HOLISTIC SUPPLIER MANAGEMENT: ORCHESTRATING THE PROCUREMENT FUNCTION FOR MAXIMUM BENEFIT

JAGGAER

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WHY SUPPLIER MANAGEMENT IS KEY TO YOUR ORGANIZATION'S SUCCESS

Supplier management is the optimization of what comes into your company so that you can optimize what goes out. It is at the very heart of procurement and managing suppliers effectively to perform in harmony with your business strategy is rather like composing an orchestral piece of music and then conducting all the different instruments in the orchestra itself. Each supplier brings something different and unique, some play a leading part, some a minor one, some in foreground, some in background, but they all have a role to play in your success.

Supplier management is strategic to business success in most sectors, because:

1. Companies produce less than they did in the past. The trend has been towards more streamlined operations, towards buy rather than build. This means that an organization's success and competitive advantage are highly dependent on the success and robustness of its supplier network;
2. Supply chains are getting longer and longer with the opening of new markets (e.g. the enlargement of the European Union, the rise of the BRIC countries etc.) Whereas 20 years ago most of a company's suppliers were probably within a very short radius, today they could be at the other end of the continent, or the other side of the world. This adds complexity and risk;
3. In most sectors, companies are required to comply with regulatory frameworks that are increasing in scope. Many of the regulations impact procurement directly or indirectly, and in the absence of effective supplier management, they will become increasingly onerous;
4. As digitalization advances, companies need more relevant and timely supplier data to drive and optimize other processes;
5. All other procurement processes now revolve around and feed into supplier management;
6. Organizations' supplier ecosystems are increasingly diverse – different suppliers need a variety of approaches based on their strategic importance, as we discuss below.

We can summarize all of the above with a simple phrase: how can I do more with less? And because supplier management drives so much else, the solutions must become increasingly powerful and data driven. Until recently, many organizations have relied on a combination of ERP (or other transactional systems), the category knowledge of individual procurement managers and staff members, and gut feel to manage suppliers. In a complex world, that no longer suffices. An ERP system does not provide the depth of information needed to manage suppliers strategically; knowledge can walk out of the door and go to the competition, and gut feeling is simply inadequate when there are so many variables at work and risk factors at play.

Thus, when we talk about “holistic supplier management”, this of course includes the operational and transactional part, but it also includes the ability to:

- Identify new suppliers
- Integrate suppliers into an ecosystem they will participate in fully
- Assess supplier risk and make decisions based on that risk
- Provide the data to drive sourcing and category management strategies
- Meet the needs of multiple departments and stakeholders that rely on procurement, e.g. logistics, production, quality management, HR, finance, auditors, technical engineers etc.
- Comply with internal and external regulatory frameworks
- Help you make sensible decisions on supplier management – discover new suppliers in order to be ready to replace under-performing suppliers if necessary

In fact, with the term *holistic supplier management* we can do away with all of the subsets of supplier management (supplier relationship management, supplier value management, supplier information management, supplier risk management etc.) because they all roll up into one common set of objectives, deliverables and actions.

Supplier management also provides the visibility needed to identify synergies and better ways to do things that reliance on individual category managers, who use siloed information in spreadsheets and databases, cannot.

SUPPLIER MANAGEMENT IS STRATEGIC, NOT OPERATIONAL

Many organizations continue to use systems (e.g. ERP systems) that are designed for transactional processing for supplier management. But such systems only address one or two operational aspects of supplier management; that is to say, they can eliminate some of the routine day-to-day work but beyond this, they do not add value. They are built to serve the needs of finance departments to process payments. They do not provide strategic value across the procurement value chain and for other departments that rely on procurement and play an increasingly important role in supporting procurement and benefiting from it.

Why does this situation persist? Organizations are often slow to adapt to new realities and tend to be focused more on outputs (customers) than inputs (suppliers), and more focused on costs than on value and risk. This reluctance to embrace new realities is often embedded at the executive level, because there is a belief that what worked well in the past must work well today. To overcome such reluctance to adapt, it is vital not only that senior managers in all organizational functions understand supplier management, but also that they are viewed and involved as important stakeholders. Suppliers can be a value-add for customers too, and an important one.

