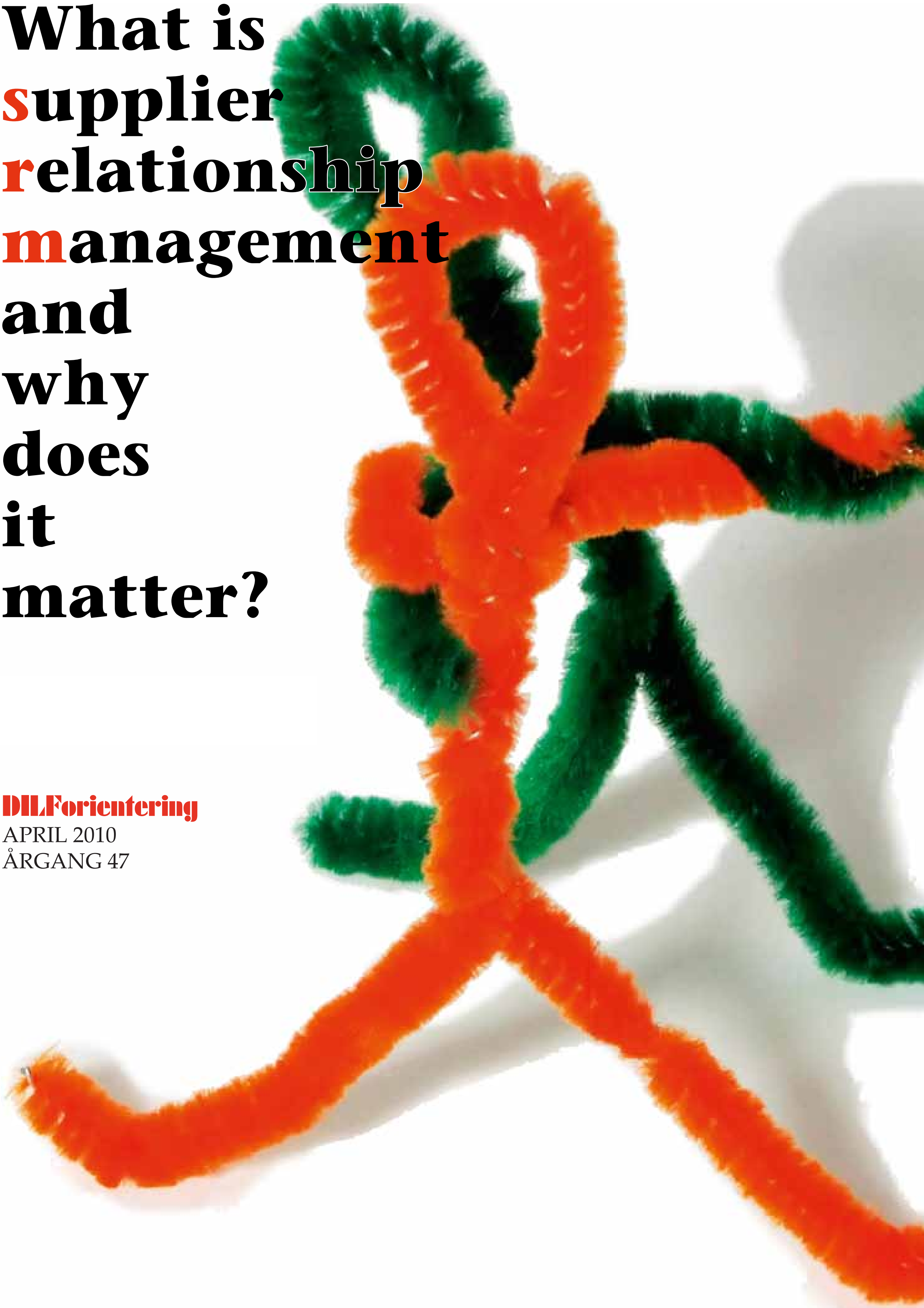
What is supplier relationship management and why does it matter?



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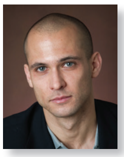

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Supplier relationship management (SRM) – which emerged as a term or an idea only a few years ago – has rapidly gained traction in the marketplace. Presentations on SRM are by now standard fair at most procurement and sourcing conferences. In March of 2005, the Conference Board hosted its first conference devoted specifically to SRM. But as with many big business ideas, reality falls short of hype. For example, few companies have yet implemented a formal SRM function within their procurement organization.

Moreover, there is no standard definition of, and not much clear discussion about, what SRM is or why it is important. Witness the following description of SRM from the popular website Bitpipe: "The consolidation and classification of procurement data to provide an understanding of supplier relationships in order to develop procurement strategies that reduce costs, make procurement predictable and repeatable, enlighten supplier partnership decisions and provide leverage over suppliers in negotiations. Also called sourcing, strategic sourcing, e-sourcing."[1] Note the overly narrow focus on data management and purchasing, the somewhat contradictory aims of "enlightened partnership" and "leverage over suppliers," and the imprecise and unhelpful equation of SRM with strategic sourcing and e-sourcing.

Before proceeding to offer a definition of supplier relationship management, it is important to explain why it is so important to articulate a clear definition. As with CRM, software vendors are increasingly at the forefront of the SRM wave. Siebel, Oracle, Ariba, and others have multiple products that bear the label 'SRM'. According to IDC, $2.3 bn was spent on SRM software in 2004, and this amount is projected to increase to $3.1 bn by 2007. Consequently, SRM seems poised to follow the evolutionary path of CRM – another powerful concept and set of principles that were overshadowed by an often myopic focus on software tools. This is not to say that CRM software has not been valuable – only that its full potential has often not been realized, because it has so often been implemented in the absence of the kind of business structure and process changes that are clearly suggested by an understanding of what CRM actually is, and why it matters. This article is an attempt to head off at the pass waste and missed opportunities in the emerging discipline of SRM by defining clearly and robustly what it is, and why it matters.

A brief primer on CRM

The original and fundamental insight of CRM was that the multiple interactions (multiple purchases, customer service requests and responses, etc.) between a company and a customer that occurred over time were not simply a collection of atomic, unrelated events. Instead, they were properly and usefully understood as comprising a relationship between company and customer. This fundamental insight suggests a clear definition of CRM – the management of a company's multiple interactions with its customers in a systematic way based on the theory that they are not discrete events, but instead related in various ways – that they collectively comprise an arrangement that can be usefully understood and treated as a relationship.

