# Chapter 10

## Relationship Management (Strategic Supplier Relationships)

<table>
<thead>
<tr>
<th>Function</th>
<th>Objective</th>
<th>Tactical Step</th>
<th>Chapter/Appendix</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supply market intelligence</td>
<td>Supply market research</td>
<td>Opportunity identification and validation</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Project approval</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Establishing the team</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Project plan</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>As-is assessment</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Supply market research</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Market forecasts</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>External and market analyses</td>
<td>6</td>
</tr>
<tr>
<td>Strategy and resource commitment</td>
<td>Detailed supplier evaluation and research</td>
<td></td>
<td>7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Evaluate current and alternative strategies</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Understand contract formation</td>
<td>8</td>
</tr>
</tbody>
</table>
306  Supply Market Intelligence

<table>
<thead>
<tr>
<th>Function</th>
<th>Objective</th>
<th>Tactical Step</th>
<th>Chapter/Appendix</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic sourcing</td>
<td>Negotiate and select supplier</td>
<td>Develop relationship strategy</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Strategy position paper</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Develop requests for information (RFIs) and build negotiation strategy</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Negotiate</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Final supplier selection</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Form contracts</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>Implement and promote compliance</td>
<td>Implement contracts</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Transition to relationship manager</td>
<td>10</td>
</tr>
<tr>
<td>Relationship management</td>
<td>Communication</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Improve supplier performance</td>
<td>Measure performance</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Resolve issues and develop supplier performance</td>
<td>10</td>
</tr>
<tr>
<td>Benchmarking processes and</td>
<td>Build an organization for supply-chain excellence</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td>driving continuous improvement</td>
<td></td>
<td>Benchmark performance and drive continuous improvement</td>
<td>12, App. B</td>
</tr>
</tbody>
</table>

10.1 Chapter Outline

- Why relationship management? Ten reasons why you need a dedicated relationship management function
- Making the transition from strategic sourcing to relationship management
- Organize the relationship management team
- The case of software development and proprietary technology
Define the relationship management leader, the team, and the change-management strategy
- Operate the relationship
- Manage performance, monitor relationships
- Common problems
- Strategic versus reactive approaches to supplier development
- Supplier development: a strategy for improvement
- CAPS global supplier development study
- Supplier development efforts that sometimes do not work
- Can you trust the concept of trust in supply-chain relationships?
- Dependence: too much is never a good thing

It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change.

— Charles Darwin

The method of the enterprising is to plan with audacity and execute with vigor.

— John Christian Bovee

When performance is measured, performance improves. When performance is measured and reported back, the rate of improvement accelerates.

— Thomas S. Monson

10.2 Introduction

Once the sourcing strategy is approved, the project closed, and the team disassembled, the member who served as the internal client department representative on the team (either the buyer or purchasing manager) is anointed as the strategy’s relationship manager (RM). This person carries forward the approved strategy, from the plan to implementation. This is particularly important for business relationships that fall into the partnership, alliance, or joint venture categories of the relationship scale discussed in the previous chapter.

The RM is tasked with addressing any operational-level issues that arise in connection with the strategy plan. Such issues could include invoice processing, quality control measures, and follow-up, sharing market forecasts and production schedules with suppliers, coordinating as-needed cooperative technical assistance with suppliers to resolve problems, or pursuing value-building opportunities. The RM also shares communications
with relevant suppliers on emerging issues such as commodity pricing, material availability, and continuous-improvement opportunities. Finally, the RM is also tasked with maintaining a supplier scorecard that provides key information to the supplier on their performance. Many companies are also now using a two-way scorecard that allows the supplier to provide feedback on how well the customer is providing them with information, paying on time, and other key elements of bilateral performance. This ensures that there is a two-way flow of feedback regarding the terms in the contract. Ideally, a standardized scorecard can be used to allow comparison of the relationship with other similar relationships that may exist across the organization, particularly if the supplier is supporting multiple business units with a single contract.

With the recent influx of E-procurement technology into the workplace, many companies are talking about “dehumanizing” supply-chain relationships, and making them more electronic in nature. This works well for standard commodity items that are ordered repeatedly. However, in many situations there is a definite need for human interaction in the form of an RM. The following section argues for having a dedicated RM as against “automating human relationships.”

10.3 Why Relationship Management? Ten Reasons Why You Need a Dedicated Relationship Management Function (Handfield and Nichols, 2003)

In late 2003, I received the following e-mail from Tom Linton, chief procurement officer of Agere Systems, stationed in Singapore.

Bob, I bought your book (Supply Chain Redesign) this weekend and started reading it. It was in a nice display of “recommended” reading at the airport bookstore in Singapore. Having been in both IBM and E2open (supply-chain software) and now Agere Systems … no doubt in my mind, the value is clear. Implementation is complex with competing solutions and agendas. The issue is, even in the same industry, you have too many competing solutions. I noticed CAPS has been pushing the same themes. I liked the way you put it together and got it published.

I am currently focused on building a supply chain which is geographically located with the supply base. This is a huge advantage, as value chains cannot overcome the time zone —
same day impact. The core advantages of key supplier relationship management are also local and cannot be overcome by distance. If we can automate human behavior in these management systems, the value chain will really gain speed.

After reading this e-mail, I started thinking about the notion of automating human behavior. Can it be done? Is it a goal that is desirable? Is it possible? Why would we wish to do so?

At first blush, it seems ridiculous. Humans are not automatons. Yet as I thought about it, I realized that what Tom was really talking about was promoting greater understanding among different people in different geographic locations around the world; getting them to think on the same plane, as a single business or, even more important get them to think that they are all part of the same supply chain (themes that are frequently repeated in this book). As I thought about it further, I realized how critical it was to promote alignment among people, yet how difficult it is. As Tom pointed out, there are no shortcuts in automating human behavior; you have to be “on the ground” and talking to one another. Based on my insights and discussions over the last year or two, I realized how this theme has recurred again and again. The following ten reasons provide concrete examples why human relationships cannot be automated; more important, they also provide us with some ideas regarding how we can better manage these issues.

