

CREATING VALUE THROUGH PROCUREMENT AND SOURCING EFFORTS IN INTEGRATED SUPPLY CHAINS

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ABOUT THIS REPORT

As part of the ongoing collaboration between Michigan State University's Eli Broad College of Business and APICS Supply Chain Council, the Beyond the Horizon research project is investigating how the supply chain management discipline is evolving into the future. Key trends have emerged following in-depth interviews with more than 50 firms around the world. This whitepaper reviews the research findings surrounding the creation of value through procurement and sourcing efforts in integrated supply chains, including key practices and implementation recommendations.

INTRODUCTION

Based on analysis of the in-depth interviews, the Beyond the Horizon research team identified a number of opportunities to create greater value through integrated supply chains. Many opportunities require deeper consideration regarding the role and impact of suppliers, and how suppliers are positioned and managed by firms' procurement and sourcing teams. In particular, executives described five actions necessary to create value and enhance procurement and sourcing impact:

1. Understanding value
2. Creating strategic impact
3. Expanding relevant scope
4. Facilitating co-creation
5. Earning preferential treatment.

The following sections provide details on each of these areas.

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UNDERSTANDING VALUE

For supply chain professionals, especially those with procurement and sourcing responsibility, the nature of value has changed over time. As shown in Figure 1, the focus has shifted from how to obtain the lowest unit price—through negotiation and, often, adversarial “win-lose” approaches—toward a more holistic value approach. This shift started when firms began to recognize that focusing on the lowest unit price created sub-optimal decisions when, for example, the lowest price supplier produced a poor quality product or the cost of transportation and additional inventory outweighed the unit price savings. As such, firms began to focus more on understanding supply chain cost tradeoffs and looking for lowest total landed or ownership cost. Now, some supply chain leaders are focused on best value arrangements understanding that total cost doesn’t always paint the full picture.

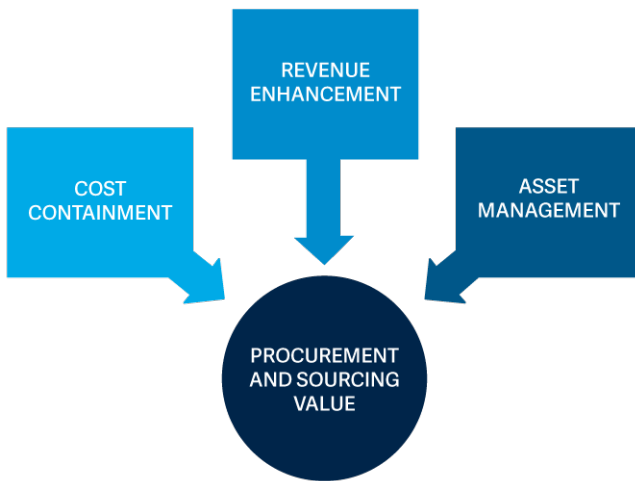
Figure 1
Evolving Performance Focus



During the interviews, one executive reported shifting focus from cost to value and time. In this case, the executive described the need to fully leverage the supply base, and not leverage in the traditional sense, such as squeezing more costs out of the relationship, but rather in terms of leveraging expertise to offer better products to the marketplace. This change was driven by the recognition that suppliers can offer much more when engaged collaboratively in pursuit of goals that are meaningful to customers, and not just internal functional metrics. As one manager indicated, “suppliers can become part of the solution versus at the end of the game.”

Value is in the eye of the beholder and, for many supply chain professionals, value is still defined by the ability to generate cost savings or mitigate cost increases, such as considering ways to contain commodity price fluctuations. While cost reduction strategies are important, they are not the only approach for generating value. Supply chain professionals also have the ability to impact revenue through ideation with suppliers and by gaining access to innovative technologies, better quality, and improved service offerings. In many cases, the supply base may have market knowledge that can assist the buying firm in responding more effectively to customer and consumer demand. As one manager indicated, “our new project focuses on giving consumers the innovation they want. So, we’re looking at new suppliers ... and suppliers we have had before to work together to bring innovation.” Supply chain professionals also impact assets with respect to owning versus outsourcing assets. Further, sourcing strategies, such as off-shoring versus near-shoring, impact inventory levels which affects not just inventory carrying costs, but also inventory (asset) utilization. For firms that operate in fast clock speeds, understanding how the sourcing strategy affects lead times becomes critical. As shown in Figure 2, value is a multi-dimensional concept that provides procurement and sourcing professionals with a wide range of options for contributing to a firm’s goals and objectives.