This fundamental insight has many implications. One is that information about customer needs and preferences can be gleaned by analyzing the universe of transactions with them. This in turn creates opportunities to increase sales, to decrease the cost of sales, to increase the return on marketing and advertising expenditures, and so on. Obviously, such analysis required previously unavailable data, and hence powerful new software tools to track, and then to analyze and report that data. Another, perhaps slightly more subtle insight is that customers are not all equal. It is essential to segment customers based on the value of relationships with them, that is, based on an assessment of the financial benefit those relationships could be expected to return. Hence the further insight that some customers should be 'fired' because they are unprofitable, and are likely to remain so. More generally, deployment of finite resources against customer service and account management should not be equal or random across customers, but clearly tied to the value the deployment of those resources is expected to return.

Further insights can be inferred from the principles above. One fundamental insight, increasingly recognized yet often profoundly shortchanged, is the need to transcend the functional silos that exist in every company in order to realize the potential benefits of CRM. At the most basic level, this means that developing a comprehensive picture of a customer relationship (in order to make fact-based decisions about how to manage that relationship, that is, how to conduct future interactions in a purposeful and coherent manner) requires gathering data from multiple sources, e.g., sales, customer service, different business units that sell to and service the same customer. These sources of data inevitably sit in different organizations within a company, and are gathered by and affect different functional processes – and are therefore inevitably maintained in different databases. Hence the major data integration efforts that often accompany an effort to roll out a CRM strategy (read: system).

SRM is about the need to rigorously analyze when and how to leverage suppliers' assets, capabilities, and knowledge as a source of competitive advantage; and the resultant need to view and manage supplier relationships as a strategic asset, as opposed to merely a cost center.

One other thought is worth noting, (but not exploring at this point since this is an article about SRM, not CRM), namely that little attention has been paid to systematically differentiating CRM in the B2B context and the B2C context. Many important aspects of B2B relationship management have been inadequately analyzed or misunderstood as a result. This is significant because SRM is inherently B2B in nature. Individual consumers do not have 'suppliers' in any meaningful or useful sense, nor do medium to large-sized companies source

ACME: THE COSTS OF FAILING TO IMPLEMENT SRM

Although ACME has interactions with many suppliers that are relatively simple (focused primarily on commodity purchase and fulfillment), the company also has many suppliers with whom it has wide ranging and complex interactions. Despite a generally positive history with many key suppliers, ACME found it was incurring significant costs and failing to capitalize on major opportunities, because it lacked appropriate governance structures and business processes to manage these interactions as comprising a single, integrated relationship.

For example, interactions with suppliers were managed by procurement (and overwhelmingly focused on purchasing), with only indirect involvement from product groups, and almost no involvement, or even input, from R&D or Marketing. Yet a critical challenge for ACME was to spot opportunities to extend its brands, spot new fads and trends quickly (and differentiate between the two), and to bring new or radically improved products to market. In the absence of formalized joint business planning with suppliers to carefully manage exchange of sensitive information about long range plans, market intelligence, as well as sharing of intellectual property, major opportunities were regularly missed.

Once a year 'executive to executive' meetings were not enough; ACME tried that. Occasionally, high level opportunities were spotted, but then nothing happened because there was no infrastructure to enable resourcing and effective management of joint efforts with suppliers. For example, it still took months of time for engineers, product managers, and others to obtain approval, if it could be obtained at all, to exchange all but the most limited information with suppliers. 'Intellectual property' meant many different things to executives and managers across different product groups and functional areas at ACME, and no tools or guidelines were in place to evaluate the risks of sharing against the potential to create value. Moreover, when suppliers shared new technology or market opportunities with ACME in the hopes of collaborating, more often than not, they felt like they got burned – not out of ill-intent, but because ACME's business processes, organizational structures, and management systems were all but designed to thwart even the best of intentions.

For example, supplier-generated opportunities would languish for months because no one had the responsibility to review them, nor the authority to make a go or no-go decision. A more complex challenge arose in those rare situations when collaboration on a new product technology did occur. No sooner did procurement get involved (as the R&D aspect of the collaboration wound down), than ACME began to pursue strategies designed to commoditize the new technology in the marketplace as quickly as possible so they could buy it for less. Not surprisingly, suppliers who had been through this experience once were loath to bring new technology to ACME the next time; they went instead to ACME's competitors. ACME had no formal means by which to internally assess optimal timeframes for commoditizing new supplier-generated technology (balancing cost concerns with the need for suppliers to realize an attractive return on their investment, and thus be incented to continue to innovate and share innovations with ACME), nor the processes or skills with which to engage in collaborative resolution of the inherent tension with suppliers.

goods or services to a material degree from individuals. Consequently, this paper will explicitly analyze the implications of the fact that SRM is intrinsically B2B so as to avoid pitfalls of misapplying lessons about B2C relationship management, and even more importantly, ensuring that the nature of B2B relationship management is fully analyzed and understood. (This chain of thought suggests further work in the field of B2B CRM).

Defining SRM

In many fundamental ways, SRM is analogous to CRM. Just as companies have multiple interactions over time with their customers, so too do they with their suppliers – negotiating contracts, purchasing, managing logistics and delivery, collaborating on product design, etc. The starting point for defining SRM is a recognition that these various interactions with suppliers are not discrete and independent – instead they are accurately and usefully thought of as comprising a relationship. But why? (See the sidebar on ACME.)

With CRM, the case is straightforward and intuitive. If I see all of my customer interactions as parts of a whole, I can track and analyze them to better understand what my customers want. This will help me market to, sell to, and service customers more effectively, leading to more revenue and higher profits. I can also make more effective decisions about how to allocate finite resources across my customer base, based on a better understanding of the value I could potentially realize from each customer.

With SRM, the case is somewhat less straightforward. After all, while it seems intuitively obvious that there is value in understanding my customers better by tracking and analyzing all my interactions with them, it is certainly not equally obvious that there is a parallel benefit to understanding my suppliers in the same way. With customers, the overwhelming goal is sales. There may be objectives beyond profitable sales that matter with some customers (reference-ability – which drives sales with other customers; reducing cost of sales; getting early insights about needs and preferences that may represent major market opportunities). Nonetheless, these interests are largely at the margins. The best customer is one who buys a lot at attractive margins. You want as many of these customers as possible.

