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FEATURES

COMMENTARY

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Getting the Most Out of

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Supplier relationship management (SRM) can deliver powerful business benefits. For companies to realize those benefits, though, SRM needs to be comprehensively understood and implemented. The core principles and change management practices offered here can guide that process. Caution: There's a lot more involved that buying a software package.

Only a few years ago, supplier relationship management (SRM) was generally thought of as a software tool. That's not surprising as SAP, Oracle, Ariba, and others have offered multiple products that bear the label "SRM." But true SRM entails much more than purchasing new software. Done right, it's a systematic approach to supply chain collaboration that enhances the business performance of both customers and supplier. But just as customer relationship management (CRM) has proven to be far more about creating a customer-centric culture, transforming business practices, and building new mindsets and skills than simply an IT solution, successfully implementing SRM requires more than the purchase of new software.

In a sense, SRM is picking up where strategic sourcing left off. Despite the significant savings many companies have realized through strategic sourcing over the past two decades, the limitations of this discipline have become increasingly apparent. In a 2008-09 global research study we conducted involving more than 500 companies, buy-side respondents reported that nearly half (46 percent) of potential value from supplier contracts isn't realized during implementation.[1] Perhaps even more surprisingly, sell-side respondents reported delivering only 66 percent of potential contract value.

These sobering statistics point to a key driver behind the development and evolution of SRM as a formal supply chain management discipline. Strategic sourcing, in practice, has led to an enormous focus on interactions with suppliers up to the point of signing new contracts. Yet it has provided relatively little guidance on how to effectively manage the complex and critical interactions between customers and suppliers as they work together to execute against agreements.

Follow-up interviews with study participants revealed the most common sources of value erosion. The research also highlighted the fact that customers and suppliers have very different perceptions of the key causes of lost value—and of who is to blame. Specifically, ***according to customers*** the main reasons

for the gap between potential and realized value are:

- Expected innovation does not materialize (95 percent of participants in a 2010 study we conducted reported a "significant amount" to a "great deal" of innovation potential with suppliers remains untapped).[2]
- Scope changes lead to additional costs.
- Off-contract purchasing undermines expected savings.
- Project delays due to supplier.
- Quality problems.

But according to the suppliers, the gaps were the result of:

- Expected volumes do not materialize.
- Changes in requirements lead to increased and unrecoverable costs.
- Customers do not provide committed resources.
- Project delays due to customers.

We have worked with many companies that prefer the terms "supplier engagement" or "supplier account management" to "SRM." Their motivation is to avoid confusion about the admittedly ambiguous term "relationship." Ultimately, concrete business practices matter more than labels. But whatever term makes sense within your company, we believe that common and unhelpful assumptions about "relationships" with suppliers need to be addressed head-on. The table below summarizes key distinctions and clarifications that need to be made when talking about SRM—both internally and with suppliers.

Not This	But Rather This
• We Play Golf Together	• We Treat Suppliers with the Courtesy and Respect Due to All People–in All Our Interactions
• We Avoid Disagreement or Conflict	• We are Candid, and Able to Disagree (Even Forcefully), Without Being Disagreeable
• We Shield Suppliers from Competitive Pressure	• We Hold Ourselves to the Same Standards as Our Suppliers
• We Don't Hold Suppliers Accountable for Commitments and Performance	• We Actively Search Out Opportunities for Mutual Benefit
• We Sacrifice Our Obligations to Our Stakeholders	• We Actively Seek to Cultivate Mutual Trust
• We Are Naively Trusting	

The objective, of course, is to move from the left to the right side of the figure. This article will help you do that. Our aim is to present the core principles underlying SRM, describe some proven best practices to advance the supplier relationship, and offer recommendations for a successful SRM implementation that delivers the desired business benefits.

Value Drivers and Business Benefits of SRM

Before examining the value drivers and business benefits of SRM, it's important to establish a clear definition of the concept. SRM is:

• Enterprise-wide analysis of what activities to engage in with companies you procure goods and services from.