Figure 2
Financial Impact



CREATING STRATEGIC IMPACT

The challenge for many supply chain organizations is understanding and defining value and also creating strategic impact. Connecting supplier capabilities to customer requirements and developing value propositions that are unique and compelling is critical, particularly when driven by more integrative, end-to-end thinking. As one participant noted, “buying standardized parts from suppliers will not help differentiate our products from competitors.” If the procurement and sourcing team is focused on cost reduction, and the need for cost reduction is not directly aligned with customer value propositions (for example, customers are seeking differentiated service), then is the activity truly strategic? Firms are challenging the conventional wisdom every day.

As shown in Figure 3, four interrelated strategic activities are required for procurement and sourcing professionals to create competitive advantage in integrated supply chains. It is important to achieve process discipline by ensuring that standard processes, such as supplier analysis and qualification, as well as financial and commercial controls are in place. If not, firms have no ability to compare and contrast options and cannot ensure compliance with policies and processes. Once in place, the firm can then begin to leverage buying power in order to enhance value as discussed previously.

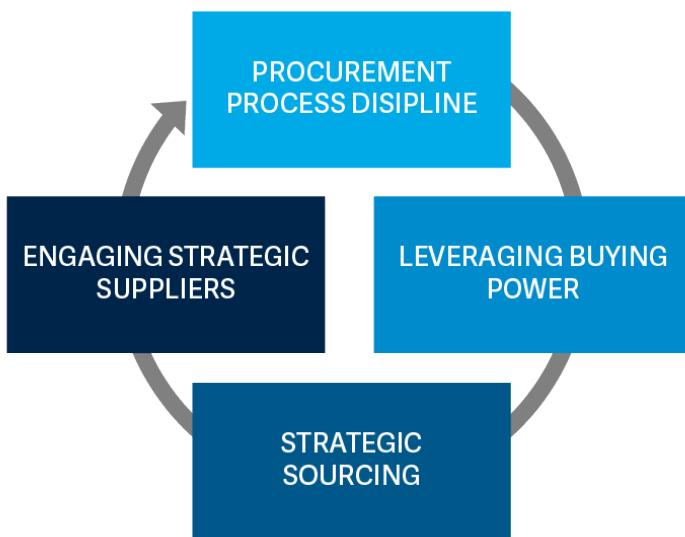
Understanding future value emphasizes the need for procurement to source more strategically. In particular, strategic sourcing means understanding current and potential supplier capabilities and focusing on matching capabilities with customer demand. In this case, it is important to understand how supplier relationships can impact the growth of the buying firm as well as its global footprint. As one executive discussed, strategic suppliers need to understand the buying firm’s plans in different global markets and associate that with the supplier capabilities needed in various regions. In some cases, when suppliers’ skills do not match what is needed in a particular region, it means new suppliers must be qualified. Given that supplier qualification can be an extensive and long process—taking 12-18 months in industries such as pharmaceutical and aerospace—failing to recognize growing supply needs can mean missed market opportunities.

Finally, engaging with strategic suppliers to understand and leverage their unique knowledge and capabilities can enhance the value proposition for the firm. As one manager indicated, “we were looking for low cost suppliers, but they can only give us lowest cost things, and there has been a huge change in that we’re looking for suppliers with capabilities, looking at suppliers with expertise that we don’t have.”

While these four strategic activities are depicted as progressive, it is important to recognize that continual investment is required at each level on an ongoing basis. For example, one executive reported that “you can never take your eye off process discipline or the foundation will quickly erode.” Process discipline isn’t just focused on the buying firm or the way it interacts with its main suppliers, but “having a good process internally to ensure everything is buttoned up (with our first tier supplier), means the tier two suppliers are able to execute an order” as well.

One key procurement process aspect that many firms mentioned involved supplier scorecards or other performance evaluation systems. One respondent, in particular, discussed that his firm's evaluation process had changed substantially over the years after it was recognized that the system had only one-way functionality in that "we measured them, but we didn't get any feedback (on us)." Another manager indicated his firm moved to a blended scorecard where data points were collected across functions, including procurement, research and development, quality, and manufacturing. "Actually tell a supplier what you expect from them, and, it's amazing what they do."