10.3.1 A Single System Never Works

Every system requires a different approach at each location. For example, in a pilot program implementation of an information visibility solution across six different plants and 50 different suppliers, Johnson Controls, Inc. realized that “a tool is only as good as the business process execution in the plant and the standardization and acceptance of the process across plants … one replenishment method would not work in all situations. Rather, it is better to have several different methods that are executed the same way across the organization” (Handfield and Nichols, 2002).

10.3.2 People Need to Communicate Better

People do not “naturally” communicate. In fact, we found in the results from roundtables with 50 different executives that the primary area in which their people lacked skills was making presentations and communication. The second area? Ethics, information sharing, and communication! Clearly, the new supply-chain managers of the future will need to
be team leaders and be able to go in front of a group, challenge them, and convince them of the need to change.

10.3.3 Better Be Nice to People On the Way Up; You Are Going to See Them Again on the Way Down

Several executives have noted the importance of maintaining supplier relationships in a price-driven economy. This is particularly challenging when conditions in one’s own market are forcing price reductions; it is a natural tendency to pass on the pressure to one’s own supply base. This cost challenge can be particularly difficult when price pressures drive suppliers out of business. How does one manage this problem? The point is that capacity will be at a premium when the economy turns around — and will you still be a preferred customer when that happens?

10.3.4 Strong-Arm Negotiation Tactics Will Hurt You in the End

One automotive executive recently commented:

Many suppliers over the last ten years have taken the lion’s share of their new technologies to [a competitor] because they trusted him. When things went wrong, the supplier would pull out all the stops to help them — including premium transportation, engineering changes, expediting, solving start-up problems, or whatever. They would not do it for us or anyone else, because they felt squeezed, and would not add any more to a part or process because of the additional cost. This competitor in the end paid more for the parts they bought than our company, but saved significant amounts by more than offsetting the cost of the higher price.

In effect, their chief procurement officer set a precedent for managing supplier relationships that until recently was unparalleled in the automotive industry.

10.3.5 The Demise of the Reverse Auction

Many organizations have reverted to reverse auctions as a way of driving costs down. However, recent studies by the Supply Chain Research Consortium (SCRC) have shown that reverse auctions are more likely to cause
harm than good, particularly in terms of supplier relationships. Further, savings down the road through second auctions are unlikely to occur.

10.3.6 Data Means Different Things to Different People

In the E-business era, software developers were selling the vision of global trade exchanges that bring buyers and sellers together on the same platform to clear markets and drive down costs. However, they overlooked the fact that data integration is still a major challenge. In a presentation at North Carolina State University, Stephanie Miles from Bridgepoint noted that data often means very different things to different people on the ground, citing an example of a large retailer in which it took a 5-hr discussion with key stakeholders to determine the meaning of “on-time delivery” in terms of the firm’s data dictionary. Thus, face-to-face conversations are almost always required to attribute meaning to data prior to automating the relationship.

10.3.7 China: Do You Have a Strategy?

China’s entry into the World Trade Organization (WTO) is a reality. If you have not yet thought about what your firm’s China strategy is going to be, it would be a good idea to begin thinking about it now, particularly with respect to supplier relationship management. Unless you understand the people you are dealing with and their connections to local government agencies, logistical pipeline issues are likely to occur. The theme of “being on the ground” and establishing a solid working relationship with Chinese suppliers is also discussed in greater detail in Appendix A.

10.3.8 Channel/Supply Chain Design: Ten Hats Are Better Than One

Cross-functional involvement in supply chain and channel design between internal functions, suppliers, and functional groups are critical. The most obvious example of this is the generic automotive product development process in North America; the design of the vehicle is frozen at least 24 months before start of production. This restriction is partly required because of the detailed production parts approval process mandated for safety reasons, as well as the existing sequential handoffs that occur during the process. The problem in most cases, however, is that purchasing, logistics, and order fulfillment personnel typically have no input into the design until shortly before this deadline — when the decisions have
already been made. How much leverage do these people have in altering the direction of a locomotive that is speeding along at 80 mi/hr on a track that has already been laid two years earlier?

10.3.9 People Are Strange When You Are a Stranger: Geographic Differences

Understanding geographic differences, particularly in the retail industry, can make the difference between a successful and unsuccessful merchandising strategy. Once a product is on the shelf, it is too late. These decisions must be made earlier. Channel design decisions in merchandising have dramatic impacts, but once the product is on the shelf, it is a lot harder to get rid of or sell at a discount; the decisions are a lot less costly to reverse if made earlier in the customer channel design and merchandise process. Analysis of a single product family identified gross discrepancies across price points in terms of inventory turns versus units sold. This data had to be manually extracted from the system; today, the retailer is seeking ways to allow store managers to download this data themselves, to allow them to make better merchandising decisions based on local geographic requirements.

10.3.10 Information Becomes Distorted

Remember the old game in which a word is passed along a line of people and eventually becomes completely different when it reaches the final person in the linkage? This effect occurs with data passed through multiple organizations in a supply chain as well. In fact, a recent study by the SCRC examining forecasts developed by GM and passed backward through a textile supply chain consisting of Lear, Foamex, Textileather, and Milliken, found that although forecast error for Lear was between 5 and 20 percent, it degenerated to 22 percent at Foamex, 28 percent at Textileather, and up to 30 percent at Milliken. To overcome this issue, a shared 20-week forecast provided by GM to all parties in the supply chain was recommended.

10.4 Making the Transition from Strategic Sourcing to Relationship Management

The transition from a strategic sourcing team to a relationship management team is often a rocky road; thus, many teams will tend to avoid it directly. It is important to recognize that this transition is a formal process, which
can be used to ensure that all of the different elements associated with change management, such as a new supplier or a new set of expectations, are closely monitored and that effective communication takes place throughout the process.