• Coordinated planning and execution of all interactions with suppliers in order to maximize total financial and strategic value.

• Leveraging supplier assets and capabilities for competitive advantage (vs. only focusing on purchasing goods and services at lowest cost).

• *Not managing suppliers*, but *jointly managing interactions* between customer and supplier.

All of our research and experience helping companies over the past 20 years to more effectively manage supplier relationships suggest that working more collaboratively with suppliers delivers significant value. Below are the key practices that have proven most effective in driving value realization.

• **Manage all interactions across the lifecycle of supplier relationships in a systematic, integrated fashion.** In particular, this means maintaining a tight connection between measurements of supplier performance and future sourcing decisions and conducting negotiations in a manner that builds a foundation for working effectively together. (For a look at how one company is accomplishing this, see sidebar on Anglo American.)

• **Manage all interactions with suppliers across business units and functions in a systematic, integrated fashion.** The objective here is to increase efficiency; maximize leverage (both competitive and collaborative); increase trust (by speaking with "one voice" to suppliers); identify and act on systemic opportunities to improve supplier performance; and reduce supply chain risks.

• **Balance competitive pressure with collaborative engagement.** Companies need to move away from the traditional over-reliance on threats (e.g., performance penalties, loss of business) as the primary way to motivate suppliers to deliver maximum value. Sourcing and supply chain organizations need to employ a broader range of strategies to maximize influence with suppliers and improve supplier performance.

• **Systematically manage the interpersonal dimension of supplier relationships.** There are, of course, boundaries that must be drawn and enforced between the personal and the professional when it comes to supplier relationships, or any aspect of business. That said, the human side of supplier relationships needs to be managed—not ignored or assumed away.

• **Fully leverage all supplier assets, expertise and capabilities to maximize competitive advantage.** Identify which suppliers can be more than simply vendors, and move beyond a narrow focus on price, or even total cost of ownership.

What are the business benefits from driving value creation through SRM? In 2006 and 2007, we conducted a global study of relationships between customers and their most strategic suppliers. Buy-side participants reported realizing, on average, 40 percent more value from those suppliers with whom they had the most collaborative relationships (characterized by high levels of trust, mutual respect, and a commitment to mutual benefit) vs. those suppliers with which they had adversarial relations.[3] Sell-side respondents reported delivering, on average, 49 percent more value to those customers with whom they had the most collaborative relationships. In the same study, a majority of respondents reported realizing significant (vs. moderate or little to no) value from their SRM programs, although far fewer reported an ability to effectively quantify benefits. Nonetheless, of those who did report a financial estimate of benefits, the average figure was more than $100 million in incremental value from SRM during the preceding year.

The value that can be realized through effective SRM can take many forms. We have developed a framework that, while not exhaustive, provides a useful way to systematically identify and capitalize on opportunities to create concrete financial and strategic value through SRM. (See Exhibit 1.)

In building the business case for SRM, companies need to recognize that the choice is not whether supplier management is necessary or worthwhile. All companies expend time and effort managing interactions with suppliers. Rather, the choice (which is encapsulated in the table below) is whether to do so in an ad hoc and uncoordinated fashion, or to do so systematically and strategically.

Seven Principles of Effective SRM

Exhibit 2 gives a high-level summary of the relative importance of key SRM levers based on research data we have collected from more than 200 companies over the past two years.[4] The data reflect a clear pattern we have observed in our work with clients in terms of what separates companies with successful SRM programs that deliver significant measurable benefits from those that are less successful. Companies in the latter group focus primarily on software solutions and on specific SRM "best practices" like holding supplier summits, designating supplier relationship managers, and implementing supplier scorecards. There is nothing wrong with any of these things—indeed, they all have the potential to be useful. But on their own, they rarely deliver significant benefits.

Those companies that achieve the greatest success with SRM focus first and foremost on changing organizational culture, and transforming the way people within their companies—and their supplier counterparts—interact on a daily basis. This requires close attention to the people-side of SRM, to individual mindset and skills. To be clear, we strongly believe in the potential value of software tools to enable companies to efficiently track and leverage data about suppliers, and to automate certain transactions and activities with suppliers. That said, many companies invest too much, too soon in SRM software, and fail to place enough emphasis on those levers that our experience and research show are actually more important—and in fact are required before SRM software can deliver its full potential.

