Supply Strategy for Enterprise Growth and Innovation

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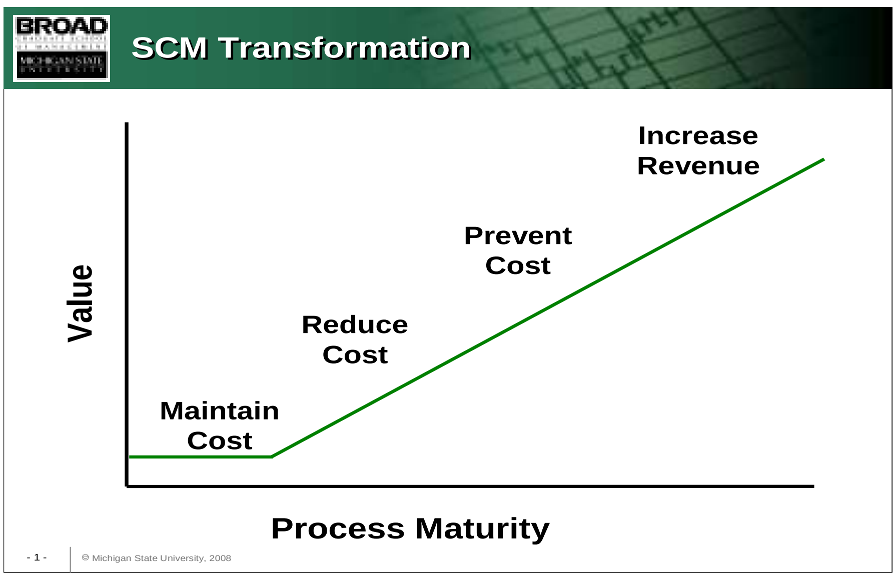
This session summarizes findings from MSU's Supply Chain 2010 and Beyond Research Initiative started in 2006 and the joint Darden / MSU September 2009 Seminar entitled, ***Supply Chain Strategies for Enterprise Growth and Innovation.***

Essentially, two major themes emerge. First, the supply function must expand its charter beyond the traditional considerations of price, delivery and quality to include innovation and revenue growth from a strategically coupled and value driven perspective. Second, delivering overall firm value requires superior supplier perception. The objective is to expand the traditional cost-focused view of the supply chain, and adapt and share a mindset which views the supply chain as a strategic lever for achieving additional organizational goals of growth, corporate social responsibility, and sustainability. Furthermore, supply chain design must deliver and blend varying degrees of the following six outcomes:

1. Cost
2. Responsiveness
3. Security
4. Sustainability
5. Resilience
6. Innovation

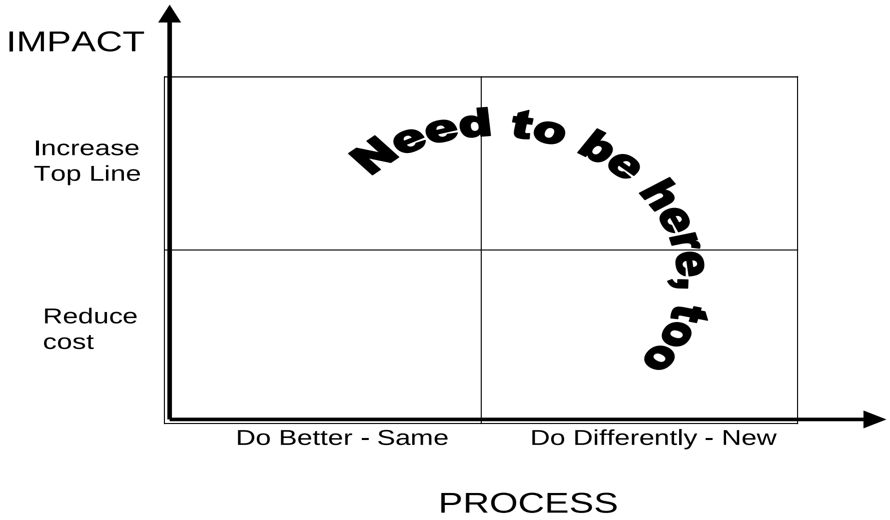
Regardless of how you define sources of innovation it's clear that more innovation is required from sources "outside" your four walls – those whose assets you don't own. The Darden / MSU workshop developed the Innovation Diamond as a framework to enhance intra-organizational innovation effectiveness and efficiency:

Furthermore, our research suggests that supply-driven revenue growth and innovation are later stage developments of sophisticated supply management organizations that evolve along the process maturity / value graph shown below:



In terms of supply management strategy, firms must broaden their perspective beyond the lower left hand quadrant to include all four quadrants below:

Supply Strategy Quads



Having the right organizational linkages, maturity and perspectives is a prerequisite to driving innovation and growth. Having superior supplier relations is a critical enabler and game changer. Next, we'll summarize the value of superior supplier relations.

