Supplier Relationships: A Strategic Initiative

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Abstract

In an increasing competitive marketplace, firms are seeking new methods of enhancing competitive advantage. Today, purchasing is becoming a strategic function and a key factor in competitive positioning. This paper suggests that effective relationship with suppliers will provide firms with next-generational competitive advantage. With consolidation of firms within industries, continuos product evolution and constant pressure on costs, supplier relationships will become more critical in the future. This paper discusses the emergence of supplier relationships, and how this shift toward supplier relationships has and will change the role, processes and strategies of firms. Although purchasing has strategic importance within a firm, good relationships between customers and suppliers are elusive. Firms, therefore, need to emphasize aspects that will enhance supplier relationships.

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Introduction

Firms are facing increasingly competitive environments characterized by continuos pressure on costs, large global players, continuously evolving products, customer fragmentation and emerging technologies. To ensure success, firms realize that they cannot be experts in all businesses and are concentrating on their core competencies. As an example, Westinghouse is selling its power and defense lines to concentrate on the broadcasting business. To enhance their performance in non-core competency areas, companies are reevaluating business relationships so as to form closer relationships with strategic suppliers [1, 2, 3]. Firms have realized that collaborative business relationships improve a firm's ability to respond to the new business environment by allowing them to focus on their core businesses and reduce costs in business processes.

In an earlier paper, we had suggested that the source of next-generational competitive advantage will be collaborative relationships that firms have with their suppliers [4]. We suggested four reasons for this phenomena. First, marketers or sellers are driving this change as firms have started identifying and catering to the needs of specific customers. Thus, having a relationship with suppliers will enable firms to receive better service and therefore be more efficient in procurement. Second, firms recognize that supplier relationships will allow them to be more effective. It is easier to implement strategies such as quality platforms, if firms have relationships with their suppliers. Third, there are enabling technologies that allow firms to select their best customers and suppliers. Computer programs allow firms to calculate profitability associated with each customer or supplier. Finally, competition and the growth of alliances are forcing firms to develop better supplier relationships to maintain a competitive edge.

The purpose of this paper is to emphasize that supplier partnerships will provide a strategic advantage to firms. This paper identifies the benefits of supplier partnerships and provides guidelines for future supplier partnering.

Shift in Organizational Strategy

The reason for the emerging emphasis on supplier relationships is the shift in organizational buying strategies [4]. Organizational purchasing strategies have been dramatically changing for four reasons (please see Figure 1). First, global competitiveness had made firms realize the competitive advantages of creating and managing supply chain relationships. Second, emergence of the Total Quality Management philosophy has encouraged "reverse marketing" starting with external customers and moving backward into procurement processes. For example, Demand Driven Manufacturing or flexible manufacturing and operations have been instituted in order to serve the diversity of demand with respect to form, place and time value to customers. The role of suppliers is critical in this regard.   Third, industry restructuring through mergers, acquisitions and alliances on a global basis has reorganized the procurement function from a decentralized administrative function to a centralized strategic function. This is further intensified by outsourcing many support functions such as data processing, and human resources. Finally, uses of information technologies have restructured the buying philosophy, processes and platforms by allowing firms to share market information and use market information to schedule design and manufacturing of products better.

Fundamentally, the consequence of changing paradigms of organizational strategy is likely to result in a two dimensional shift as shown in Figure 2. Organizational purchasing strategy shifts from a transaction oriented to a relational oriented philosophy, and from a decentralized domestic sourcing to a centralized global sourcing process.