But is the best supplier one from whom you buy a lot at low prices? Not in an analogous way. Typically, a high volume, low price supplier is a commodity vendor: Relatively easy to replace, and by most measures not a source of competitive advantage. Other factors, like product and service quality, willingness and ability to innovate, and the degree to which a supplier's products and services help you differentiate your own in the marketplace are more important than volume or price in determining how important or valuable a supplier is.

An essential insight of SRM: View suppliers as a source of competitive advantage, not just a cost center

In the early days of CRM, there was skepticism about whether CRM could really deliver higher sales and profit. But there was no uncertainty about the nature of the potential value. On the contrary, with SRM, no clear definition or framework for evaluating value has been defined. Many companies are simply looking for ways to continue to drive costs down, typically by demanding lower prices from suppliers, and they are trying to figure out whether and how SRM might help them do so. Other companies have an instinctual sense that better relationships (whatever 'better' might mean) will deliver more value.

While not exhaustive, the chart in figure 1 provides a framework within which to think about the potential forms of value that can be realized from suppliers.

The framework should not be interpreted to mean that every supplier should be managed in order to realize all the kinds of value noted. In fact, analysis using this framework will often indicate (or validate) that the most important way to realize competitive advantage from many suppliers is by driving costs down. Indeed, in some cases, the primary lever may be using sourcing and negotiation to get lower prices, though in other cases (certainly not all), greater cost savings will be available though more collaborative approaches like streamlining supply chain activities, jointly redesigning product specs for cheaper manufacturability, etc.

How strategic sourcing and SRM are distinct, and related

In part, SRM is about the need to rigorously analyze when and how to leverage suppliers' assets, capabilities, and knowledge as a source of competitive advantage; and the resultant need to view and manage supplier relationships as a strategic asset, as opposed to merely a cost center. In this sense, certain key distinctions between strategic sourcing and supplier relationship management become clear. Sourcing is about applying analytic rigor (at an enterprise, rather than local, level) to decisions about what to buy and from whom to buy it. SRM is about looking at supplier assets and capabilities (also from an enterprise-wide perspective), and determining where formal management of relationships makes sense, and, given the nature of the opportunities identified, what sort of relationship management infrastructure (organizational governance, business processes and the like) is required to realize different forms of value from different types of suppliers over time.

Sourcing is driven by internal needs analysis; SRM is driven by external opportunity analysis. Sourcing takes as its fundamental unit of analysis carefully defined categories of purchasing; SRM takes as its fundamental unit of analysis carefully defined categories of supplier relationships. As such, strategic sourcing and SRM are natural, and necessary, complements: View your business through only one of these interpretive lenses and you will miss important opportunities, and important risks.

Finally, inasmuch as common outcomes of strategic sourcing analysis are to consolidate more purchasing with far fewer suppliers and to forge more interdependent relationships with certain key suppliers, SRM is about putting in place the organizational capabilities required to manage these more complex supplier interactions – to manage them strategically, as part of an overall relationship, rather than tactically through the various organizational and functional silos that separate R&D from Purchasing, Finance from Manufacturing, and the other functions which affect or involve suppliers.

What is a 'good relationship'?

The term relationship has never been clearly defined in the CRM context, nor yet in the SRM context. This is no surprise because the word has three different but related senses – each of which is fundamental to SRM (as to CRM), and hence essential to distinguish among.

Sense one: A relationship refers to the collective set of interactions between two (or more) parties (e.g., a company and a supplier, a company and a customer, three companies in a joint venture). In this sense, a good or bad rela-

tionship is most naturally understood as referring to the value of the relationship.

Sense two: Relationship refers to the manner in which interactions take place between two (or more) parties. Are they

SRM is about putting in place the organizational capabilities required to manage complex supplier interactions — to manage them strategically rather than tactically.

efficient or inefficient? Contentious or cooperative? Characterized by secrecy or openness, deception or honesty? This sense of relationship is procedural rather than substantive. To distinguish it from the first sense, it is useful to refer to it as the working relationship: how we interact with each other; how we work together. It is worth noting that the working relationship has a significant impact on the value generated by a relationship.

Sense three: Relationship also refers to how parties perceive each other and feel about one another. Here there is a common and natural tendency to anthropomorphize companies. It is often said that a company and one of its suppliers trust or mistrust each other. While this could clearly be true of individual people, what could it mean to say that an organization trusts or mistrusts another organization? A useful definition of relationship in this third sense would be: "A systematic tendency of individuals in one organization to believe things about, and

POTENTIAL VALUE

Bottom line savings	Top line value	Operating efficiencies
Elimination of redundant supply chain assets and processes (e.g., QA, distribution) Joint (re-)design of product specs for more efficient manufacturing Reduction of inventory levels Shift of inventory to suppliers Reduction of capital expenditures by shifting them to, or sharing them with, suppliers	Faster product development cycles; faster time-to-market Customer and marketplace insight Technology, process, and product innovation Joint marketing/advertising Access to, or penetration of, new markets Suppliers as customers and channels	Improved value-chain forecasting and response Improved quality and speed of decision-making Reduced time and effort in scope management Enhanced service quality, responsiveness, flexibility Reduction in errors, conflicts Streamlined management of order, fulfillment, rebates, etc. Reduced time spent on selection and contract negotiation

Figure 1.

expect certain attitudes and behaviors from, individuals in another organization." Again, it is worth noting that relationship in this third sense has a signifi-

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Sense 2: Relationship refers to the manner in which interactions take place between two (or more) parties.

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cant impact on the quality of the working relationship, and ultimately on the value of a relationship. For example, whether I (and others in my company) have confidence (or lack it) in the ability of one of my customers to reliably deliver on commitments made by the individuals I interact with from that organization will have a significant impact on whether or not we share IP or other sensitive and valuable information, whether we invest in assets dedicated to servicing that customer, and the like.

As Jeffrey Dyer has usefully pointed out, such perceptions and expectations are not solely or even primarily a function of judgment about individual counterparts[2]. After all, I may trust my contact at a key supplier, but he might take a new job tomorrow, or he might make a commitment to me in good faith, but be overruled by his boss. Instead, perceptions about and expectations of any given individual in an organization are largely based on what most people in that organization do, and a theory (not necessarily explicit) of how policies and procedures in that organization are likely to lead anyone in that organization to think and behave.