We have identified seven principles that underlie successful SRM initiatives.

1. Focus SRM efforts on suppliers where there is greatest potential to create value and reduce risk. Implementing SRM entails significant investment in change management. This investment should be carefully aligned with opportunities to create new value and/or better manage risk with suppliers. Attempts to implement SRM in an undifferentiated fashion across too many suppliers typically results in wasted time and effort as well as reduced benefits.

2. Treat all suppliers with a high degree of professionalism and respect. The tendency to treat some suppliers in a high-handed fashion (after all, we're paying them) is deeply engrained in many organizations. A company that tolerates disrespect of even a few suppliers will find that such behavior inevitably leaks over into interactions with strategic suppliers as well—where it has a corrosive impact on value realized.

3. Invest in understanding suppliers better. Get to know their strategies, business models, organizational structure, cultures, and capabilities. This enhances your ability to influence suppliers and to identify opportunities to create more value with them.

4. Invest in helping suppliers understand your company better. Similarly, suppliers need to understand your strategy, priorities, organizational structure and culture, and policies and procedures. ,Increase the ability of key suppliers to align their resources and investment, develop solutions, and provide service in a way that optimally aligns with your needs.

EXHIBIT 1

Framework for Creating SRM Value

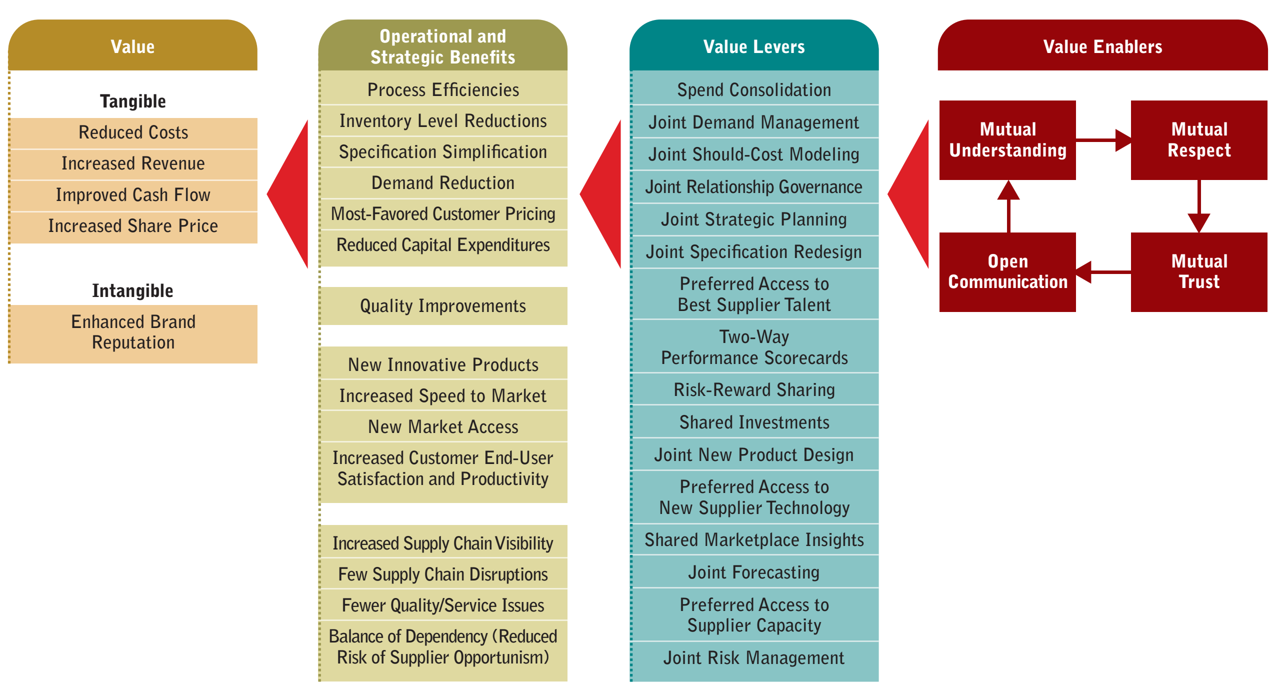
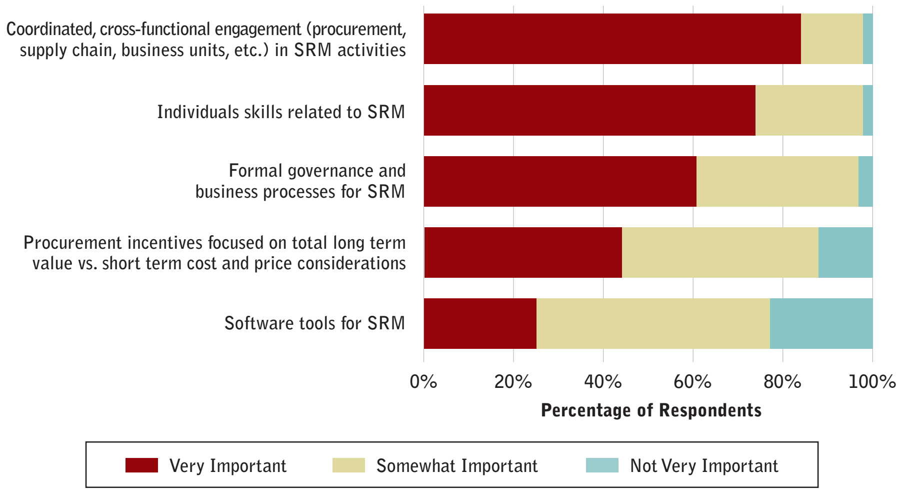