As shown in Figure 10.1, there are several groups associated with building and managing a buyer–seller relationship: the relationship management team, the functional sponsor, the relationship manager, the contract administrator, and the customer. The process basically falls into four major “chunks”: organizing, operating, performance management, and continuous improvement. Let us review how this process takes place, and then we will delve into some of the chunks in more detail.

10.5 Organize the Relationship Management Team, Define the Vision

As shown in Figure 10.1, the transition from strategic sourcing to relationship management involves first establishing a relationship vision and a relationship team. The development of the vision and team charter should occur before the final contract negotiations and should be a direct outcome of the sourcing strategy developed in the position paper. The charter should describe the defined benefits, risks, and costs associated with the proposed relationship in light of the discovery and due-diligence findings from the supply market intelligence research. It should establish final key performance indicators (KPIs) for strategy. It should also reflect the internal customer requirements discovered during the early stages of sourcing strategy development. Some of the most common of these are the following:

- Business unit and sourcing strategies for the end products or services should cover, at a minimum, business-unit-level needs in:
  - Cost/price reduction
  - Quality improvement
  - Delivery improvement
  - Product and process technology improvement
  - Reduction in concept-to-customer cycle time
  - Increased responsiveness
  - Other requirements, depending on the nature of product, commodity, or service

- It is important to review how the following requirements will be addressed for the internal customer:
  - Importance of the product to the buying firm
  - How and where the product is used by the firm
  - Price paid
Figure 10.1 Relationship management.

- **Organize**: Organize the supply chain design and strategic sourcing.
- **Manage**: Manage relationships through continuous improvement.
- **Performance**: Ensure performance of the relationship management team.
- **Continuous Improvement**: Continuously improve the relationship management process.

- **Define RM**: Define the relationship management vision and objectives.
- **Define & Select RM Leader**: Select the leader for the relationship management team.
- **Define RM Team**: Define the relationship management team.
- **Establish RM Team**: Establish the relationship management team.
- **Operate RM Teams**: Operate the relationship management teams.
- **Operate Relationships**: Operate the relationships effectively.
- **Sustain and Manage**: Sustain and manage the relationships over time.

Decision Points:
- **Receive Information**: Receive information about changes in the relationship.
- **Monitor Relationship**: Monitor the relationship for gaps and issues.
- **Resolve Issues**: Resolve any issues or gaps identified.

Flowchart includes additional steps and decision points, such as:
- **Major Change?**: Check if there is a major change in the relationship.
- **Gaps Resolved?**: Check if the gaps identified are resolved.
- **Termination**: Termination of the relationship.
- **High-Level Opp?**: Check for high-level opportunities.
- **Take Action**: Take action based on the outcomes of the assessment.

Bookshelf:
- **Define Opportunity**: Define opportunities for improvement.
- **Receive Information**: Receive information about new opportunities.
- **Define & Establish RM**: Define and establish the relationship management process.

The flowchart illustrates a comprehensive approach to managing relationships effectively, ensuring continuous improvement and alignment with strategic goals.
Many of these issues may also come up in the form of specific contractual service-level agreements, or statements of work. It is important to explore these issues in detail and to involve the functional sponsor as well as the supplier in explicitly identifying the meaning of these elements.

In the past, performance was measured very narrowly: Were the costs reduced? Was the cycle time faster? The review was intrinsically one-dimensional. Yes, pass; no, fail. This binary analysis approach is not only overly simplistic and superficial, it rapidly deteriorates into an argument over details. Generally speaking, a team of key individuals who will be the direct recipients of the supplier's products or services should be established and involved in identifying the key metrics and elements for success. This should be done through the following approach:

- Step 1: Conduct cross-functional discussions and benchmarking to establish measures, measurement objectives, and performance targets.
- Step 2: Formalize measurement objectives into written policies and procedures.
- Step 3: Formally communicate measures and objectives to the supply base and key internal users.
- Step 4: Receive feedback from suppliers.
- Step 5: Modify, if necessary, performance measures and their objectives.
- Step 6: Implement final distribution of the measurement objective and process.
- Step 7: Collect and maintain performance data.

At one company, a core set of critical measures included the following:

**Quality:**

- Supplier defects in parts per million
- Internal manufacturing defects in parts per million
316  Supply Market Intelligence

- Internal process capability (Cpk)
- Damage
- Number and cost of warranty claims

Price/Cost:
- Actual price versus market price comparisons
- Price/cost reductions
- Tooling cost management
- Transportation cost management

Cycle Times
- New product development cycle time

Delivery and service
- Supplier on-time delivery

Inventory/Forecasting
- Total inventory dollar value over time
- Raw-material, work-in-process, and finished-goods inventory turns
- Forecast accuracy

Supplier quality performance was determined during on-site supplier visits and statistical inferences from product receipts. The frequency of calculation varies with each supplier's current quality levels. Suppliers with known quality problems or higher levels of defects are targeted for more frequent measurement.

10.6 The Case of Software Development and Proprietary Technology

Service requirements, especially in software development, may necessitate an entirely different approach. This is especially true if it involves the development of proprietary technology. If the nature of the sourcing agreement at least partially involves the development of proprietary technology, then the two companies will need to determine the respective allocations for patent ownership and funding, control over the technology, and returns on investment. The contract’s confidentiality clause also assumes even greater significance in this type of scenario; be sure to include it. All of the key elements that could impact ownership of intellectual property need to be specifically communicated and discussed with the RM and the software vendor in detail prior to handoff by the strategic sourcing team. In software purchases, items that fall in the strategic/leverage quadrant typically require a high number of licenses and maintenance, lengthy contracts, and a high degree of professional services such as consulting. Nonstandard, common contracts are typically
low dollar with little maintenance, highly distributed, with shrink-wrap attached, and few associated professional consulting services. Some of the factors considered in defining the statement of work and the contractual elements to be included are the following:

**Contract execution**
- Terms and conditions
- Strategies
- How much room is there for “give-and-take” in terms of defined deliverables?