Relationship with Suppliers

As stated earlier, we suggest that developing relationship with suppliers will be critical for the effective functioning of firms. This trend is reflected in Table 1 that shows that large firms have substantially reduced their number of suppliers. This trend also suggests that some suppliers would be exclusive to firms. The primary reasons are that corporations are becoming leaner. The procurement function is becoming more centralized while the profit-and-loss (P&L) responsibility of firms is becoming less centralized. Business-unit heads are raising more questions about the way things are bought. And as vertically integrated companies - those that have complete internal capabilities and are self-sufficient - become relics and outsourcing of operations become a reality, more opportunities to partner with suppliers will arise. Taking advantage of these opportunities is increasingly important for several reasons:

- *Declining market prices.* Nobody expects prices to rise anymore. There is going to be a tighter squeeze on the margins of customer companies. They would like to get that margin reestablished by working with suppliers.
- *Rising competitive intensity.* With the restructuring of the world economy, the formation of the World Trade Organization, and greater economic integration within and between regions, global and regional consolidation is clearly taking place and resulting in greater

competition.

- *Advanced technology enablers.* Electronic commerce and networked computing are here. Dramatically reduced cycle times are becoming an ordinary achievement. These require partnering with suppliers.
- *Reverse marketing strategies.* The traditional process flow - from R&D and sourcing to manufacturing, sales and service - is becoming a thing of the past. Today, market-focused organizations are organizing into reverse marketing - starting with the end users. Partnering with suppliers is critical to this strategy.
- *Strategic positioning.* In the past, companies partnered primarily for operational efficiency (i.e., just-in-time procedures or zero-inventory models). Today, intense competition is coming from existing rivals, new entrants and the threat of substitutes. Partnering with suppliers is an increasingly important way of minimizing the competition's negative impact on an industry.

Example of Companies Benefitting from Supplier Relationships

The major research regarding the advantage of supplier relationships comes from a study of the Japanese automotive component industry [5]. They found that the average length of the relationship between suppliers and buyers was 22 years. In addition, the major customer bought about half the output of the supplier firm. About 26% of the supplier's development effort was devoted to a single customer. Competition was restricted to 2-4 other suppliers. Finally, the quality of delivered product was very good. The data would suggest that supplier relationship enhanced the design efforts of the buying company and reduced uncertainty and costs for the supplier company.

Eastman Kodak, Ford Motor Company, Levi Strauss, DuPont , McKesson and Bose corporation demonstrate that some savings can be achieved by supplier relationships [2]. These firms as well as examples of other firms using specific tactics to benefit from successful relationships are discussed next:

Eastman Kodak Company: Eastman Kodak Company has outsourced its data and information processing system to IBM. Kodak has achieved substantial cost savings through reducing personnel, assets and capital expenditures in an area that is not its area of core competency. This shift toward asking data processing and systems management consultants to manage the information and data processing of a firm has accelerated as major firms such as Xerox and Ryder have outsourced their internal data processing systems.

Ford Motor Company: Ford formed a relationship with one of their own clutch suppliers. Ford examined the production process of their supplier and was able to reduce the cost of the clutch by 20% benefitting both Ford and the clutch supplier. Similarly, based on their past experience with Donnelly, Honda picked Donnelly as an exterior mirror supplier, although Donnelly had no experience in the area [3]. Honda sent its engineers into Donnelly's plant, and Honda and Donnelly engineers reorganized the plant and re engineered the product process. Sales are expected to be $60 million in 1997 and costs are expected to decline 2% annually benefitting both Honda and Donnelly.

JC Penny and Levi Strauss: JC Penny and Levi Strauss are linked with an electronic Data interchange (EDI) that allows Levi Strauss to obtain sales data. Levi Strauss obtains data on the exact size of jeans sold in individual stores. This data allows Levi Strauss to better plan the production process as well as better control inventory and delivery. This saving leads to a reduction in costs and prices benefitting both JC Penny and Levi Strauss.

DuPont: Dupont has reduced the costs of each purchase transaction in the maintenance and repair supplies division from $120 to $16 by working with a smaller number of suppliers. DuPont selected one distributor in each region for a supplier relationship. They then implemented a paperless order, receipt and payment process. In addition to decreased costs of transaction, inventory at the maintenance and repair facilities were reduced by 50%.