SUPPLIER POSITIONING

Given all of the complexities mentioned above, it is already clear that there cannot be a “one-size-fits-all” approach to supplier management. But at the risk of oversimplifying things, we can probably segment all suppliers into one of three buckets:

Strategic suppliers. These are the small number of suppliers from which companies buy in high volume, and/or which are mission critical. They may even be directly involved in co-designing products (in manufacturing) or go-to-market channels (e.g. in financial services) etc. They can propose product innovations. If not managed correctly, strategic suppliers may expose you to excessive costs and risks. It typically take one or two years to find suitable and valid alternatives to strategic suppliers.

Approved suppliers. These are the middle ranking suppliers that are important but not mission critical. Alternatives exist but they expose you to some additional costs and (for example) order fulfillment risks.

Basic suppliers (or your “tail spend”). Most of your suppliers are in this bucket. Many alternatives exist and switching suppliers exposes you to minimum cost and risk.

Let’s look at these in more depth.

STRATEGIC SUPPLIERS

Note that we have not mentioned spend volume in the above classifications, nor have we mentioned the type of products they supply. Rather, it is the cost and financial risk to your business that matters here. However, in terms of managing strategic suppliers, it is wise to divide them into those that are strategic high value and those that are strategic low value. An example of the latter could be the supplier of an apparently trivial and low-cost component, which nevertheless has to be manufactured in a highly specialized material, for which your supplier holds the patent. This puts the supplier in a position of relative power.

A further important type of strategic supplier includes so-called bottleneck suppliers that are “high risk” in that their non-delivery will seriously harm the business, but “low profitability” in that their services do not immediately add value to the company’s bottom line. Generally speaking, the supplier is more powerful than the buyer in the negotiation. Typically, these strategic suppliers are in the IT sector. E.g. some of your customers require you to install a piece of software to meet certain standards; the bottleneck supplier, which is a major ERP vendor knows this, and can squeeze you on price.

Dependence on strategic suppliers can create an uneasy partnership since they have something you really need and can’t readily purchase elsewhere.

One approach to this situation is to create mutually beneficial co-dependence by working with suppliers as partners in the business to identify problems and inefficiencies and find solutions that help to grow the business. This will help make the supplier feel part of the extended enterprise. A supplier development plan that formalizes this approach, planning corrective actions or co-innovation activities can increase the collaboration and partnership.

In this type of relationship each party understands they need the other to maximize success. This level of strategic relationship often finds expression in *personal relationships between senior executives*, which can be of use when either party faces challenges.

Less than 10% of your suppliers should fall into this category, as they require quite a lot of supplier management effort and having a larger number starts to pose a significant risk exposure.

APPROVED SUPPLIERS

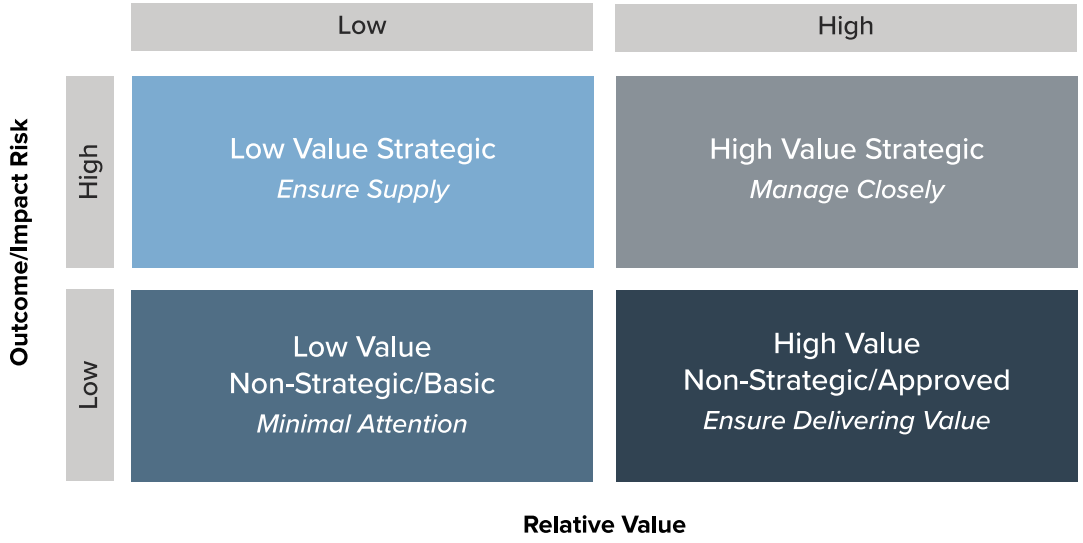
There are alternatives to approved suppliers. Business is sourced with them initially based on the value they deliver in relation to their competitors and will remain with them only if their performance meets expectations and they continue to deliver high value. On the other hand, if they prove their worth, going above and beyond the call of duty, you may consider extending your commitment with them. In other words, they may, in exceptional circumstances, become strategic suppliers. In all other circumstances supply managers should identify and develop alternative sources of supply.
This increases competition by reducing the dependence and increasing flexibility in sourcing.