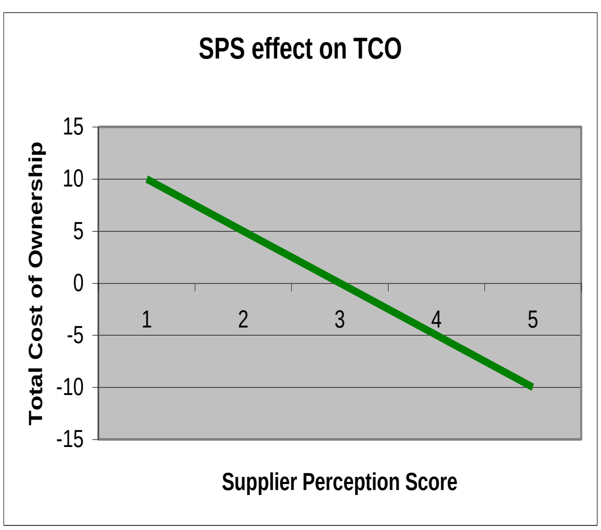
We tend to build relationships with suppliers cautiously and may often take suppliers for granted. Generally, lasting and mutually beneficial buyer / supplier relationships seem to develop only after years of arms-length dealings. Even then, relationships are regarded as tenuous and temporary and are more likely to develop between individuals who have discovered they can leverage each other's benefits through close cooperation than whole organizations or departments. Generally, buyer / supplier relationships are not measured. And, even when measured, the process is sporadic, recommendations not routinely followed and trends are not seen as organizationally relevant.

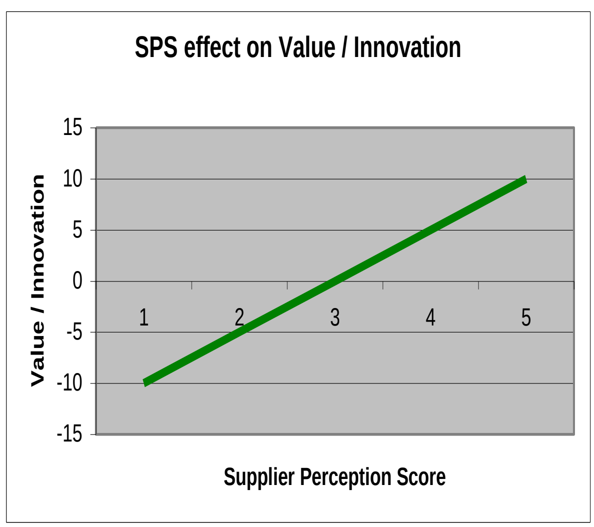
In contrast, Marketing and Human Resource folks have spent decades driving improvement in Customer and Employee satisfaction and refining measurements and metrics to track their performance. Management theorists such as Warren Bennis and Tom Peters have long demonstrated the value of collaborative leadership behavior that enables much of the current information sharing we see today. Command-and-control structures are morphing into cooperative, almost democratic, organizations. Empowered groups are everywhere transforming how customers are served, how people work together, how innovations are found and exploited and how things are made and delivered. Yet, 50 years after Bennis, much of supply chain management remains authoritarian even as internal hierarchies are dismantled and customer-facing activities are more open, collaborative and team-driven.

For the past couple of decades, business pundits have linked success to customer focus and employee satisfaction. Indeed, every firm aspires to be both the supplier and employer of choice. Pleasing customers and attracting and retaining the best employees remain critical components of success. Arguably, in today's globally competitive markets, loyal customers and employees are even more important. But, there are three loyalty legs to the business success stool – customers, employees ***and suppliers***. And, the supplier leg is not only often neglected, it is both the fattest and, perhaps, offers the best opportunity for overall business improvement. The current recession / recovery will only intensify the surge to outsource further. More and more, the challenge is to manage assets you do not own – namely suppliers for not only an increasing array of goods and services but also an underutilized source of ideas and opportunities.

Firms are coming to realize that companies don't compete, supply networks do. Supply networks compete against one another for the end customer's purchase. The network of sources from mother earth to end consumer that can consistently win the customer's purchase will be the network that is best integrated and most collaborative. The key metrics are not only customer approval but also supplier perception. High customer approval translates into customer loyalty. All CEO's want to be their customer's first choice. There is a constant stream of literature attesting to the value of customer loyalty. The same value exists on the other side of the coin. Supplier loyalty is extremely valuable. Since supplier loyalty matters, we need to begin to better understand and measure it. Most of our collective resources and management thinking around sustainable competitive advantage focuses on demand – customers. Increasingly, however, the neglected frontier of supply management offers the best opportunities to drive both increased earnings and revenue. Although we don't always execute, we clearly understand the need to hear the voice of the customer or be a customer-driven organization. Rarely are calls made that get serious attention or resources to hear the voice of the supplier or be a supplier-driven firm.