EXHIBIT 2

Key SRM Levers



5. Actively build and sustain trust with suppliers. Trust may seem like a "soft" factor. Nonetheless, the evidence is overwhelming that a lack of trust between customers and suppliers acts as an enormous tax on productivity and a barrier to value creation. Conversely, a high level of trust between business partners facilitates more transparent and efficient information-sharing, as well as a greater willingness to invest time, effort, and capital. This, in turn, enhances the ability to identify new business opportunities, develop innovative solutions, understand and mitigate risk, and diagnose and expeditiously solve problems. Moreover, our experience shows that, contrary to common assumptions, trust with suppliers can be systematically cultivated.

6. Invite supplier feedback on your own company's performance and track benefits to suppliers. Though supplier scorecards are becoming more prevalent, their focus too often remains on measuring supplier performance and related value to the customer. But the root causes of many performance problems do not lie only with suppliers. To illustrate, at one of our clients a 20-year relationship with a key supplier was almost terminated because the supplier could not diagnose and solve a persistent problem with one of their production lines. Fortunately, before relationships were severed, the newly designated SRM manager got involved. After talking to key stakeholders on both sides, he convinced the senior quality engineer at his own company to look at their testing equipment. The punch line: the equipment was miscalibrated. But earlier, when one of the supplier's engineers had raised this as a possibility, he was quickly shouted down.

For value from suppliers to be sustainable, the suppliers must benefit as well. One respected consumer products company has an explicit policy of comparing the performance of suppliers in the same category, and then committing to award more business to those that outperform their peers (and reducing spend with those that underperform). Without incurring the risk of guaranteeing specific purchase volumes to key suppliers, the company motivates continuous improvements in supplier performance through a tight and transparent linking of performance to suppliers' share of spend—which they track and regularly review with their suppliers.

7. Invite and be open to supplier ideas and suggestions. Sourcing and procurement organizations often work to develop tightly defined requirements and specifications, creating (or forcing) apples-to-apples comparisons between and among suppliers. In part, these tactics arise from a tendency to rely heavily on competitive pressure to get best value from suppliers and motivate optimal performance. While such approaches have undeniable benefits, and are certainly appropriate in some circumstances, companies can gain greater value by becoming less prescriptive in their interactions with suppliers, and more willing to undertake apples-to-oranges comparisons between suppliers that have different business models and expertise.