From this perspective, the comment by a senior executive at a Fortune 500 company (which we'll call "Matrix Corp" to protect the innocent) that "Our company's goal in any negotiation is to beat the other side" could be expected to have a negative impact on relationships (in every sense of the word) with suppliers, as well as customers, channel partners, and the like – irrespective of, though not unmediated by, personal relationships between individuals at those companies and the people they interact with at Matrix. That is, if I believe this executive's views carry weight and affect his company's policies, I will need to be skeptical, and careful, in my interactions with anyone from Matrix, regardless of how much I may like, trust, and respect them as individuals. After all, if you're going to be evaluated by management at Matrix according to whether or not you 'beat me' in our negotiation, then I'll have to be wary of assertions that any deal between us is fair or good for me.

The second and third sense of relationship are symmetrical (between customer and supplier) in the B2B context, but not in the B2C context. That is, B2B relationships are comprised of interactions, (often complex and strategic), among multiple people in two or more companies, and those companies and their relationship outlast the vast majority of relationships between or among individuals who interact on their behalf. By contrast, in the B2C context, many representatives of a company typically have interactions (rarely complex, almost never strategic) with a single consumer.

Inasmuch as the majority of thinking and writing about relationship management has been in the context of B2C customer relationships, the exploration of

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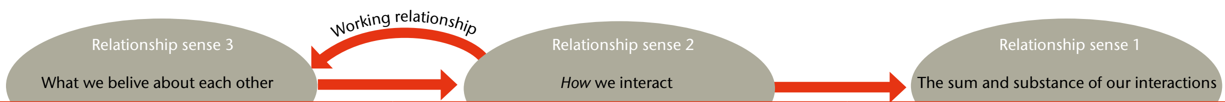
the second and third senses of relationship (what they entail, why they matter, what can and should be done to address them) that has been undertaken has little relevance to B2B relationship management, particularly with suppliers. As is apparent in the sidebar on ACME, what is needed to build trust and a high quality of interactions with individual consumers has little to do with building trust and having efficient and productive interactions with suppliers.

What is a good working relationship (sense 2)?

While electronic marketplaces and reverse auctions highlight the opportunity to substantially automate some business arrangements with suppliers, many other arrangements with suppliers are more complex (or complex in ways that resist automation). In particular, they involve far more interdependence than the setting of price, and the order and delivery of basic goods or services. These more complex, and typically more strategic, supplier relationships may involve collaboration on design of product specifications, around joint business planning on research and development, around logistics,

WORKING RELATIONSHIP



Key questions	Key questions	Key questions
❙ How much do we trust each other? **In particular** ❙ To what extent do we believe they will do what they say they will do? ❙ To what extent do we believe they will actively try to help us and avoid actions that would harm us?	❙ How efficiently do we communicate? ❙ How well do we understand each other (goals, constraints, etc.)? ❙ To what extent do we rely on persuasion rather than coercion to resolve our differences? ❙ How efficiently and creatively do we solve problems together?	❙ What is the actual value of our interactions? ❙ What is the potential for value through any (other) interactions we might have?

Figure 2.

on quality management, and the like. Inherently, these relationships depend in large part on the ability of multiple individuals on each side to regularly solve problems, make decisions, and resolve conflicts in the face of multiple, competing priorities – some shared, and some not.

The more complex the interactions which comprise a relationship with a given supplier, the more a good relationship (in the second and third senses of the term) matters, that is, the more they impact the value of (or created by) that relationship (relationship in the first sense). Why? Because more complex interactions tend to require the application of human intelligence and judgment, and thus depend for their success on whether people are able to work effectively together.

Is it necessary to make more explicit the logic that undergirds the assertion in the preceding sentence? Consider the case of a large manufacturing company and one of its key suppliers who decided to collaborate on a new product design that optimized for various product performance criteria, as well as various manufacturing criteria, e.g., low cost and low defect rates. A joint engineering team made up of the best and the brightest from each company was assembled. Unfortunately, the individuals on the team neither liked nor trusted one another, and also each believed that the other company was committed to systematically taking advantage of its business partners in order to maximize gains for itself. Did this group efficiently come up with an optimal design? Of course not. Information was withheld rather than shared. Ideas proposed by individuals from one company were attacked or ignored by individuals from the other. Six months after it began, the effort was disbanded, each side blaming the other (somewhat schizophrenically) for a combination of incompetence and conscious sabotage of the effort. The original business case (which ran into the tens of millions of dollars in benefit to each side) was never realized, and each side wasted the time and effort of some of its most talented people for half a year.

Debriefing the effort a year later, one of the executive architects of the deal reflected that: "I really thought that if the business case was there, although it might be difficult, rational self-interest would inevitably lead to success. Now, I know that's not true. I also thought that a group of engineers would behave rationally, that something as 'soft' as relationship management didn't matter. I now know firsthand that people don't check their emotions at the office door. All the emotional energy that, in a collaborative, high performing team, is channeled into exchange of ideas and creative debate became, in this situation, absorbed and reflected by ad hominem attacks, defensiveness, and absolutely irrational, ego-driven arguments about who was more or less competent, who was ethical and who wasn't, and who had secret agendas."

It is essential to formally define what constitutes a good working relationship in order to maximize supplier relationship value through effective supplier relationship management. A useful place to begin is to juxtapose common, often implicit ideas about what constitutes a good working relationship, versus a more robust and rigorous set of characteristics. These contrasting views of a good relationship are depicted in figure 3 at the individual, rather than the organizational level, specifically because certain classes of organizational relationships (in the SRM context – those that are least like arms-length commodity vendors), depend so heavily on the quality of interactions among individuals. Further, the quality of these interpersonal interactions is driven in part by assumptions held by individuals about working with, and managing their relationships with, others. (Later, we will examine how these common assumptions about relationships and relationship management lead senior management in many companies to create an environment – instantiated through management systems, business processes, and organizational structures – which systematically undermines people's ability to work effectively together.)