BASIC SUPPLIERS (TAIL SPEND)

Business is also initially awarded to basic suppliers based on competitiveness and they are retained if they attain certain performance levels. The difference, however, is that the cost and risk of finding and appointing alternatives is low or negligible. These basic suppliers make up the majority of organizations supplying a company, and because there are so many, and each represents so little value, there just aren't the resources available to manage them and get the best outcome. However, there should be processes and checklists in place to ensure that they are meeting service level agreements and other KPIs. Much of this is routine and should be automated to deal better with the high volumes and numbers of these suppliers that are often neglected.

DIFFERENTIATED APPROACHES TO MANAGING SUPPLIERS

Chart 1: Supplier Positioning Matrix



To understand the different approaches to managing these suppliers it is helpful to use a matrix diagram, with Outcome/Impact Risk (Low to High) on one axis, and Relative Value (Low to High) on the other. The suppliers that require closest attention and management are those that are both high value and strategic. Your focus here is to get security of service at a good price. That means maintaining a close, collaborative relationship, negotiating a medium to long-term contract to support security of supply and having a contingency plan in place in the event of problems.

With low value strategic suppliers, such as the supplier of the strategically important but low-cost component mentioned above, the focus is on ensuring continuity of supply. Typically, there are few suppliers, so you are likely to negotiate long-term contracts to support security of supply. It might take a year or more to find an alternative supplier. You will maintain a close relationship to manage problems proactively and you would be wise to consider supporting your supplier(s) to develop additional capacity. Price may be less of a concern.

Approved suppliers deliver high value, but they are non-strategic. If they cease to be competitive, or reliable, you should consider re-sourcing. Shorter term contracts will enable you to re-source to achieve better value and/or to get a better price.

Finally, basic suppliers or your tail spend. Suppliers of low-value, low-risk products and services can be managed on standard outcome agreements of shorter term, with standard measures, monitoring and reporting. You should only focus on closer monitoring of those suppliers falling below average standards, volumes or outcomes – but measuring/tracking this is problematic (see comment above about volumes and lack of resources).

VALUE & RISK ARE MORE IMPORTANT THAN SPEND VOLUME

Supplier management technology supports you in managing these different approaches, working very closely with strategic suppliers, keeping track of approved and basic suppliers, but only triggering an alert when there is a problem and action needs to be taken. Rather than you having to look through pages of reports, service level agreements etc., an effective system collects and analyzes data to tell you when a supplier is underperforming or not delivering the expected value.

Without such a solution the tendency is to focus attention on suppliers with which you have high spend rather than those that are difficult to replace and whose impact on your organization's outcomes is high, and therefore pose a high risk should they fail you.

SUPPLIER MANAGEMENT IS CROSS-FUNCTIONAL

Usually supplier management is seen as an activity that is specifically and entirely the responsibility of the sourcing or procurement function. And of course, it is often sourcing and procurement professionals who have the task of dealing directly with suppliers. But there are many other stakeholders in any organization who want and need to have a say on which suppliers they work with. In manufacturing, for example, the quality management team absolutely must be confident that any bought in goods (e.g. components) and services (e.g. outsourced maintenance) comply with your internal quality standards. This is fairly obvious. Your finance department will want to ensure that terms of payment meet company standards. Logistics, engineering, IT, the legal team and other functions are likely to have a view and their own requirements. And increasingly, today, corporate social responsibility (CSR) has a role to play, especially in countries that incentivize procurement from suppliers that follow certain standards in terms of environmental protection and sustainability, diversity of employment and so on.

It is the combined objective view of all of these functions and organizational entities that will bring you to the correct decisions on which suppliers are the right ones for certain tasks. It is of critical importance that as part of best in class supplier management, you should capture the requirements of all of these stakeholders and provide a mechanism for them to verify that these requirements are being met. To ensure that this happens requires very flexible workflows: once you have decided who should be informed about a particular type of supplier, who has rights of approval, who can access assessment information, etc. this should be implemented in the system as a set of processes, so you don't have to think about them any more, unless of course you change the rules and workflow for any reason.

