select the Best

In spite of substantial empirical evidence to the contrary, most supply managers continue to use price as the primary differentiator in source selection. Lowest total cost formulas, using data from past performance in quality, delivery, and cost improvement to adjust quoted prices, have been available for decades. However, the inability to collect and interpret meaningful data has limited their application. Meta Group analyst Carl Lehmann says, "Understanding supplier performance is critical to managerial control. Unfortunately, many companies have not invested appropriately in the tools and techniques to track and analyze supplier performance information."

The wide-open, price-focused markets of electronic exchanges are fine for nonstrategic, commodity-type items, but are not the place for forming long-term, cooperative relationships. AMR Research reports that forming collaborative relationships is at the bottom of the list of desired capabilities for a sampling of organizations participating in such exchanges. Before investing in joint improvement efforts with suppliers, it's essential to know that the organization has chosen those suppliers (not by price alone) with the best prospects for success in such efforts. New information technology (IT) software and Web services make the collection and analysis of such complex data possible, even at frequent intervals.

Develop Collaborative Relationships

A 2001 report by Deloitte Consulting showed that the slowing economy had prompted a full 54 percent of respondents to increase the importance of collaborative commerce initiatives in their organizations. When seeking to develop a collaborative relationship with key strategic suppliers, it's vital to ensure that both parties are interested in achieving long-term competitive advantage, and that progress is measured and reported frequently. With the globalization of markets and the speed of information exchange made possible by the Internet, it is more evident than ever that competition is moving away from individual organizations and toward competing supply chains.

According to management consulting and systems integration firm NerveWire, the largest barrier to shared accomplishment is not technology but rather "distrust in sharing proprietary information with other companies." Based upon a survey of 162 North American executives, NerveWire found that companies considering themselves "very highly integrated" with their trading partners had increased revenues 40 percent, reduced costs 30 percent, and increased customer retention rates 35 percent as a result of collaborative initiatives. Sanjiv Gossain, Ph.D., chief technology officer for NerveWire, advises, "Start small and show demonstrable returns for all parties." He also suggests that interested companies "get their own house in order" by attending to internal integration projects. Dell and Wal-Mart are excellent examples of this last point. In-process metrics such as quality, cycle time, and inventory levels can be used to track such improvements both in-house and in various tiers of the supply chain.

Share the Gains

Suppliers are often slow to respond to e-procurement initiatives, such as reverse auctions and online bidding, for fear of losing product differentiation in the market. Indeed, if the purchaser's only selection criterion is price, there is no product differentiation. To overcome this reluctance when forming a long-term relationship, it's advisable to create a memorandum of understanding (MOU) between the purchaser and the supplier outlining the specific actions and results expected by each as a result of the joint efforts. The MOU must be based upon measurable criteria such as quality, cycle time, productivity, and cost, so that gains are recorded and will be acknowledged by both parties. Naturally, the supplier wants to know, "What's in it for me?" A good gain-sharing plan will contain details of how both the purchaser's and supplier's resources are to be allocated to making the improvements and how the measured improvements will benefit each. Also, cost reductions and increased revenues should be considered in the benefit calculations.

Outsourcing Drives Integration

Many enterprises are convinced that the path to maximum topline growth and profitability is by concentrating internal resources on core organizational competencies and outsourcing all other activities to suppliers with that core competency. The implication for supply managers is profound not only in terms of increased opportunity to contribute to business success but also the need to manage critical activities performed by others. Collaboration and joint improvement efforts with this small number of business-critical suppliers will rapidly become a vital role of supply managers. Again, tracking the performance metrics of suppliers is essential to managerial control.

Create Systemic Improvement

The gains from supplier relationships depend upon continuous improvement at all levels of the supply chain. This is not a one-shot effort, but rather a way of doing business that is constantly being refined and improved through participation at many levels of the chain simultaneously. An excellent example of this approach is Honeywell's Industry Solutions (IS) division in Phoenix, which hopes to instill its own Six Sigma culture among the organization's supply base. Improvement starts with a system that documents supplier performance with enough frequency to spot trends and catch problems before they get out of hand. Monthly reports are provided by the nearly 100 percent Web-based system. Suppliers may access their individual numbers as well as their ranking in their field at any time. Supplier scores are used to factor prices received during an e-auction in order to base the award on lowest total cost.

There is also an annual assessment incorporating past performance with financial risk, succession planning, health and safety records, quality systems, and supplier relationships and control. Jon Lyons, director of global supply management for IS, indicates that going forward, it intends to become more engaged with second-tier component suppliers. This process of continual reassessment combined with improvement efforts throughout the supply chain provides a platform for constant reduction of supply risks and for business gains for the supply chain participants. Supply chain management is capable of playing a lead role in most organizations. Opportunities to improve results by getting greater contributions from the supply base are everywhere. Only by using supplier performance indicators and analyzing risk mitigation and improvement priorities can supply management personnel provide the leadership expected by the enterprise.