Individual versus organizational relationships and relationship management

In figure 3, a description of what constitutes a good (working) relationship is juxtaposed against a more common picture. As written, the description in the right column refers to relationships between or among individuals. So what does it look like to extend this thinking to the organizational level? One useful way to think about a good working relationship between organizations is that the beliefs held by individuals in each organization about individuals in the other organization, and interactions among those individuals, are generally consistent with the attitudes and behaviors articulated in column two of the chart – call this a picture of 'collaborative' attitudes and behaviors.

An added gloss would be that people in each organization believe that the other organization is characterized by policies, management systems, and business processes that will systematically lead people who work in that organization to think and act in a collaborative manner. So, another way of defining supplier relationship management is: "Actions taken by an organization (namely, by people in that organization, in particular senior management) to create an environment (through policies, management systems, business processes) that reliably leads people in that organization to exhibit collaborative attitudes and behaviors in their interactions with suppliers."

Another way of defining SRM is "Actions taken by an organization to create an environment that reliably leads people in that organization to exhibit collaborative attitudes and behaviors in their interactions with suppliers."

Implications for SRM of distinguishing among the three senses of relationship

Why is it so important to distinguish among these three senses of relationship? Primarily because by distinguishing among them, it is possible to articulate and map out a series of causal connections that provide organizations with a

A GOOD RELATIONSHIP – CONTRASTING VIEWS

A common view of a good relationship	A more realistic view of a good relationship
You do what I want I keep you happy We like each other We have little or no conflict	We trust each other Communication is robust and efficient Tensions are surfaced early and easily We understand and respect each other, even when we don't agree We rely on persuasion rather than coercion to resolve differences

Figure 3.

THREE RELATIONSHIP SENSES

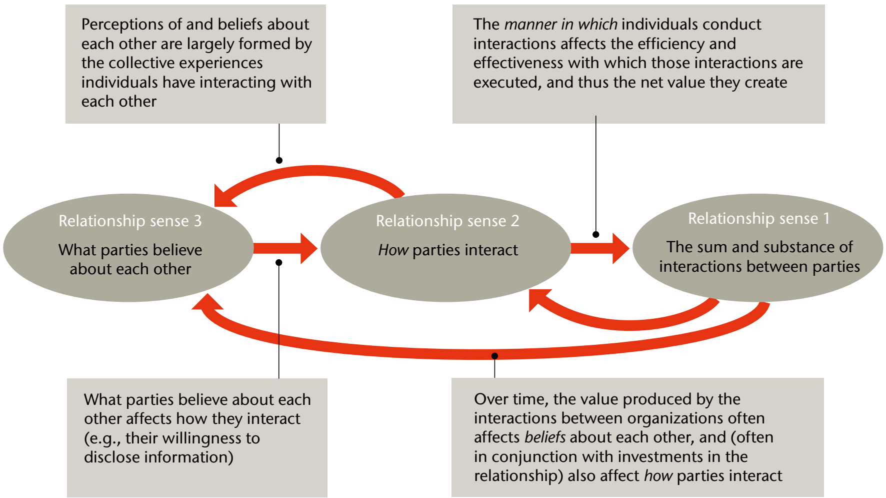


Figure 4.

framework for maximizing the value of their interactions with suppliers (figure 4).

As depicted in figure 4, a good relationship (first sense) is fundamentally distinct from a good relationship in the second and third senses of the word. In the first sense, a good relationship is one that produces significant value. This sense of the term relationship is descriptive and outcome focused. In the second and third senses, a good relationship is one characterized by attitudes and behaviors that accord with some picture (generally not explicitly or robustly defined) of the attitudes, actions, and individual behaviors likely to lead to significant value being produced by, or through, the relationship (first sense) over time. The second and third senses of the term relationship are normative, and have to do with factors that are causally related to relationship (first sense) outcomes (figure 5).

Unfortunately, most organizations (not only leaders within those organizations, but also, in turn, the organizations themselves through their policies and business processes) conflate these senses of relationship. Consequently, most managers lack an effective framework within which to make optimal strategic decisions about how to create more value with and through suppliers, or (perhaps more significantly) about how to create an organizational environment in which their people consistently operate and interact with suppliers in ways that maximize the value of interactions with them.

Of course, most people intuitively grasp that the kind of working relationship attributes articulated in figure 3 are important. They know that a high level of trust is correlated with more open and efficient communication, and hence to more productive relationships with suppliers. Similarly, most people understand that the ability to collaboratively resolve conflicts over competing objective and priorities is essential to creating value with and through suppliers.

Nonetheless, through our research, and by working with senior management across hundreds of our clients, my colleagues and I consistently observe that most people believe there is little that they and their organizations can do to systematically build and maintain strong working relationships with suppliers. They tend to think of a good working relationship primarily as a consequence of a valuable relationship (first sense), rather than as a critical enabler of value creation. Hence much that could be managed is left to chance, and many levers for producing greater substantive value with and through suppliers are underutilized. In particular, few managers act to create an environment that encourages and enables all those who interact with suppliers (as well as those who have significant impact on supplier relationships) to consistently make decisions and exhibit the kinds of behaviors that maximize the value realized from suppliers over time.

As seen in figure 3 – the common (usually implicit) picture of what constitutes a good relationship gives little guidance on how to build one. Insofar as it involves a relationship where suppliers do what we want, it is unrealistic – especially if our suppliers hold a similar theory of what constitutes a good relationship (namely, that we do what they want). That is, it is highly unlikely in a complex customer-supplier relationship that we will both simply do 'what the other side wants' on a regular basis. Similarly, while interpersonal affinity may be helpful, it is not nearly enough to make a complex B2B relationship successful when large numbers of people need to work together, and who those individuals are regularly changes. (Though it is this idea that leads companies to attempt to avoid or solve complex B2B relationship management challenges primarily through ropes courses and other 'team building' activities.)

To a large extent, the common view of a good relationship is a fantasy – we might think we want relationships like that with suppliers and other business partners, but we're not going to get them.

Moreover, even when such relationships exist, they rarely produce significant value – they are captive vendor relationships – they do not nimbly respond to or weather change, and they do not produce breakthrough savings, substantial innovation, or otherwise contribute to competitive advantage.