Figure 3
Creating Competitive Advantage



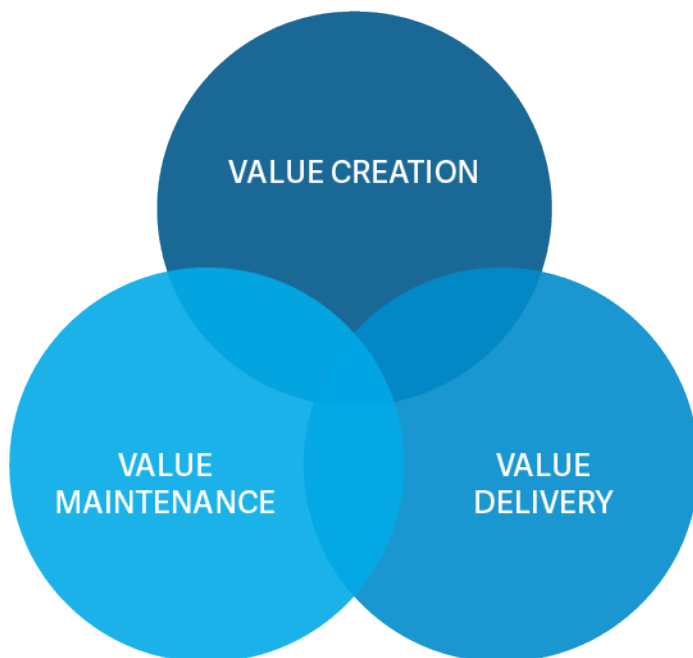
So, in order to achieve strategic impact, firms must connect customers and suppliers in the integrated supply chain. One executive suggested that her supply chain organization is now focused on giving customers the innovation they want and need and not simply delivering on a generic cost reduction goal. Another executive commented, "We need to win at the handoffs" describing how integration will not be achieved without recognition that internal and external connections have to be managed more effectively. Often, this connection involves increased visibility across the supply chain through information sharing. Many participants discussed improved information technology or systems, such as enterprise resource planning (ERP), streamlined demand planning processes that provided suppliers with information sooner, and using different inventory management systems, such as vendor managed inventory (VMI). "The increased visibility certainly makes everything smoother. Not only did we reduce our inventory, but our suppliers also decreased their inventory."

While we often think of integration that connects customers and suppliers, another form of integration connects suppliers with each other. An executive in one firm discussed a collaborative initiative that was linking logistics providers together, particularly across different transportation modes. “Bringing together the air providers, the ocean, ground, 3PLs [third-party logistics providers], custom house brokers, freight payment, and getting them to work more together” has provided greater opportunities. Whether it is to quickly find alternative service on a particular lane that the regular provider cannot accommodate or to work on creating new network opportunities to improve cost or delivery speed, working in a horizontal collaboration can be beneficial.

EXPANDING RELEVANT SCOPE

One of the interesting challenges for procurement and sourcing organizations is how to expand the relevant scope of responsibility in order to provide more opportunity for value creation and strategic impact. When supply chain professionals remain locked in functional silos with functional metrics and limited visibility or responsibility for end-to-end integrative processes, the value potential is limited, and often results in a focus on lowest price. An integrated supply chain includes three processes related to value, as shown in Figure 4: (1) value creation (new product/process/service development); (2) value delivery (customer order fulfillment); and (3) value maintenance (after-sale service and support). This understanding of the role of the end-to-end supply chain in enhancing value is critical for firms seeking to create meaningful outcomes for customers.

Figure 4
Value Perspectives



The interviews illustrated that when procurement and sourcing professionals span traditional functional boundaries, value creation can occur. For example, the earlier that firms can engage critical suppliers in the innovation and co-creation processes, the more likely innovation success will be created. As one manager indicated, “It takes a long time to design a final product, so we want to integrate our suppliers as much as possible into our early designs.” Another manager indicated, “as a heavy engineering company, we [used to] like to create drawings and then thrust them on suppliers, who are probably better at what they do than we are in their specific space... Bringing them in earlier in the design process [is important] because that’s where the cost gets set up.”

Supply chain executives reported expanded opportunities for value creation in new product development and after-sale service and support areas. The ability to bring supplier expertise together to work on challenges beyond traditional procurement and sourcing reach is a new horizon for many organizations. For many firms we interviewed, the ideology has shifted to recognize that “we do not believe everything has to be invented inside our four walls.” Bringing innovation to the market involves more than one’s own firm and innovation may be an innovative service as opposed to product related.

Further, procurement and sourcing professionals will increasingly be called up to understand and mitigate risks as part of value maintenance. Given that a supply chain is only as strong as its weakest link, procurement and sourcing professionals are increasingly expected to identify weak links. Many of the firms in our research project discussed the increasing importance of risk management and the need to develop initiatives to better manage risk. One firm discussed the development of a risk register as a means to formally identify and share risk information across the firm. Sharing often needs to occur across functions (such as marketing, procurement, engineering, manufacturing) as well as across regions (such as manufacturing operations in various countries). This risk registry considers “not just the guys building the parts, the suppliers building the parts or the tools/equipment, but also the sub-tier suppliers... because there is a lot of risk potential even in those lower tiers because of consolidation.” Risk management also involves more focus on compliance. Whether it is social compliance, government compliance, or customer compliance, procurement and sourcing professionals have to be more involved. For example, sourcing from suppliers in the right countries can be a means for avoiding not just duty fees, but also dumping claims.

FACILITATING CO-CREATION

The research has also suggested vast opportunities for supply chain professionals to facilitate co-creation and development of integrative product and service solutions. Firms must move toward a new understanding that value is derived from the ability to combine knowledge and capabilities in new and compelling ways. As one executive reported, “It starts with co-creation...the strategic understanding that you are building something collaboratively.” This perspective was further reinforced by another executive who said, “The thing that is important is to try to figure out how to extract more value out of a relationship to help us meet our joint business goals.”