Optimally leveraging suppliers' ideas and expertise requires new skills—the ability to effectively communicate to suppliers about the problem you are seeking to solve, rather than assume too much about the nature of the solution and impose requirements on suppliers that constrain their ability to be creative. This, in turn, requires sourcing and supply chain professionals to get closer to internal business partners; to better understand the underlying needs and priorities of internal stakeholders, as well as the unique capabilities of suppliers; to become more facile in exploring and evaluating various feature, performance and cost trade-offs; and to become more confident and competent at qualitative analysis. The table at the top of the next page summarizes the transformation required:

Practices that Maximize Supplier Value

With the above SRM principles in mind, we offer the following summary of specific practices that enable companies to maximize the value realized from suppliers.

Multi-Year Joint Business Plans

To realize the huge potential value from greater supplier commitment and from alignment of supplier investments with your priorities and needs, companies need to conduct annual strategic planning with key suppliers. The purpose is to identify and plan for risks and opportunities to both sides over a multi-year time horizon. The output should comprise documented plans with clearly defined goals, initiatives, and committed resources. To obtain full benefit from joint strategic planning activities, the right senior business, commercial, and technical leaders from both sides must be involved. These are the individuals who are best positioned to explore and evaluate new opportunities, make decisions about commitment of resources, and agree on how to share risks and rewards.

Balanced Two-Way Scorecards

SRM requires a balanced scorecard framework to assess both tangible and intangible value to be targeted with different suppliers. Specific metrics should comprise a mix of leading and lagging indicators. Of course, with some suppliers, a limited focus on cost, quality, and service is entirely appropriate; in such cases, traditional KPIs like perfect orders and cost savings are sufficient. For many other suppliers, an expanded focus is needed, though specific metrics will vary significantly from one supplier to another, depending on different risks and opportunities. An effective scorecard framework should guide identification of relevant metrics for any given supplier. Metrics can relate to technical and product innovation; process improvements; end-user satisfaction and productivity; or safety, social, and environmental responsibility. (See Exhibit 1 referenced earlier.)

Relational characteristics like mutual trust and understanding are major drivers, for better or worse, of supplier performance. Thus, regularly and systematically measuring the quality of working relationships with suppliers is essential. The best approach is to carefully construct a set of survey questions that measure concrete behaviors and beliefs. So instead of simply surveying individuals within your organization and supplier counterparts about "the level of trust," ask about specific constituent elements of trust—for example, reliability in meeting commitments, to what extent either side believes the other side has behaved opportunistically, and so on.

Finally, scorecards should include metrics that evaluate customer performance and track benefits realized by suppliers. Measures of benefits realized by suppliers often include year-on-year changes in account sales, account share, solutions developed in collaboration with the customer, and the ROI suppliers realize from developing new technology for a customer and then bringing it to other customers in non-competitive fields.

Traditional Procurement	New Procurement Paradigm
• Source Goods and Services	• Solve Business Problems
• Leverage Over Suppliers	• Engagement with Suppliers
• Focus on Internal Stakeholder Compliance	• Trusted Advisor to Internal Business Partners
• Analytical Skills	• Soft Skills
• Primary Value is Cost Reduction/Management	• Primary Value is Competitive Advantage
• Manage Transactions	• Manage Relationships

Joint Performance Reviews and Improvement Initiatives

The use of supplier scorecards has become increasingly common. However, this practice is too rarely coupled with effectively structured review meetings with suppliers where the root causes of any performance shortfalls are jointly diagnosed, where concrete improvement plans are developed, and where excellent performance is formally recognized and celebrated. In the absence of conversations focused on joint learning and defining and committing to actions that will drive improvement, supplier scorecards quickly become a "check-the-box" administrative activity.