Principles of supplier segmentation

At the most fundamental level, SRM is focused on four categories of activity:

1. Identifying opportunities to create value with and through suppliers
2. Evaluating opportunities and determining which to pursue with which suppliers

INCREMENTAL VALUE GENERATED THROUGH STRONG WORKING RELATIONSHIPS WITH SUPPLIERS

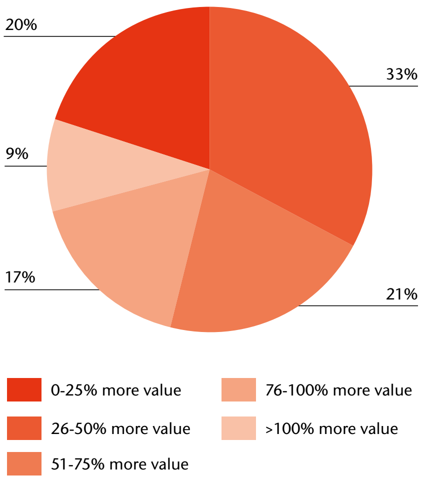


Figure 5. *Source: Hughes, Jonathan, Mark Gordon, et al. "Negotiating and Managing Key Supplier Relationships: A Cross-Industry Study of 20 Best Practices." Boston: Vantage Partners, LLC, 2003: 7.*

3. Creating value through effective management of interactions with suppliers
4. Distributing value between customer and supplier

While conceptually distinct, these activities, in practice, are highly interrelated and iterative, and involve myriad individuals at multiple levels of a company from senior management to individual contributors. Consequently, it is an essential and a non-trivial task to design and implement effective internal and supplier-facing business processes that ensure these activities are effectively managed. Before sharing a framework for designing and implementing such business processes, it is useful to consider what challenges must be overcome to ensure effective execution of these fundamental SRM activities.

Two kinds of relationship management challenges: Operational complexity and strategic complexity

Note that the ability to manage differences effectively, so that they are a source of innovation and value, rather than a source of dysfunctional conflict and an impediment to value creation, is at the heart of SRM (and of B2B relationship management in general).

While conceptually distinct, the forms of complexity highlighted in table 1 are not only often correlated in practice, they are also often causally related. For example, a company that works with a supplier who provides a range of products and services to multiple business units is more likely to confront a greater number of differences, and potential conflicts over goals and strategy, than with a supplier who provides only a single product.

Segmenting supplier relationships

Based on these ideas, it is possible to segment suppliers in a more sophisticated and useful way than most companies have done. Working with the first sense of what constitutes a relationship, suppliers can be segmented, not just by spend, but by the total actual and potential for value (measured across multiple dimensions) of interacting with them. Further, suppliers can be segmented by the degree of risk to which the realization of that value is subject. One critical dimension of such a risk analysis is the extent to which supplier interactions require human judgment and intelligence, and hence the ability of people to work effectively together. Evaluation according to this criterion therefore indicates the extent to which capabilities for building and maintaining good relationships (senses 2 and 3) are important.

While it is certainly possible to put value and risk on orthogonal dimensions to produce a two-by-two matrix for supplier segmentation, in practice, the most useful supplier segmentation tools are more like decision trees than a simple matrix. The number of factors that need to be weighed in assessing potential business value, as well as the interrelationships among them, plus the various interrelated factors that create risk require analysis along multiple, numerically scoreable dimensions. Nonetheless, a visualization of the basic concept of supplier relationship segmentation based on potential business value, and risk in the form of strategic and operational complexity may be useful, and is depicted in figure 7.

What enables the formation and management of effective working relationships?

At the most general level, there are two fundamental approaches to, or strategies for, maximizing the value realized through interactions with suppliers. One is more effective coordination, both internally across groups and functions, and externally, with multiple functional and organizational touch points at the supplier. The more analysis suggests that the risks and barriers to value associated with a given supplier have to do with tactical complexity, the more improved coordination should be the focus of SRM. Of course, this almost always involves leveraging more integrated, and often enhanced, IT tools, and so the focus on software in the implementation of CRM and SRM is not surprising.

However, when strategic complexity constitutes an important, or even the primary, risk and barrier to creating value with suppliers, enhanced coordination, while useful, is not enough. Total transparency, instant access to perfect information, and the like, will still not ensure efficient and effective resolution of conflict over multiple conflicting priorities. Nor will it be possible to eliminate significant uncertainty in highly interdependent relationships in which companies and suppliers are collaborating on long-term initiatives – uncertainty which by its nature requires interpretation of ambiguous and incomplete data, and hence on the collaborative application of human judgment to arrive at good decisions.

Moreover, as Robert Spekman demonstrates in his book “The Extended Enterprise”, effective coordination itself depends in large part not just on technology, but on collaboration, or, if you like, on the quality of working relationships[4]. Coordination and sharing of information bring risk, namely, the risk that others will use information opportunistically. Coordination and integration also entail the sacrifice of autonomy, something that becomes exponentially more risky and less attractive if there is not a high level of trust between or among the parties involved.

Maximizing coordination and collaboration: A basic framework for the implementation of SRM processes

Capitalizing on the potential of SRM to create value requires work along multiple dimensions: integrating category-centric sourcing strategies with strategic analysis of supplier relationship-centric opportunities; improving coordination and collaboration (internally, as well as with suppliers); systematically addressing the interplay of the organizational and interpersonal dimensions of collaboration and relationship management. What does this last point entail? Supplier relationships characterized by significant strategic complexity comprise interactions that are resistant to automation; therefore success requires effective collaboration

SOURCES TABLE

Sources of tactical/operational complexity	Sources of strategic complexity (i.e., differences)
Number of business units involved Volume of business Number of products or services involved Total transaction volumes (orders, shipments, etc.) Geographic breadth of customer/supplier interactions	Differences in goals Differences in business strategy Differences in organizational culture (values, norms) Differences in expertise and capabilities Extent and frequency of technological change relevant to the relationship

Note that the ability to manage differences effectively, so that they are a source of innovation and value, rather than a source of dysfunctional conflict and an impediment to value creation, is at the heart of SRM (and of B2B relationship management in general).

Table 1.