Recently, Supplier Loyalty has been getting attention. As one Supply Management Executive put it, "We must become the customer of choice for our suppliers because there are no more rabbits to pull out of the old hat of contentious supplier relationships." Current Supply Chain Management literature around Supplier Relationship Management (SRM) and recent trend studies have shown some organizations seem to have a better cooperative culture that accordingly earns sustainable supply advantage. Such advantage manifests itself in two ways – lower total costs of owners and higher innovation – as shown in the following charts:





In most industries and geographies the relative difference between the supplier perception of the various buyers they serve or might serve is fairly small. However, this is not the case in the US Auto Industry. It has long been known that the domestic Big-3 are at a cost disadvantage to the Japanese auto company plants in the US. It is estimated that Toyota and Honda have a $3,500 cost per vehicle advantage over GM and Chrysler. 43%, or $1,500, is due to lower legacy costs. This gap is closing as the domestics slash their workforces and the workers at Japanese plants begin to retire. The remaining $2,000 advantage comes from "productivity". Productivity is a word economists and academics use when they cannot explain a difference more precisely. But, in this instance, understanding is relatively straightforward. Since 80% of the cost of a car or truck is purchased goods and services, $1,600 of the advantage comes from the way the Japanese auto firms integrate their suppliers.

Do Honda and Toyota pay lower piece prices for the same goods and services from the same suppliers as GM and Chrysler? Probably not. Instead, Honda and Toyota earn preferential treatment from their suppliers as compared to GM and Chrysler. This advantage is manifest in lower total cost of ownership amounting to about $1,600 per vehicle. This advantage is the tangible result of superior supplier perception earned by markedly better performance in the following areas:

- Trust
- Communication
- Collaboration
- Cost Understanding

A somewhat counterintuitive insight is that mutual dependence is often a more successful approach to supply management than enhancing one's bargaining position. Put differently, benefits from mutual dependence are greater than the benefits from enhanced relationship power. A recent study concludes that buyer-supplier relationships featuring elevated mutual dependence result in greater information exchange and joint value creation. Clearly, Honda has turned the danger of vulnerability from a traditional Porter Analysis perspective into a competitive advantage that allows them to prosper against the more authoritarian and adversarial approaches taken by its US counterparts.

Part of the effort to improve supplier loyalty requires solid understanding of current supplier perceptions. Most buyers live in Lake Wobegon – they are all well above average. Indeed, most buyers honestly believe that they are good customers, that their suppliers and other potential suppliers covet their business. As a result, they believe that they are their suppliers customer of choice. As mentioned earlier, the desire to be the customer of choice, to delight suppliers, to earn preferential supplier treatment is becoming the new mantra for enlightened supply management executives. We've even invented a new acronym – SRM (Supplier Relationship Management).

But, according to a PSC survey, only 5% of all customer's regularly receive preferential treatment. To a large extent, the typical sales effort encourages sellers to tell buyers what they want to hear. Often, what the buyer wants to hear or believe is at odds with both what the seller believes and how he or she acts. Sellers are justifiably suspicious. As one example, witness large buyer moves to unilaterally extend payables and demand across the board price reductions. It's therefore no surprise that supplier perceptions are still dominated by the following feelings toward buyers:

- Dangerous to share actual evaluations and rankings of buying firms
- Buyers offerings dominated by price and volume
- Reluctant to share innovation
- Reception to improvement suggestions is discouraging
- Limited intellectual property protection
- Unbalanced sharing of risks and rewards

The first step to improving buyer / supplier relations is an honest assessment of where the relationship stands. In challenging economic times, the supply base is contracting due to falling demand leading to company failures. This raises significant questions for the future as the global economy recovers:

- Will my suppliers fail?
- If not, will they still be able to supply me?
- Will they still want to?
- What will make them stay with me and give me their best resources?
- What will make them eager to invest in my business?
- What will make them bring breakthrough technology to me before my competitors?
- What will make them prioritize my requirements during times of material shortage?

Proactive buyers will make sure they get the right answers to these questions and will use Supplier Perception Metrics as a key performance indicator for their supply management operations. Such metrics should not only be important to Supply Management folks but, like customer and employee satisfaction measurements, ought to be keenly regarded by the CEO.

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