Formal Governance

Many companies assign individuals the role of supplier manager or designate executive sponsors for key suppliers. But too often, such roles are poorly defined. Nor are they integrated into a coherent governance structure that ensures coordinated communication, planning, decision-making, and issue escalation and resolution across the range of customer-supplier interactions and touch-points.

Typically, when analyzing relationships with key suppliers for our clients, we find that they involve dozens to hundreds of people on both sides, who are involved in thousands or even tens of thousands of interactions a year. These include everything from demand forecasting, to contracting, to technical collaboration on product design and manufacturing, to quality management to collaboration on special projects. Companies with the most successful SRM programs take a more structured approach by:

- Formally and robustly defining the roles and responsibilities of supplier relationship/account managers and executive sponsors.

Of companies reporting a financial estimate of benefits, the average figure was more than $100 million in incremental value from SRM.

• Clarifying how those roles map to other sourcing and supply chain roles (for example, category managers) to minimize confusion, overlaps, and potential conflict.

• Carefully defining and ensuring alignment between the SRM-specific roles and business leaders and end-users who interact with suppliers.

Finally, to be fully effective, SRM needs to be a two-way street. To that end, effective governance of key suppliers requires careful mapping and alignment of relationship management roles between customers and their suppliers. Of course, a perfect one-to-one mapping of roles typically is neither possible nor necessarily desirable. Instead, the goal should be to ensure that each side understands how decision-making authority and responsibilities are allocated within their counterpart's organization, and that both sides know who to go to get information, escalate issues, and engage in different kinds of conversations.

Change Management and Implementation

Sourcing and supply chain leaders constantly tell us that the most difficult aspect of SRM implementation is change management. Below are four strategies that successful companies employ to meet this challenge:

1. At the outset, engage stakeholders from outside procurement and supply chain. While sourcing and supply management organizations are usually the catalysts for implementing SRM, and are typically responsible for facilitating ongoing SRM activities, supplier relationship management is inherently a cross-functional discipline. As noted above, success depends greatly on the depth and breadth of cross-functional engagement and commitment. Moreover, even in companies that have not yet implemented a formal SRM program, there are always pockets of effective supplier management practices—though they may not be fully systematic or consistent. The earlier that business and other functional stakeholders are involved, and the more they are engaged as partners in implementation, the more likely that the new SRM processes and practices will be successfully adopted.

2. Engage a cross-section of key suppliers to provide early input. It is somewhat ironic that many companies develop and seek to implement SRM programs with little, if any, input from their key suppliers. Failure to do this entails three major costs. First, suppliers are a rich source of ideas and experience about what works, and what doesn't work, when it comes to SRM. It only makes sense to get their input, including what they are doing with other customers.

Second, SRM requires changes not only within the customer organization, but within the supplier's organization. Engaging key suppliers early in the development (or restructuring) of an SRM program means that they are much more likely to understand your expectations and their responsibilities. Equally important, they also are more likely to exhibit genuine buy-in and commitment.

Finally, SRM has the potential to benefit not only customers, but also suppliers—providing them with greater transparency and predictability, and opening up new business opportunities. In exchange for such benefits, customers need to engage their suppliers in explicit conversations about what changes and investments they will make to mirror changes and investments their customer is making in SRM. In particular, this means committing executive time for joint planning and governance activities, and assigning account or relationship managers.

3. Define a clear and compelling business case. Perhaps not surprisingly, companies that define clear, measurable, and business-relevant goals for SRM report significantly greater financial and strategic benefits than those companies that undertake SRM initiatives simply because it's considered to be a supply chain "best practice." In particular, supply chain leaders need to ensure close alignment of SRM priorities with overall business strategies and objectives.

4. Be realistic about required resources. As noted above, our experience shows that formalized supplier relationship management (ultimately) requires little net increase in organizational resources. Implementing SRM entails redirecting the significant time and effort that goes into managing interactions with suppliers in an ad hoc and reactive fashion, into a proactive and coordinated approach. That said, in the short term, significant time and effort is generally required to re-organize, re-train staff, and implement new processes and policies. The most successful companies either make significant investments in change management and in building or enhancing SRM capabilities or they adjust their goals and expectations accordingly. So while SRM is not a "free lunch," we find that it typically yields anywhere between a tenfold and hundredfold return on investment over a three to five year time horizon.