Also for this reason a modern supplier management system should not, under any circumstances, be a standalone system and supplier management data should not be siloed. It has to be integrated, for sure, with your upstream sourcing software and your downstream eProcurement and payments software, and of course with contracts and category management applications, but also with ERP accounting systems. Supplier information, performance data, and risk factors need to be accessible and pervasive, and it needs to support each of the aforementioned functions , so that it can be leveraged to drive value.

APPROVED SUPPLIER LISTS

One of the many ways supplier management data drives value is through the creation of approved supplier lists (ASLs). This enables sourcing professionals to identify immediately a list of potential suppliers of a product or service by simply typing in the relevant parameters. But it could even be used by user departments – such as engineering or R&D – before products are in production. If they access supplier management information and work together with supplier management even at the new product introduction (NPI) stage, rather than leaving it until later in the process, they might identify half a dozen candidate suppliers that could meet their needs for a particular product or service, or who could help with co-design by virtue of their specialized knowledge. It is then possible to enquire further and conduct a sourcing event focused on value and innovation, rather than on price. By contrast if the engineers do not have access to such data, they may choose a supplier on a more or less personal basis – the only one they know that can meet the criteria – in which case all procurement can do is negotiate on price with no leverage.

ASSESSING SUPPLIER PERFORMANCE

The appropriate KPIs for assessing supplier performance will vary according to category, but some basic ones that are likely to figure on most scorecards include:

- Ability to fulfill orders accurately
- Status as a strategic, approved or basic supplier
- Ability to provide goods or services of superior quality
- Record of on-time delivery
- Ability to comply with your company's terms and conditions
- Ability to comply with legal, manufacturing, and safety requirements
- Pricing structure and potential changes to it
- Cost risk: how often does the supplier raise prices?
- Strategic opportunities (if any) available during contract negotiation
- Financial results (revenue, EBITDA) and risk
- Legal structure
- Best practices as an employer
- Social responsibility
- Innovation: is the supplier an innovator that will bring frequent improvements to product or service quality?
- Certifications e.g. ISO

The scorecard is thus likely to include many items that must be weighted for each category (e.g. security of on time delivery will be more important for some categories than others). Tracking any or all of these KPIs and using supplier scorecards as part of a well-executed supplier management program is significantly easier and more cost-effective if you are using a centralized supplier management application that integrates with every stage of the entire procurement process. Corrective action plans can help here. They enable an organization to work with suppliers in a constructive and formal way to track each task performed, which provides a basis for improving performance.

However, this is not simply about scorecards. The system should make relevant KPIs, especially risk factors, instantly visible when you open up the supplier file. It should also be flexible enough to reflect regional factors. Is this a supplier that you can use globally? Some suppliers might be excluded from participating in sourcing events in countries where there is a requirement to meet regulations governing the percentage of locally sourced content, i.e. from local vendors. Alternatively, you might use a supplier specifically to meet such a requirement, or because it is a customer-imposed supplier,

but want to exclude it from bids for work in other geographies. Such data points and details must not only be visible to procurement but also shared and transparent for all other stakeholders to ensure maximum efficiency.

Finally, it is important to provide transparency into the known or likely internal costs of going with certain suppliers. Perhaps it is better to go with one supplier that can handle everything (e.g. a specific carrier to handle your transportation needs) even if this comes at a higher cost than using an assortment of local carriers, as the latter strategy implies greater administrative burden on your logistics and finance teams, and possibly other stakeholders too.

BEST PRACTICES IN VERTICAL INDUSTRIES

Everything discussed so far in this document applies pretty much across the board for all industries, and in both direct and indirect spend. However, every industry has specific needs and best practices, which in turn may vary by geography. Here are a few pointers:

Banking: Banking is a unique industry in many respects. The tough regulatory compliance environment sets limits on how banks can achieve goals like cutting costs. But there's another aspect, often overlooked, that sets the banking industry apart. A bank's suppliers are, in most cases, also its customers. And this provides enormous scope for conflicts of interest for individual employees, for departments, and for the bank as a whole.