McKesson Drug Company: McKesson a major drug distributor, developed a relationship with Johnson and Johnson, one of their major suppliers. Through a joint computer system development effort, both firms receive data on inventory, point of sale, demand, and customer information. This has led to Johnson and Johnson providing better service to McKesson increasing the level of service that McKesson provides to its customers. Due to the success of the relationship, Johnson and Johnson has turned over a million dollars worth of business to McKesson.

Bose Corporation: Bose corporation has attempted to eliminate both purchasers and salespeople by bringing suppliers into the manufacturing process. Suppliers have access to Bose’s data, employees and processes. They work with Bose’s engineers on present and future products. The reduction in personnel reduces costs for both sides, and a direct contact between the user and producer enhances quality and innovation.

Establishing and Maintaining Supplier Relationships

Wilson [6] suggests that the majority of alliances fail. We feel that most of the problems are associated with the selection and maintaining of supplier relationships. We present research finding from academic research, USGAO [2] and our own experiences. In order to establish relationships, we suggest that firms be very selective in their criteria. In addition to the normal criteria of competency and quality, we suggest the following additional factors be taken into consideration:

- **Trust and Commitment to Long-term Goals**. Both suppliers and buyers need to demonstrate trust and commitment toward a long-term vision. Trust and commitment have been shown to be the major predictors of successful relationships.
- **Mutual Benefit**. The relationship should be of benefit to both the buyer and the seller. If the relationship has one-sided benefits, the relationship will not last.
- **Top Management Support**. Most successful relationships are associated with support from the top managers of a firm. As examples, the success of Walmart and Corning in forming relationships is because their CEOs have supported supplier relationships. Also, DuPont and Roadway Express have formed an Executive Board that meets at both companies to enhance their relationship [2].
- **Compatible Organizational Culture**. The culture of firms should be compatible. This

suggests that they share common values and share common reward systems. A major relationship initiative between two telecommunication firms did not work because they did not share a common work philosophy. One firm was very intense, whereas the other firm was laid back. The relationship dissolved in six months.

- **Sharing of Information**. Relationships require sharing of information. The benefits of relationships arise from reducing the uncertainty associated with transaction oriented exchanges. Information increases certainty and reduces needless interaction. As an example, Bailey Controls, a manufacturer of control systems shares data with two of its main electronic distributors that has allowed Bailey to reduce inventory and costs [3].
- **Strong and Open Communications**. Strong and open communications reduces misunderstanding and enhances the quality of relationships.

Maintaining Successful Relationships

The following aspects are regarded as important for the successful maintenance of relationships.

- **Simple and Flexible Contract**. Simple and flexible contracts enhance relationships as they are used as guides rather than specifying all contingencies. For example, when Kodak outsourced their computer support services to IBM, they used an eleven-page contract [2]. In contrast, typically simple business contracts run to about 30 pages.
- **Intensive Management Involvement**. Cross functional teams from both the supplier and buyer organizations that meet periodically to enhance their relationships. For example, Ford uses salespeople to provide suppliers with consumer feedback [2].

- **Periodic Performance Monitoring**. We have found that performance monitoring is critical for relationships. Suppliers also appreciate a formal performance evaluation method. As an example, Motorola evaluates and generates a score card for all of its suppliers [3]. The supplier's next order is based on the supplier's previous performance. Suppliers appreciate this knowledge and compete better.
- **Internal Controls**. It is intuitive but companies need to protect access and distribution of confidential information with rigorous internal controls.
- **Problem Solving Procedures**. Companies need to establish problem solving procedures that reduce conflicts or prevent conflicts. One of the simplest forms is frequent communication at all levels of the customer and supplier organization.

Organizational Changes Need to Establish Supplier Relationships

As stated earlier, as we traverse from a transaction and domestic orientation to a relationship and global orientation, firms will need to emphasize the development of relationship with suppliers. This emphasis of a relationship orientation toward suppliers will lead to an expertise in many aspects of business buying. These areas are highlighted in Figure 3, raised in our earlier paper [4] and discussed next.