In order to engage customers and suppliers in product and service co-creation, procurement and sourcing professionals must become involved in innovation activities early in the process. From idea generation to concept development and prototyping, such active involvement provides maximum opportunity for enhanced outcomes in terms of cost, quality, delivery, design, etc. When suppliers are involved later in the process, the cost to make any design changes is substantially higher and the flexibility of the design is substantially lower than when suppliers are involved at earlier stages. The following quote illustrates the importance of early supplier involvement: “We practice quality by design rather than by testing. By the time we test a product, we feel it is too late and too expensive [to change]... So, we want to integrate our suppliers as much as possible into our early designs to get it right the first time.”

Procurement and sourcing professionals recognize that early supplier involvement not only enhances outcomes, but also enables suppliers to bring new innovations to the table. As one participant indicated, “If technology is complex, we bring suppliers in and discuss design ideas together, because our suppliers, of course, know a lot about their manufacturing ability, and we need our own guys to discuss, for instance, serviceability.” In this situation, managers recognize that it is important to consider how the product will need to be serviced after the sale. Early supplier involvement assists in both the quality and cost of the initial finished good, but also in the ability to keep the product in service after the sale.

EARNING PREFERENTIAL TREATMENT

The last approach for creating value is to become a “customer of choice” for your suppliers. It is widely accepted in business that customers have the power to decide who to conduct business with. Less widely accepted is the recognition that suppliers have choices too. This perspective is increasingly important today when limited supplier capacity is becoming a critical constraint in many industries (for example, transportation capacity or supplier consolidation). Further, as one manager indicated, “we were the big gorilla at the plate and I don’t think we estimated the impact we were having” which resulted in lost opportunities for cost savings by not listening to suppliers and failing to create win-win opportunities. As another participant indicated, the “win” needs to go both ways and that’s possible through collaboration. “By showing some of our suppliers some of the things we’ve done to improve speed and reduce cost, we’ve been able to help them.”

In order to attract the best suppliers—those that have capacity and capability to co-create and drive higher levels of value, those that have the best talent, and those that have the best ideas—firms must learn how to become preferred customers. As consolidation reduces the number of superior suppliers, firms must think about attracting those suppliers. One executive recommended that firms should ask suppliers, “Am I your best customer?” Another participant reported, “we are known for caring about our suppliers...” In these situations, trust is key to earning preferential treatment. One manager discussed how his firm had started to recognize suppliers for innovative products and processes as a means for generating trust and building up the relationship.

For many companies, this requires a new way of thinking about strategic sourcing. As one executive indicated, “some people just treat them as suppliers and they beat them up for cost and they beat them up for performance and that’s their whole mentality on how you manage manufacturing and supply chain partners. Our philosophy or my philosophy is much different than that. My philosophy is if we treat them like partners, they feel like partners.” As part of building trust, this executive discussed how his company started having quarterly meetings with strategic suppliers to review business performance and also to share future directions and new developments that may affect suppliers’ operations.

CONCLUSION

If the goal is to create value in integrated supply chains, the research suggests that procurement and sourcing professionals must redefine traditional value concepts, improve strategic impact, extend scope of responsibility, drive co-creation, and earn preferential treatment. “More and more now we’ve realized that the capabilities that our suppliers have are integral and pivotal to our future success ... We know that a unique capability is going to be a project differentiator for the future.” How is your procurement and sourcing team delivering on these recommendations?

ABOUT ELI BROAD COLLEGE OF BUSINESS

Michigan State University's Eli Broad College of Business prepares students to make business happen through an innovative curriculum and collaborative culture, guided by a distinguished faculty. The hardworking, team-oriented students of Eli Broad College acquire deep knowledge of their chosen disciplines and a broad understanding of how global businesses work, enhanced by study abroad and real-world projects in research centers and experiential labs. The college, consistently ranked among the top business schools, offers undergraduate, graduate, and executive development programs. Broad graduates are ready to tackle business challenges around the world, part of an unparalleled peer and alumni network.

ABOUT APICS SUPPLY CHAIN COUNCIL

APICS Supply Chain Council (APICS SCC) is a nonprofit organization that advances supply chains through unbiased research, benchmarking and publications. APICS SCC maintains the Supply Chain Operations Reference (SCOR) model, the supply chain management community's most widely accepted framework for evaluating and comparing supply chain activities and performance. APICS SCC enables corporations, academic institutions and public sector organizations to address the ever-changing challenges of managing a global supply chain to elevate supply chain performance. APICS SCC is part of APICS, the premier professional association for supply chain and operations management. Visit apicsscc.org to learn more.