VIEWS ON SUPPLIERS

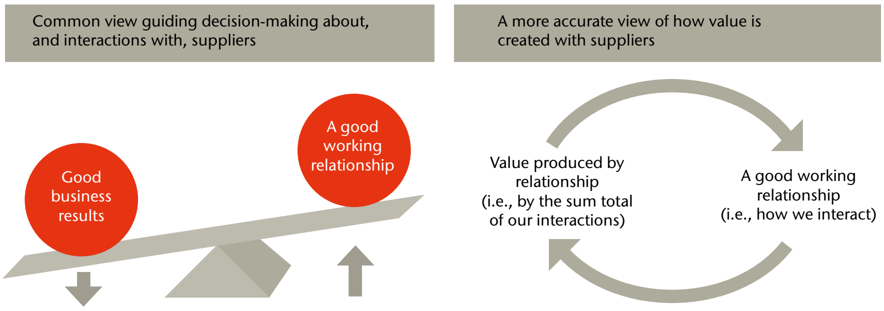


Figure 6.

A VISUALIZATION OF THE BASIC CONCEPT OF SUPPLIER

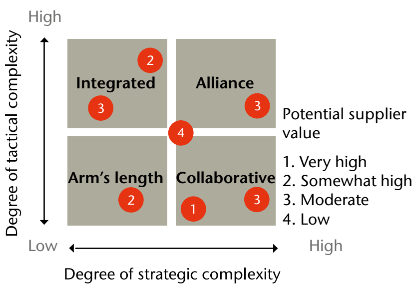


Figure 7.

among multiple individuals. Consequently, enabling effective interpersonal interactions and relationships is essential. However, these individuals act within an organizational context, and so addressing the organizational policies, structures, and business processes that shape the way individuals interact (for better or worse) is also essential.

A basic framework that depicts the key business processes that need to be put in place and integrated to enable effective coordination and collaboration at both the organizational and the interpersonal level is shown in figure 9.

- **Develop sourcing strategies:** The process of forecasting and analyzing materials or service needs and creating optimal strategies (e.g., volume concentration, rationalization of specifications, sole sourcing, global sourcing, and the like) to obtain those goods and services
- **Supplier evaluation and selection:** The process of identifying and selecting suppliers (including requests for information and/or proposals, site visits, and the like). Ideally, this process is designed and managed so that it produces not only good selection decisions, but serves to gather information about how best to work with suppliers selected (e.g., identifying risks that will need to be proactively managed), and building a foundation of mutual understanding and trust that will enable effective collaboration
- **Negotiation and contracting:** The process of developing and putting in place master contracts and other supply agreements after suppliers have been selected
- **Supplier portfolio governance**: The process by which a company regularly evaluates what kind of relationships it wants with its different suppliers (e.g., where it will invest in forming and maintaining alliance-like relationships), and which opportunities to pursue with which suppliers in support of enterprise strategic objectives (e.g., should we design a new product component on our own, or jointly with one of our suppliers?)
- **Supplier development**: The process by which a company (1) identifies and evaluates opportunities to enhance suppliers' capabilities, and (2) resources and manages initiatives to do so, thereby ensuring they produce results. The philosophy behind this process is one of enlightened self-interest – where are there investment opportunities with suppliers that will produce an attractive return for us in the form of improved quality, reduced cost, and the like?

ON BUILDING AND MAINTAINING GOOD RELATIONSHIPS

Most companies' interactions with suppliers are guided by an implicit theory that building (or preserving) a good working relationship requires making substantive concessions; not aggressively negotiating for the best price, not holding suppliers rigorously accountable for commitments made around project scope or delivery schedules, and the like. The common view that good relationships must be 'bought' produces an irresolvable paradox at the heart of relationship management: Either sacrifice substantive business value today in the hopes of getting greater value tomorrow, or focus on maximizing value today (often at the expense of suppliers), recognizing that the tactics employed to do so will likely damage relationships, and hence reduce opportunities to realize value over the longer term.

While principles of supplier segmentation can be used to guide such trade-offs, the reality is that short and long-term relationship value are not opposed in such a binary fashion. Certainly there are some trade-offs between maximizing current value versus a longer-term value stream, but in fact a more sophisticated way of thinking about relationships and relationship management recognizes the positive feedback loop between how interactions with suppliers are managed and the value realized in both the short and long term. Upon reflection, most managers realize that trying to buy good relationships with suppliers, customers, and other business partners only trains them to hold the relationship hostage in order to extort further concessions in the future. That is clearly not a 'good' relationship in any sense of the word.

Why then do management decisions and the behavior of individuals who manage important business relationships so often manifest this approach? The most plausible explanation is that most organizations and individuals lack a better one, and recognizing the overwhelming importance of building and maintaining strong business relationships with key partners, they proceed with this strategy despite the clear downsides of trying to buy strong relationships. The key to avoiding unnecessary trade-offs between short and long-term relationship value is a clearer distinction between the first (substantive) sense of the term relationship and the second and third (procedural) senses of relationship, and in turn, a more robust theory for how to build and maintain a strong working relationship.

COORDINATION AND COLLABORATION

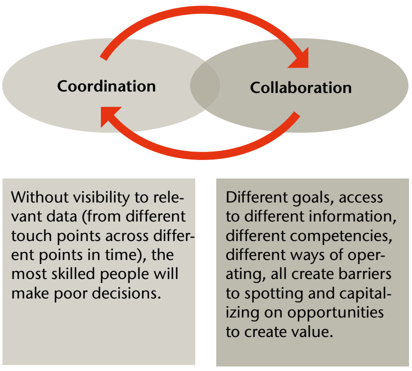


Figure 8.

- **Joint business planning:** The process by which individuals representing different functional areas and business areas within a company and a supplier jointly exchange information about business plans, priorities, capabilities, and marketplace trends and opportunities, and analyze where and how to collaborate in order to create value for both sides
- **Coordination of day-to-day operations:** The process by which various ongoing activities between a company and its suppliers (e.g., ordering and fulfillment, project management, quality assurance, and the like) are monitored and supported in a coordinated way across the various functional areas and groups that need to interact
- **Performance and value measurement:** The process by which a company and its suppliers define and align around appropriate metrics to measure and manage performance and value delivered to both sides. Ideally, this process is collaborative, and two-way (that is, suppliers give feedback to their customers as well as vice versa) and aimed not at simply producing scorecards, but also at enabling data-driven conversations about the diagnoses and possible solutions to problems, as well as the identification of opportunities. A good performance measurement system is based not only on outcome oriented metrics (e.g., cost savings, incremental revenue contribution), but also on leading indicators that enable proactive management of the relationship. Similarly, metrics should address both tangible operational and financial factors (e.g., cycle time, inventory levels, etc.), as well as intangible factors (like level of trust).
- **Issue escalation and resolution:** The process by which important business issues and conflicts between a customer and its suppliers are escalated and jointly resolved at the proper organizational level (based on a clear articulation of escalation paths, and of which stakeholders at each company will be involved in what ways), thereby ensuring timely and effective resolution, and minimizing the risk of disruption to operations or to the working relationship

As with any processes, carefully defining roles and responsibilities is essential to ensure that activities are executed (if it's not part of someone's job, it won't happen), and executed efficiently and effectively (if there's lots of overlap or lack of clarity across responsibilities and authorities associated with different roles, the result will be inefficiency at best, significant conflict at worst).