1. **Supplier as a Customer**. As discussed earlier, there will be a thrust toward developing and maintaining relationship with customers. However, firms' understanding in this area is very limited. Firms will need to develop commitment, trust and cooperation with their suppliers. Firms will need to invest in mutual goals, interdependence, structural bonds, adaptation, non retrievable assets, shared technology and social bonds to ensure successful relationships [6].

2. Cross-Functional Supplier Teams. Marketers have used interdisciplinary teams to contact and maintain relationships with their customers. As individual suppliers relationships become more important we expect a similar thrust toward cross-functional teams that are dedicated or focused on their key suppliers. The importance of individual suppliers is expected to increase because of the emergence of sourcing on a global and relational basis with a few key suppliers. Firms will need to change goals, reward structure and group norms of the purchasing function.

3. Does Partnering Pay? Firms will need to monitor the return on investment in establishing relationships with suppliers. Therefore, firms will need to develop a performance metric that analytically quantifies supplier relationship equity. We feel that supplier partnering with smaller share suppliers will not be economical. The cost-benefit analysis of supplier relationships should result in increased supplier selectivity.

4. Supply Experience Curves. Managing supplier relationships will not be an easy task. The task of managing relationships on a global basis will be more complex and not analogous to domestic supplier management as most business customers have realized. Therefore, in industries where supply function is a key strategic advantage, companies need to focus on creating core competency in supply side management and develop sharper experience curves.

5. Hub and Spokes Organization. We expect organizations to reduce the number of suppliers in each product or service category. In addition, re engineering has forced firms to out source internal activities. We expect the results of these two trends to lead to a hub and spoke organization in which one or two suppliers in each product or service category are the spokes and the procurement organization becomes the hub on a global basis.

6. Bonding with Suppliers. Marketers, specifically those that practice relationship marketing have learned to bond with their customers. Bonding relates to the empathy that the marketing organizations feel toward their customer groups. With an increasing trend toward creating, managing, and enhancing ongoing relationships with suppliers on a global basis, organizations will have to invest in supplier bonding processes and philosophies.

7. Global Sourcing. We expect global sourcing to be a source of strategic advantage. While several global enterprises, especially in the automotive, high technology and the aerospace industries are establishing processes and platforms, it is still at an infancy stage of practice in other industries. Firms will have to develop expertise in global sourcing strategies as well as global logistics.

8. Cross-Culture Values. Firms will need to be more aware of cross-cultural values. These values may be in conflict with the firm's present value system. As an example, firms in the US are accused of focusing on short-term profitability whereas firms in Japan are concerned about long-term positioning. Similarly, in some cultures, reciprocity is declared illegal and unethical whereas in other cultures it is the preferred way of doing business. What is considered as an agency fee in one country is recognized as a bribe, subject to prosecution under the anti-corruption laws. Similarly, doing business with family members and politically connected individuals are presumed to provide a sense of trust and commitment in some cultures whereas it is considered as nepotism and unethical behavior in others.

9. **Cross-National Rules**. Firms will also have to learn about cross national rules. Specifically, the two tier regulations (one for domestic and the other for foreign enterprises) are common with respect to ownership, management control, and co-production practices in countries such as China. With the rise of nationalism in recent years, this has become a key issue for global enterprises such as McDonald's, Coca-Cola, General Electric, and Enron, especially as they expand their market scope and supply scope in large emerging nations such as India, China, and Indonesia.

10. **Services Procurement**. As organizations out source more and more internal services, and as suppliers engage in providing value-added services to their customers, firms need to better understand and research services procurement. Additionally, as most advanced countries are services economies, services procurement will rise in prominence.

Conclusions

The paper examined the reasons for the emergence supplier relations as source of competitive advantage. The paper discusses successful relationships, rules for developing relationships and concludes with organizational strategies that will enhance supplier relationships.