**Annual maintenance**
- Specify exactly what the maintenance budget will be, and what the exact level of support will be. This should define the labor class, availability, any added charges, etc. Do you want 8 to 5, or 24/7?
- Will annual maintenance be a professional service, and how much of it will be separated from the level of implementation support during the start-up phase.

**Acceptance of work**
- Revenue recognition — How and when will payments be made based on what final deliverables are provided by the vendor?
- Statement of work — Be as specific and accurate as possible. Be sure to define what is acceptable and what is not in terms of final scope of work and features to be developed.
- Scalability — Will it be an application, a utility, a desktop feature, or a data warehouse? All of these have different scope elements associated with deployment, implementation support, and postsales support.

**Reviews and approvals**
- How many licenses do you need? Will this software be used by a small group, or across the entire organization? Is there a fee for every license or a single fee?
- Will a test product be delivered or an actual scalable product?
- What level of disaster recovery is provided by the vendor?
- What is the expected volume of work associated with delivering the product and what are the deadlines for completion?
- Insurance, audits of performance, information security, and corporate communication channels need to be established.

**Past-execution support and monitoring**
- What is the intellectual property, and who owns in (including residuals)?
- Ownership of works made for hire
- Warranties and representations (beyond defined documentation)
10.7 Define the Relationship Management Leader, the Team, and the Change-Management Strategy

Once the charter has been defined, every agreement should have a scope that clearly defines the nature of the relationship management channels. Who is going to be the direct line of communication and the leader responsible for resolving issues as they arise? Who will define the means for managing the relationship when there are conflicts? The scope should include deliverables, deadlines, and budget.* The scope should also state whether rewards and penalties will be used and if profit is going to be put at risk. It should also describe how a major scope change is to be handled. In some cases of major scope changes, the agreement can be renegotiated. The scope also needs to include nondisclosure statements to address how this situation will be handled to protect the purchasing company’s interest. Finally, the scope needs to include statements as to who has control over the people once the contract is signed. Many of the issues regarding the individuals who will form the sourcing team (considered in Chapter 3) also apply to establishing the relationship management team.

One company we interviewed in stated that when sourcing from a supplier they have not used before, they develop a very detailed project scope. However, if they are using a preferred supplier, the individual project scopes will be limited. This may be due to their long-term relationships with suppliers that allow for work to be released with only a phone call.

10.7.1 Build Change-Management Strategy and Plan

Having established a scope for the relationship management team, the transition should also be carefully defined and managed. What will be the cutover policy from old suppliers to new ones? How will obsolete inventory and materials be dealt with? What is the communication plan — with suppliers, internal users, accounts payable, invoicing, etc? Think of

* Executive interview, March 26, 2002.
all the people who could possibly be impacted by a change from the old supplier to a new one. In particular, communicate change orders, specifications and specific elements regarding delivery, quality, service, and other elements that are important to the end user. The devil is truly in the details on these issues; the specific requirements written in a contract may mean many different things to different people. In the earlier example in which a large retailer needed a 5-hr discussion with key stakeholders to determine what the term “on-time arrival” actually meant in the firm’s data dictionary, it was found that “arrive” in various contexts meant one of the following:

- Arrive final destination — port of destination
- Received into inventory
- Arrive load port
- Arrive destination port
- Unloaded from container
- Out-gate to consignee
- Wheels down
- Portion of shipment received
- Last item of shipment received

The problem of data definition inconsistencies is one of only several major miscommunication pitfalls. Others mentioned by Miles (see Subsection 10.2.6) include:

- Location and code disparities in which different supply-chain member organizations use different sets of codes.
- Time zone reconciliation from disparate systems (e.g., What does “ready for pick-up at 4:00 pm” really mean?)
- The nonlinear relationships and hierarchies between supply-chain documents across different parties provide endless opportunities for error (e.g., shipment line items aligning with bills of lading, purchase orders, purchase order line items, etc.).
- Source system data quality is often poor in terms of timeliness, accuracy, and completeness.
- Data does not meet operational requirements (“I need to know the contents of specific containers on a line-item basis, but my ERP system does not provide that level of detail.”)
- Data is not available when managers need it (“I need to know if my order is being shipped on time, but I do not receive the information until 48 hr after the goods have been shipped.”)

The solution to many of these data problems lies in attributing meaning to data in face-to-face meetings prior to automating that aspect of the relationship. Supply-chain participants need to conduct data definition
summits in which business and technology owners from all source information systems agree to common data definitions for all data exchanged. Participants need to meet and select “common denominators” for real operational events, which ultimately means translating events into consistent definitions. Once agreed upon, the participants should then publish data definition guidelines and a data dictionary. The data dictionary should be reviewed periodically to ensure that it is current and accurate. Business rules for interpreting data based on shared knowledge of trading partners’ systems are also important. When data quality at the source is an issue, participants need to “scrub” the data to ensure that it is accurate and complete. When system constraints prevent data from being consistent, expectations regarding timelines and alerts for missing data need to be established. Information systems are required to effectively link supply-chain member organizations, and they will allow a level of automation in the relationship to be realized. However, the need for face-to-face discussions as well as ongoing communication to develop and implement these information systems should be understood.

The RM team should also understand the elements of change that will be required to deploy the new sourcing relationship across the business, especially the elements of communication. It may also be important to explain to people why the change is necessary. Kotter (1996) recommends the following approaches:

- **Increase urgency:**
  - Show examples of waste or opportunities to relevant people.
  - Describe weaknesses of the current situation, what would happen without change, and how change will create improvements and benefits.
  - Include visualization — graphs and presentations, preferably. Be as specific and detailed as possible.

- **Build the guiding team:**
  - Describe the guiding team and give the reasons why these people became elected.
  - Ensure that it is a team of people with credibility, skills, connections, reputations, and formal authority.