Conclusion

In a global marketplace characterized by ever-increasing levels of competition, companies need to reorient themselves to systematically identify and capitalize on ways to create value with and through their suppliers. To be successful, companies will need to build the capabilities required to be collaborative, trustworthy, and desirable business partners to their suppliers. Seeing the value Eli Lilly has realized by positioning itself as a 'partner of choice' within the pharmaceutical industry, a number of companies are beginning to try to position themselves as a 'customer of choice'. To date, few of their suppliers have found reason to be impressed, perhaps because few companies have made the investments Lilly has made in becoming truly competent partners.

The discipline of strategic sourcing is not enough. Partnering with key suppliers, not merely purchasing from them, requires systematic coordination across multiple boundaries within companies and a fundamental change in how companies view, and work with, their suppliers. Leading this change represents an enormous opportunity for procurement in its continuing evolution from a back office purchasing function to a strategic business partner to the enterprise. /

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KEY BUSINESS PROCESSES

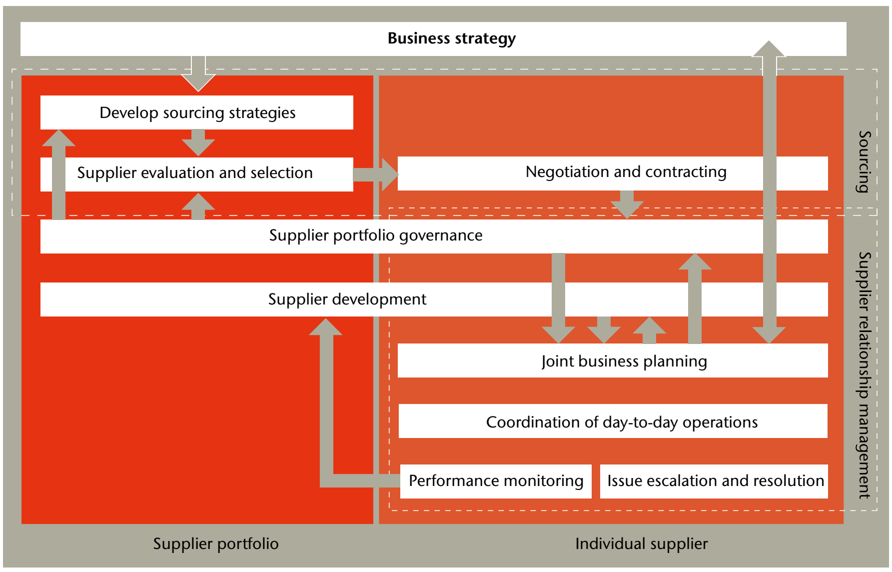

Figure 9.

A NOTE ON ORGANIZATIONAL STRUCTURES

While significant research and experience support the broad relevance of the key SRM business processes noted earlier, there is no one right model for defining organizational structures to enable execution of these processes. Because an essential aspect of SRM is to ensure coordination of processes and functions that impact, or are impacted by, suppliers (procurement, logistics, marketing, R&D, etc.), and because companies are organized differently, (and equally, because companies have different business models and strategies, and thus confront different opportunities and risks with their suppliers), there is no one-size-fits-all structural solution for deploying SRM.

That said, the following structural elements of SRM are relevant in most organizational contexts:

1. Creating a formal SRM team or office at the corporate level, with a mandate to facilitate and enable the kind of coordination across functions and business units that is essential to maximizing the value of supplier relationships. Such a structure is most effective when it serves to broker and coordinate development of policies among multiple stakeholders (rather than dictate those policies), and when it helps to coordinate and support execution of SRM business processes among multiple groups, as opposed to owning the majority of resources required to execute those activities
2. Creating a formalized relationship manager role (and/or full time job – depending on the complexity and importance of the supplier relationship) for key suppliers. These individuals may be part of procurement, but often sit within a business unit that has significant reliance on, and interaction with, a given supplier. Relationship managers act as internal champions for the relationship with the supplier, act as a point of contact and resource to the supplier, and coordinate the execution of supplier relationship management processes like joint business planning and performance measurement
3. Creating a formalized executive sponsor role and cross-functional steering committees for complex, strategic, supplier relationships. Such structures ensure appropriate linkage to overall business strategies, provide a forum for making trade-offs among a company's different priorities as they impact suppliers, and act as a final point of escalation for conflicts

A NOTE ON INDIVIDUAL COMPETENCIES

When designing and implementing processes and adjusting organizational design and structures to support SRM, it is useful to think of this effort as one that is aimed, in part, at creating an environment in which the many individuals who interact with suppliers will be optimally enabled and encouraged to exhibit collaborative behaviors – those behaviors that support the development and maintenance of effective working relationships, which in turn enable greater business value to be realized from supplier relationships. As a result, it is worth noting five core individual competencies that are essential to effective B2B relationship management:

1. The ability to diagnose problems by identifying each party's contributions to a situation or outcome, rather than by attempting to allocate and assign blame
2. The ability to explore and learn from different perspectives and opinions, rather than focusing on assessing who or what is right or wrong
3. The ability to develop solutions that maximize joint value by exploring the underlying interests (needs, goals, constraints) of each party, rather than by haggling over positions (preconceived solutions or demands) and trading concessions
4. The ability to resolve conflicts through the identification and application of relevant criteria, rather than through threats, bribes, or coercion (thereby setting useful precedents for the efficient resolution of future conflicts)
5. The ability to manage strong emotions (e.g., frustration, anger, anxiety) – one's own and those of others – in a constructive way so that they do not impede effective problem-solving and collaboration

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