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Table 1

Reduction in the Number of Suppliers

Company	**Number of Suppliers**		**Percentage Change**
	Current	**Previous**	
Xerox	500	5,000	90.00%
Motorola	3,000	10,000	70.00%
Digital Equipment	3,000	9,000	66.66%
General Motors	5,500	10,000	45.00%
Ford Motor	1,000	1,800	44.44%
Texas Instruments	14,000	22,000	36.36%
Rainbird	380	520	26.92%
Allied-Signal Aerospace	6,000	7,500	20.00%

Source: Emshwiller [7].

Figure 1
Changing Paradigm of Organizational Purchasing Strategy

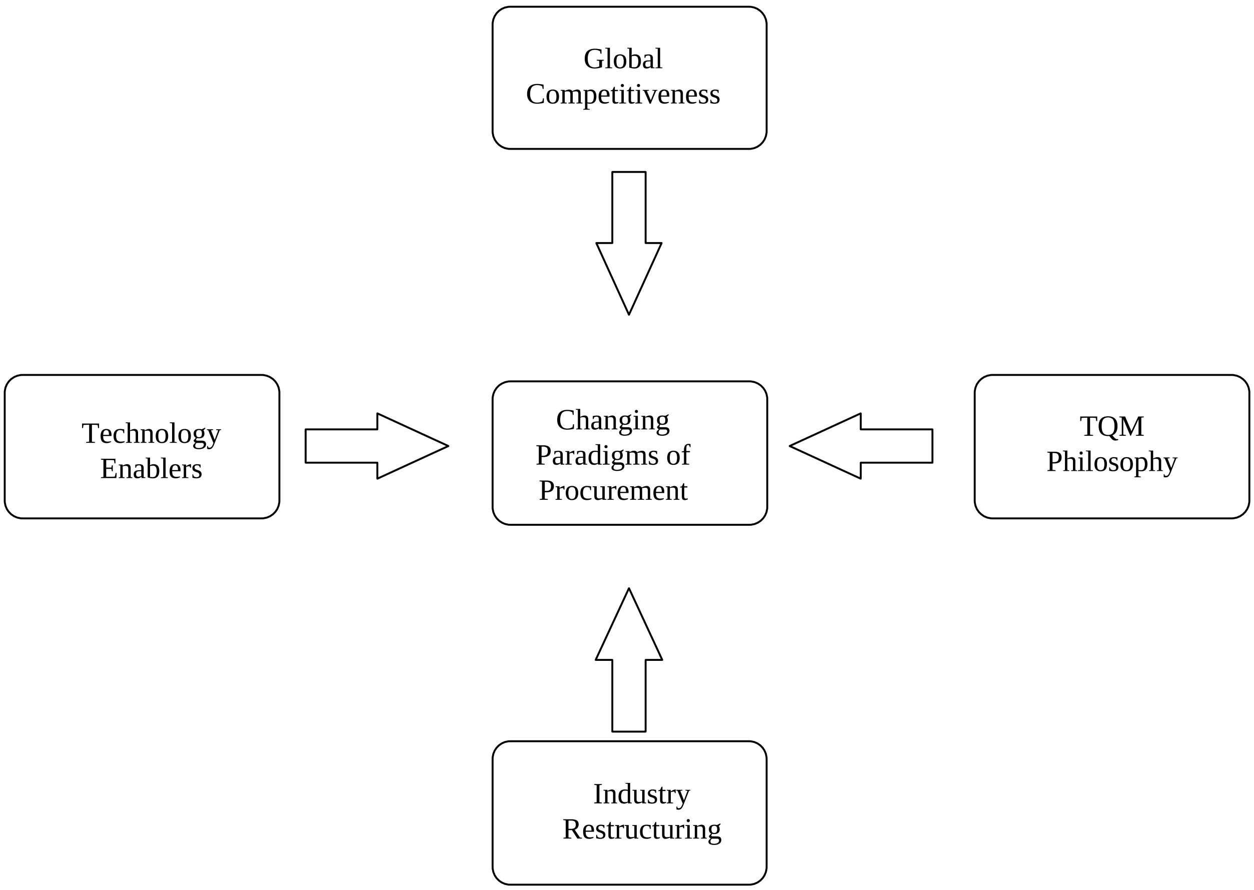

Figure 2
Shift in Organizational Purchasing Strategy

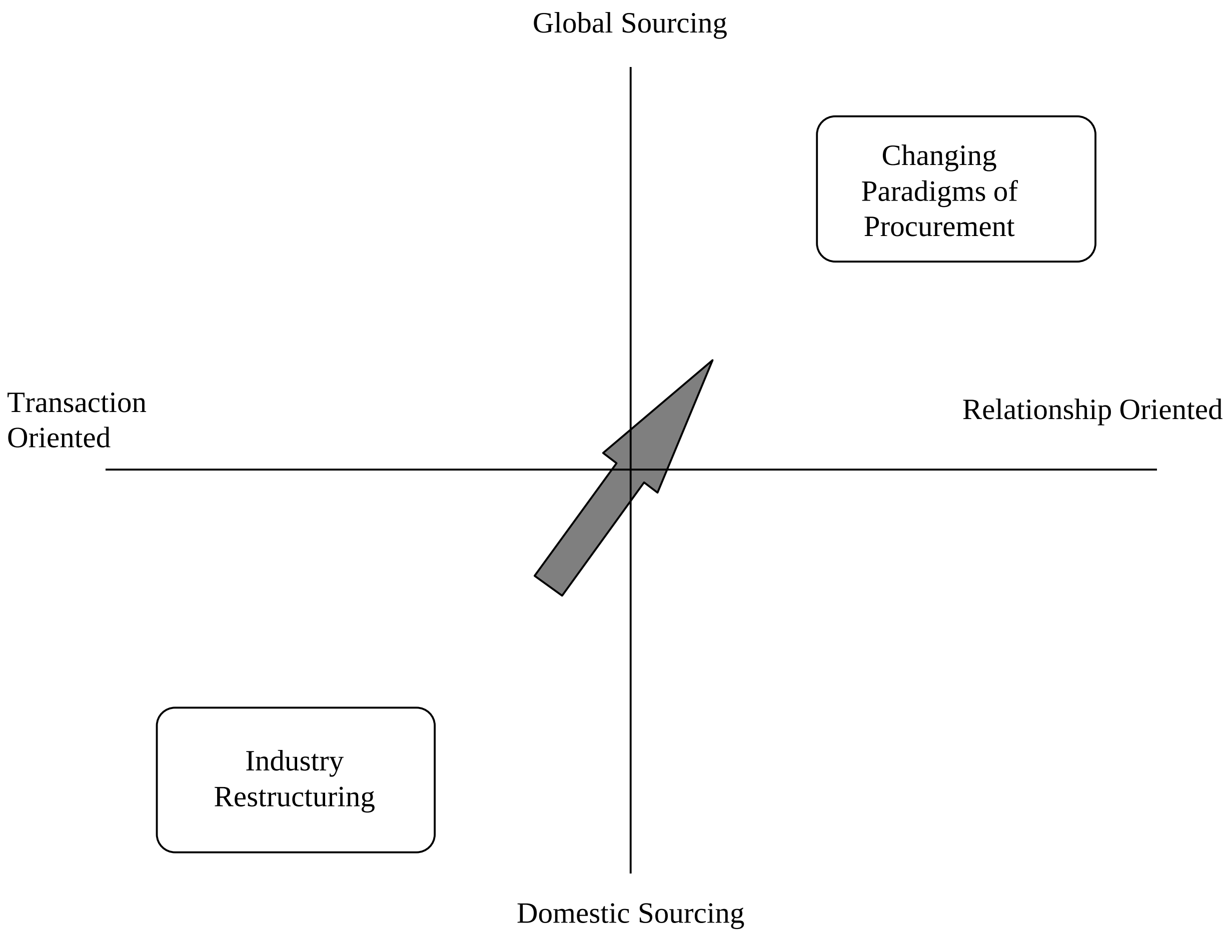

Figure 3
Emerging Areas of Expertise in Supplier Relationships