- **Get the vision right:**
  - Describe the vision created by the guiding team.
  - Ensure that the guiding team creates sensible, clear, simple, and uplifting visions.
  - If necessary, use concepts and techniques to create vision.

- **Communicate for buy-in:**
  - Develop a communication matrix with timelines that incorporate results of adoption curve analysis to create buy-in and ensure long-term motivation.
- Recognize that the goal is to induce understanding, develop a gut-level commitment, and liberate more energy from a critical mass of people; symbols speak loudly, and repetition is the key.

**Empower action:**
- Describe risks and obstacles, as well as measures to overcome them.
- Understand that the issue here is removing obstacles and not giving power.

**Create short-term wins:**
- Describe short-term wins, focus on those that have a high possibility of success.
- Remember that wins are critical to provide credibility, resources, and momentum to the overall effort.

**Do not let up:**
- Multiply short-term wins to create momentum; create wave after wave of change until the vision is a reality.
- Remember, momentum builds after the first wins, and early changes are consolidated.

**Make change stick:**
- Describe how you will make change stick (handover, sustain processes, etc.).
- Nurture a new culture through appropriate promotions, skillful new-employee orientation, and events that engage emotions.

### 10.8 Operate the Relationship

Once the contract has been turned over to the relationship management team and leader, it is important to periodically assess the impact that the recommended sourcing strategy has had on operations and in meeting the project’s mission. There will typically be many bumps in the road during the initial period despite the best-laid change-management plans. If the relationship management team has not taken adequate time to promote their program, communicate the changes and define the scope of the changes, then the mission would inevitably fail, resulting in a failure spiral, as shown in Figure 10.2.

The transformation can be challenged by any number of different elements that can hit right at the roots of the change-management team, or escalate up to middle management and executive sponsors. Some of these challenges that may occur early in the relationship management process include the following:

- **Scope crisis:** The nature of the changes required escalate far beyond the initial scope of the proposed changes to the new suppliers.
The changes now go beyond the impact that a single relationship management team can handle and escalate into multiple problems affecting multiple functional and business units.

- **Sniping and rumor mongering:** As the changes associated with scope creep and poor communication get worse, rumors start to fly, and fingers begin to be pointed in every direction.

- **Resource draining:** Middle managers called in to resolve these problems and mend fences find that they are being drawn into the minutiae of the conflicts and are having their time taken away from major projects on which they have been tasked to add value. HR and IT people also find themselves caught in the crossfire and become scapegoats and wet blankets for all the problems.

- **Sponsorship issues:** Executive sponsors may feel they are on a losing team because of the rumors and may switch their positions or even attempt to sabotage the effort.

Once the relationship management team has taken over the ownership of the supply arrangement from the strategic sourcing team, a whole set of other ugly issues may raise their head:

- **Ownership struggles:** Additional scope creep occurs. Internal battles may rage over who is responsible for working with the supplier and communicating expectations and other information.

- **Informed resistance:** The executive team may be aware of the start-up problems and issues and may tacitly ignore them, or even
Relationship Management (Strategic Supplier Relationships)

worse, deny that they exist, hoping that they will go away on their own.

- Disappointment over results: As the early wins predicted for the program do not materialize, executives who are disappointed and at a loss to explain why they have not occurred face the wrath of the corporate council.

- Shock over failures: These early disappointments lead to shouting and further finger-pointing. The situation becomes more tense, and the potential for a total failure of the relationship and sourcing team becomes evident.

This spiral can be avoided if many of the early elements of the relationship are established prior to the “operate” segment of the relationship. Part of the importance of designing the relationship management process lies in identifying the processes to be used when conflict occurs (as it inevitably will). This is described in the next section.

10.9 Manage Performance, Monitor Relationships

The only way to effectively manage a relationship is to monitor and measure supplier performance at regular intervals and provide feedback to your suppliers based on the performance metrics discussed during the negotiation stage. This is a two-way street, as some of the performance failures may be due to internal issues that originate from one or more individuals at the buying company. In effect, you are also asking suppliers to help your company with its developmental objectives; be willing to commit to helping them with theirs. Such aid can come in the form of colocation endeavors. Colocation involves housing some of your company’s staff at the supplier’s site and simultaneously housing some of the supplier’s staff at your company’s site to give both organizations the opportunity, at an empirical level, to learn about the issues and priorities that affect each.

Performance measurement is the first step of a new strategy called supplier development being deployed by many companies, which is closely related to relationship management. Supplier development is a bilateral effort by both the buying and supplying organization to jointly improve the supplier’s performance or capabilities in one or more of the following areas: cost, quality, delivery, time to market, technology, managerial capability, financial viability and environmental concern.

In employing this definition, it is important to identify the hierarchy of strategies that must be established prior to deployment of these practices. As shown in Figure 10.3, firms often begin the process of continuous
improvement through extensive internal training programs to educate company and purchasing personnel in basic continuous-improvement principles. Quality department managers, using two-to-three-day seminars, impart training on continuous improvement, customer satisfaction, basic statistics, and process capability. These initiatives later mature into a focus on the goal of assessing supplier performance. Organizations at this level realize that to improve material quality and performance, a history of supplier performance is necessary for effective decision making and sourcing strategy formulation in the future. Key measures of quality include percentage acceptable versus rejected lots, parts per million defective, warranty percentages, reliability, process capability ratios, percentage of parts rejected and internal/external customer satisfaction. Practices also included developing a cooperative approach to setting specifications, listing of “problem” suppliers, definition of target quality levels, employing common measurement systems across strategic business units, and prequalifying suppliers.

Once assessed, companies often focus on consolidation of volumes with fewer suppliers to eliminate those suppliers incapable of meeting expectations. Supplier databases pinpoint those suppliers consistently unable to perform, resulting in fewer suppliers getting more of the business. This “first cut” of reducing the supply base is fairly easy to implement, as nonperformance is identified once an assessment system is in place. Many of these practices were implemented during the 1980s and early 1990s. An evolution is outlined in Figure 10.3.
Although there are a wide array of problems that can occur in a supplier relationship, clearly establishing and measuring performance is a critical first step. Once the supplier is selected and the relationship is “kicked off”, there are likely to be a series of small bumps that must be addressed on a day-to-day basis.