SRM as Competitive Differentiator

According to research we have been conducting over the past two years, 67 percent of supply chain executives and managers believe that SRM will be very important to their company's success during the next three to five years, and another 31 percent say it will be at least somewhat important.[4] As companies become increasingly dependent on suppliers—not only to provide goods and services, but also to support research and development activities, assist with product design and development, and drive innovation—supply management strategies and practices need to catch up to the reality of new risks and new opportunities.

Business and supply chain leaders need to view and treat suppliers as business partners, not simply vendors. This means creating opportunities—and incentives—for suppliers to make investments and align resources (their "A" team personnel, their R&D dollars, and so forth) to support your company and its strategy. Companies that use SRM to become a "customer of choice" can achieve significant competitive advantage relative to their peers who fail to transform their approach to working with suppliers.

Anglo American's Experience with SRM

A structured approach to SRM commenced in Anglo American, one of the world's largest mining companies, in October 2010 with the support of the Group Executive Committee. Aimed at improving buying power, supplier performance, predictability of project delivery, and access to resources, SRM is providing a consistent approach for developing relationships. In short, it means better service, greater collaboration and sustainable value creation. "We will be maximizing the quality of goods supplied, improving the supply chain process, and looking at the total cost of ownership across our business," said Dominic Podmore, Senior SRM Manager. "With key suppliers, in particular, we'll harness the technical expertise that they can offer as strategic business partners."

Regular account management meetings with suppliers will be used to review performance and discuss any issues, including those encountered at local site level, that have been escalated for effective resolution. "SRM is a supply chain initiative but we don't own the relationships with suppliers. Business units and functions in Anglo American engage suppliers and what we are finding is a number of strong relationships are already well advanced and require little additional input," said Dominic. Supply chain's role is to be the facilitator, supporting the business with useful tools, processes, and fact-based information so that meaningful discussions can be held. "Our goal is to establish a consistent approach to the engagement with our suppliers across our business units and functions," added Dominic. "It requires cooperation from everyone in Anglo American as well as suppliers. SRM seeks to manage performance through our relationships to create value for our organization."

According to Barry Murphy, Head of Projects at Anglo American Copper: "Going beyond the traditional single project commitment and developing associations that are long-lasting and fruitful means that our suppliers can attract and retain the right workforces in support of our pipeline of projects. This is particularly relevant in a labor market where the skills necessary for successful project execution are becoming increasingly scarce."

Andrew Hinkly, Group Head of Supply Chain, added: "The aim of SRM is to establish new ways of working with processes and associated behaviors which forge collaborative value based partnerships. Effective partnerships are essential for our business: based on mutual respect and trust, they allow us to solve problems and create value. Anglo American benefits greatly from supplier partnerships to develop new technology, improve operational performance, and deliver mutually beneficial commercial outcomes."

End Notes:

1 Hughes, Jonathan, et al. *Customer-Supplier Negotiation Study.* Global research comprising 747 survey responses from at least 591 companies. (Not all respondents disclosed their company.) Boston: Vantage Partners, 2009.

2 Hughes, Jonathan, et al. *Customer-Supplier Negotiation Study.* Global research comprising 499 survey responses from at least 157 companies. (Not all respondents disclosed their company.) Boston: Vantage Partners, 2010.

3 Hughes, Jonathan, et al. *Transforming Trading Relationships into Partnerships: A Cross-Industry Study of Customer-Supplier Collaboration.* Global research comprising 532 survey responses from at least 250 companies. (Not all respondents disclosed their company.) Boston: Vantage Partners, 2007.

4 Hughes, Jonathan, et al. Ongoing research on supplier relationship management. Global research comprising 139 survey responses from at least 71 companies. (Not all respondents disclosed their company.) Boston: Vantage Partners, 2010-2011.