In Europe the European Banking Authority (EBA) has published a set of guidelines regarding outsourced activities, which must be followed by all European banks. The ECB requires banks to track, report and evaluate each of their outsourcing necessities (and awarding decisions), from the very beginning when an outsourcing necessity arises, followed by the evaluation of the potential risk assumed when awarding a contarct, then with the evaluation of the service provided and finishing with the supplier development plan (or with a continuity plan) if the supplier is not meeting the service level agreed. In the UK this is usually called a Service Impact Assessment (SIA), which maps the entire service journey, associated risks and continuation into contracts, suppliers etc.

Automotive: The automotive industry is highly process driven. Component and service delivery has to be just-in-time to ensure competitiveness, but at the same time, the very mention of the word "recall" – meaning that a faulty component has to be replaced, perhaps in thousands of vehicles – can cause panic among industry executives. To avoid this there must be an even greater focus on quality rather than price and more strategic relationships especially with Tier 1 suppliers. Automotive is also more reliant on advanced technology to streamline supplier management than most other sectors.

Public sector: In some countries the whole supplier identity, diversity definition, tracking and reporting can be critical aspects of supplier management, together with regional nuances and how (for example, how many local small businesses are participating in events, submitting responses, winning contracts, and what is their impact on local environmental, social and economic outcomes.)

Food and beverage: This sector is subject to many regulations issued by the Food and Drug Administration (FDA) and the European Union, as well as those in each country.

Construction: It is very common in construction to have a multi-tier supplier management system in place. The terminology of subcontractor has a different meaning in the construction. It is also common that suppliers are evaluated after every project, but also the project is evaluated by the supplier. Multi-tier supplier certificates need to be managed and integration with sales/calculation tools is a big advantage.

Clothing & fashion: The fashion industry is uniquely complex and fast-moving. The challenge today is for purchasers to find suppliers that are flexible, reactive, and able to develop a product very quickly as collection lifecycles have shortened drastically. Supply management professionals must also contend with a great deal of risk from volatility in the currency and commodity markets, to geopolitical unrest and the adherence to ethical standards within the supply chain. Corporate social responsibility (CSR) became a very important issue for the industry in recent years following scandals about poor working conditions, which can be seriously damaging for the reputation of brands that were its customers. Some suppliers may be very small and “non-replaceable” for certain lines, collections or brands. Every strategy involves benefits and challenges, and the procurement function must understand which one is the best, depending on constraints.

SUMMARY

Effective supplier management depends above all on being able to position suppliers based on the relative impact and cost of having to change suppliers and the value they deliver to your organization or for a particular project. Secondly, you must have all the relevant data about suppliers, accessible and transparent to all of the stakeholders. This means that you will be able to invite all of the appropriate candidate suppliers to a sourcing event, while excluding those that are disqualified, and procurement will be able to focus on bringing value up rather than simply driving price down.

That is the basis for getting the best results for the price you pay, which will be a sustainable decision rather than a short-term fix.

Your organization's leadership should fully understand what supplier management is and how it can help your organization succeed. Senior managers need to be involved in choosing the right strategies to align supplier management with organizational goals and should ensure that the procurement team is equipped with the technologies, partners and personnel to execute these strategies.

SUPPLIER MANAGEMENT WITH JAGGAER ONE

The JAGGAER Supplier Management solution, part of the JAGGAER ONE platform, provides a central repository to collect and assess supplier information and documentation. It enables you to make informed strategic decisions about which suppliers best support your goals and gives you visibility into supplier performance and development activities with real-time data and analysis. With JAGGAER Supplier Management you can manage all your suppliers strategically and effectively, with multi-tiered visibility to understand their cost structure, strengths and weaknesses, their performance and how they add value in order to negotiate better contracts and generate long-term savings. You can not only capture more quantitative and qualitative supplier data but also gain deeper insight and understanding of what you measure with structured data capture and a 360° view. The system guides you with master data management and data enrichment, analytics, and predictive analytics about supplier performance and risk for better decision making. You can also assess and evaluate your entire supplier base across multiple evaluation dimensions, such as code of conduct, sustainability, finance and categories.

JAGGAER Supplier Management is fully integrated with other processes. It can be set up to incorporate data from other departments and stakeholders, and, in turn, makes SM data visible to whoever needs it, when they need it, with flexible workflows. JAGGAER understands and covers the specific SM requirements of different industry verticals and integrates the appropriate industry best practices accordingly.

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