**10.9.1 Making Changes**

It is not uncommon that contract terms might need updating in light of changing circumstances. If, for example, after the contract is made, the specifications dictated by the functional sponsor change in such a way that additional costs may have to be incurred by the supplier, how should the RM handle the situation? Explore the idea of changing the contract! Talk to the supplier and explain the situation. Specifically, cite the changed circumstance and how it is impacting the scope of the contract. Explain how the contract, as it stands, no longer optimally aligns with the need. As always, be fair and equitable; do not go to the supplier every other month with a list of changes to be made to the contract. But if there are legitimate changes that were beyond anticipation, or even if there was an oversight (e.g., omitting a confidentiality clause), approach the supplier about it. Also, be sensitive to the supplier’s situation, just as you would hope that they would be sensitive to yours. They might not have the resources to be able to adjust the contract the way you would like. And if that is the case, sit down and brainstorm possible solutions that would work for both parties.

It is also important not to make contract changes too often (the initial contract should be well thought out in the first place). But sometimes, things do happen that are beyond our control and are not reasonably foreseeable. In these situations, it is perfectly reasonable to go back to the supplier and seek modification of the contract’s terms.

If the RM asks the supplier to change deliverables, then a proposal to alleviate their concerns should also be offered. For example, if the initial order was for 1,000 widgets in exchange for $5,000, and the order increases to 2,000 widgets, then the price increases to $10,000, for example. Otherwise, the addendum order is deemed a gift and the law dictates that the seller is not obliged to perform, even if they signed the addendum. The legal rationale for this is that the supplier is simply choosing to confer a gift benefit to the buyer, and gifts are purely optional on the part of the giver; so the addendum order is not legally enforceable.

Mutually acceptable changes should be recorded in an addendum, cross-referenced to the altered term from the original contract, or specify if they are new and then describe them fully (keeping in mind the five mandated terms: parties, subject matter, price, quantity, and delivery).
10.9.2 Handling Problems

In any contractual relationship, some bumps are to be expected. Some are more serious than others. If a performance issue impacts the total cost of a supplier’s product, the decision becomes whether to change suppliers or try to resolve the problem with the current supplier. Gauge this by assessing (1) the relationship with the supplier (How strategic are they? How compatible are they in terms of corporate culture?) and (2) the commodity’s strategic value (refer to the portfolio analysis if there is some ambiguity). Performance metrics are critical in identifying the problems that need to be resolved. For instance:

According to our computer tracking database, we have placed 17 separate service repair calls for copier breakdowns in the last month. And in the past year, we have placed a total of 221 service calls. This is a high ratio, and it causes problems at our end of having to wait for the copier to get repaired. We often have to work around the copier’s functioning capability, instead of it working around our copying needs. And we wondered if we might be able to work together in some way and assemble a team from both our companies to really address and resolve the problem.

If the supplier welcomes your recommendation, that is often half the battle won. A written action plan detailing the resolution and itemizing each party’s responsibilities can become an addendum to the contract.

10.10 Common Problems

Common contract problems in supplier contracts consist of nonconforming goods and other types of nonperformance. These performance problems are collectively referred to in the legal field as breach of contract.

10.10.1 Cancellation of Orders and Breach of Contract

A good contract will protect the interests and rights of both buyer and seller. As a result, contractual obligations are equally binding upon both parties to the agreement. In some instances, however, one of the parties to a contractual arrangement may seek to cancel the agreement after it has been made. In other cases, the supplier simply fails to perform in the manner agreed to in the contract. Under these conditions, the buyer will always go back to the original contract to determine potential remedies.
10.10.1.1 Cancellation of Orders

Contract cancellations can generally be classified into three categories: (1) cancellation for default, (2) cancellation for convenience of the purchaser (anticipatory breach), or (3) cancellation by mutual consent.

Cancellation for default can be defined as failure of one of the parties to live up to the terms and conditions of the contract. Supplier actions that can result in this type of breach of contract include late deliveries, failing to meet product specifications, or otherwise failing to perform in accordance with contractual provisions. The types of damages that might be awarded include production cost penalties, additional overtime, or expedited transportation costs. In actual practice, more effective settlements can be reached through negotiation with the supplier rather than through the litigation process.

Cancellation for the convenience of the purchaser, or anticipatory breach, makes the purchaser liable for any resulting injury to the supplier. A general rule here is that the supplier should not be called upon to incur any loss due to the purchaser’s default. Generally speaking, purchasers should stay away from this term altogether in their purchase contracts. The term is highly interpretable in court and can result in any number of negative actions.

Cancellation by mutual consent indicates that cancellation of a previously agreed-upon contract does not automatically lead to legal action. If both parties mutually agree to terminate the agreement then they have, in effect, created another contract with the intent of nullifying the first agreement. If there is no potential loss, the supplier will often accept a purchaser’s cancellation in good faith as a normal risk of doing business. Even when suppliers have purchased special components or materials in anticipation of fulfilling their responsibilities under the agreement, the parties can usually reach a mutually agreeable resolution through the process of negotiation rather than through litigation.

10.10.1.2 Breach of Contract

Under a commercial contract, the supplier is obligated to deliver the goods according to the contract’s terms and conditions, and the purchaser is likewise obligated to accept and tender payment for the goods according to the terms of the agreement. A breach of contract occurs when either party fails to perform the obligations due under the contract without a valid or legal justification. A breach may entitle the offended party to certain remedies or damages.

Buyers should avoid the practice of routinely tolerating suppliers who breach purchase contracts. Doing so may result in the buyer forfeiting the
right to legal action. If the purchaser has systematically accepted late deliveries from a supplier in the past and continues to accept late deliveries even though they must be expedited, then the company may have waived its right to pursue legal action for damages caused by late shipments. For example, to regain his or her legal rights, the buyer must give explicit written notice to the supplier and provide the supplier a reasonable period of time to gear up to meet the new delivery requirements. The new contract should also include the minimal lead time required for design changes, etc.

10.10.1.3 Damages

The concept of damages is based on the remedy of a party being "made whole." In other words, a purchaser who is damaged by a breach of contract must receive damages that bring the purchaser back to the position where he or she would have been if the breach had not occurred. Damages include either actual damages (which include losses that are real, known, or can be reasonably estimated), as well as punitive damages (extra money as "punishment" for the defendant's bad behavior). Normally, punitive damages are not allowed, even if such a provision is contained in the contract. There are essentially three types of damages available to the purchaser:

1. Restitution: money the plaintiff actually paid to the defendant in connection with the contract
2. Reliance: money the plaintiff lost because he or she was relying on the contract, depending on the defendant to live up to their obligations under the contract
3. Expectancy: money the plaintiff was hoping to gain from the contract

There are various methods of calculating damages. General damages are equal to the difference between the value of the purchased goods at the time of delivery and the goods' value at the time of specified delivery. Incidental damages include expenses reasonably incurred in inspection, receipt, transportation, and the care and custody of goods appropriately rejected by the purchaser. Consequential damages are those expenses incurred by the purchaser because the goods were not delivered when expected or as specified. Liquidation damages are those that result if the terms of the contract are not fulfilled, and are typically defined prior to the breach under the terms of the contract.

It should be noted that attorney fees are not recoverable. Also, speculative damages and lost time of executives are not generally recoverable.
The bottom line is that a breach-of-contract lawsuit will rarely make the nonbreaching party completely whole again.

10.10.1.4 Acceptance and Rejection of Goods

The purchaser can accept part of a shipment and reject the remainder for cause, or accept or reject the entire shipment. After the point of acceptance, the supplier’s rights increase and the purchaser’s rights decrease. Once the purchaser accepts the goods, there is only one recourse: make a claim against the supplier. The purchaser does not have the legal right to withhold payment from the supplier once acceptance has been made. The purchaser also does not have the right at this point to send the goods back unless the supplier consents to this action.

The legal concept of acceptance is closely related to the concept of inspection. Purchasers have a legitimate right to inspect contracted goods before accepting or rejecting them. The law is quite explicit when it states that the purchaser should accept the goods within a reasonable time whether or not the goods are physically inspected.

Obvious defects must be discovered and rejected within this reasonable timeframe, or the purchaser has no recourse against the seller. Latent defects are those that could not have been easily discovered during an inspection and do not fall under this rule. In certain limited situations, the purchaser is able to revoke an acceptance of delivered goods. A purchaser may revoke a prior acceptance if a problem is discovered that substantially impairs the value of the goods. Moreover, a purchaser can revoke a prior acceptance when a prior inspection could not take place for reasons not related to negligence on the part of the purchaser.

When the goods delivered by the supplier are actually rejected by the purchaser due to nonconformance, the purchaser must provide notice to the supplier within a reasonable period of time. The purchaser should be specific in notifying the supplier that he or she is in breach of contract. General statements about the problems at hand without stating that the supplier is considered in breach of contract are not adequate notification. The exact terms “breach of contract” must be used, or the purchaser stands to lose his or her right to recourse from the supplier.

Once goods are accepted there are two obligations that the purchaser must meet to recover his or her rights. First, the purchaser must carry the burden of proof that the goods did not conform to the terms and conditions of the contract. Second, the purchaser must, within a reasonable time after the breach is discovered, notify the supplier of that breach or lose the chance for remedy.

Acceptance of the contracted goods by the purchaser means that ownership of the goods has been transferred. There are no rituals or
formalities required to make the transfer of ownership. Any words or acts by the purchaser that provide an indication of the purchaser’s intention to transfer ownership are enough to effect the transfer.

Even though the goods may have been formally rejected by the purchaser, actions typifying ownership may indicate that acceptance has instead been accomplished. To prevent or mitigate problems arising from the acceptance or rejection of goods, a number of steps to manage the acceptance process can be implemented by the purchaser (Hancock, 1986, 22.05–06):

- The receiving department should stamp all receipts of goods with a statement such as, “Received subject to inspection, count, and testing.”
- A thorough set of purchase order terms and conditions should indicate that all receipts from suppliers are subject to inspection, count, and testing.
- All delivered goods should be inspected as quickly as possible, ideally, immediately upon delivery.
- If goods are not inspected until they are used, it is a good idea to maintain a stock rotation system to ensure that older quantities of goods are used first.
- In some cases, purchasers may want to consider inserting language in their purchase order terms and conditions that defines the reasonable time for inspection and acceptance.
- An internal reporting system should be set up to ensure that defects encountered in the organization are reported to the purchasing department within a reasonable time so that remedies can be pursued.
- Contracts for such items as production equipment should contain a clause stating that acceptance will not be made until the equipment has been installed and run satisfactorily for a certain period of time.
- For hardware- and software-related contracts, the purchaser should carefully define the acceptance criteria and notify the supplier of the specific processes that this equipment and software will be subjected to.

10.10.1.5 Honest Mistakes

Sometimes, in spite of the best efforts of the purchaser and the supplier, honest mistakes occur when parties draw up a purchase agreement. In such instances, careful consideration of all the circumstances is necessary to determine whether or not the resulting contract is valid or invalid.
Generally, honest mistakes by a single party to the contract will not void the contract. If the other party was truly unaware of the mistake, then the contract is still intact. Mistakes made by both parties do not necessarily affect the validity of the contract.

Parties must rely on traditional contract law to solve any dispute resulting from a mistake. "As a general rule, a party will not be given relief against a mistake induced by his or her own negligence. But the rule is not inflexible, and in many cases, relief may be granted although the mistake involved some element of negligence, particularly when the other party has been in no way prejudiced" (Hancock, The Law of Purchasing, 10.18–23 18). The rules for determining whether or not a contract exists after a mistake has been made are the basic fairness rules. The judicial system will more than likely allow a supplier to be absolved from the contract owing to a mistake if the supplier gave the purchaser notification of the mistake before the purchaser relied on the bid. Buyers should therefore attempt to minimize the occurrence of contractual mistakes.

### 10.10.2 Dispute Resolution

Disputes can be systemically avoided or mitigated by following the good contract development practices discussed earlier and by consistently practicing good relationship skills (be clear, be fair, be considerate). But even so, parties might have disagreements over the course of the contract relationship/period. Some disagreements are relatively minor, usually due to functional and operational tensions or frustrations. Some disagreements can be nipped in the bud by holding frequent and frank discussions, and by regular, open communications. Some disagreements cannot be so easily set aside. In these cases, more severe actions might be required.

### 10.10.3 Collections

Another option is charge-backs, or collections for nonperformance. Consider the type of relationship with the supplier and the extent of the nonperformance. If the nature of the breach is substantial and the situation warrants switching to another supplier, instigate collections for nonperformance. If initiating collection proceedings, it might be prudent to consult with your company’s legal department.

### 10.10.4 Continuous Improvement of the Relationship

Results from a large-scale survey of over 500 supplier development efforts by Krause (1994) indicate that respondents found supplier development
Supply Market Intelligence

results (measured as supplier performance before the development effort versus after) that included:

- Reductions in incoming defects by 6.2 percent
- Improvement in on-time delivery by 21 percent
- Reductions in order-to-delivery cycle time by 12 days
- Improvement in orders received complete by 8 percent

However, results (shown in Figure 10.4) also suggested that not all of the buyers surveyed were satisfied with the outcomes of their supplier development efforts. Moreover, some supplier development efforts actually resulted in deterioration in the level of satisfaction (Figure 10.5). This was particularly true with respect to supplier performance in product innovation and ability to reduce total cost. A supplier development manager at Chrysler noted that:

Some suppliers do not respond after multiple interventions. Even though they are “saying the right things,” nothing happens. Involvement with suppliers spans between 6 months and 1.5 years on average. During 80 percent of the time, there are significant performance improvements. In 20 percent of the cases, there are none.

So what explains these differences? In many cases, it is the approach to relationship management used to manage performance and continuously improve the relationship.

### Figure 10.4  Supplier development results.

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Before Supplier Development</th>
<th>After Supplier Development</th>
</tr>
</thead>
<tbody>
<tr>
<td>Incoming defects</td>
<td>11.65%</td>
<td>5.45%</td>
</tr>
<tr>
<td>% on-time delivery</td>
<td>79.85%</td>
<td>91.02%</td>
</tr>
<tr>
<td>Cycle time (from order placement to receipt)</td>
<td>35.74 days</td>
<td>23.44 days</td>
</tr>
<tr>
<td>% orders received complete</td>
<td>85.47%</td>
<td>93.33%</td>
</tr>
</tbody>
</table>
10.11 Strategic versus Reactive Approaches to Supplier Development

In 1996, another research effort was initiated through the Global Procurement and Supply Chain Benchmarking Initiative, focusing on supplier development best practices. This research studied written responses from 84 companies to questions regarding supplier development practices, as well as responses to a survey.

As shown in Figure 10.6, companies employed a diverse set of supplier development strategies. Moreover, these approaches can be classified into supplier-specific improvement projects or efforts to improve the capabilities of the entire supply base. Further, initiatives either focused on product-level or process-level improvements.

Companies reporting in the study were classified as belonging in one of two categories: those firms focusing on strategic supplier development or reactive supplier development. The former group of 50 companies was focused on actively concentrating efforts on improving the long-term capabilities of suppliers of the most important commodities, whereas 34 companies with reactive supplier development strategies adopted an ad hoc response to eliminating supplier deficiencies.

As can be seen in Figure 10.7, companies employing a strategic approach to supplier development often focused on improving capabilities of the entire supply base, and then “funneled” these efforts into supplier-specific improvements. On the other hand, reactive companies typically reacted to major deficiencies that arose as a result of a crisis situation (described by one manager as a "burning platform")
Specific techniques/tools/activities that firms employ in supplier development vary. The following framework organizes supplier development:

<table>
<thead>
<tr>
<th>PRODUCT FOCUS</th>
<th>PROCESS FOCUS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supply Base Management Activities</td>
<td>Supplier Quality Assurance programs</td>
</tr>
<tr>
<td>Supplier awareness</td>
<td>Supplier Councils</td>
</tr>
<tr>
<td>Supply base reduction</td>
<td>Quality audits</td>
</tr>
<tr>
<td>Cost savings programs</td>
<td>ISO 9000</td>
</tr>
<tr>
<td>Supplier suggestion programs</td>
<td>Information system developments</td>
</tr>
<tr>
<td>New product development information sharing</td>
<td>EDI/planning systems</td>
</tr>
<tr>
<td>Technology sharing</td>
<td>Provides for Overall Supply Base Improvement</td>
</tr>
<tr>
<td>Part level qualification databases</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Supplier Development Activities</th>
<th>Provides for Specific Buyer/Supplier Improvement</th>
</tr>
</thead>
<tbody>
<tr>
<td>New product development teams</td>
<td>Buyer-supplier alignment</td>
</tr>
<tr>
<td>Sharing forecasts with suppliers</td>
<td>Process mapping</td>
</tr>
<tr>
<td>Value analysis teams</td>
<td>Quality engineering work teams</td>
</tr>
<tr>
<td>Cost savings projects</td>
<td>Joint cost savings sharing projects</td>
</tr>
<tr>
<td>Developing full service supplier capabilities</td>
<td>Supplier training</td>
</tr>
<tr>
<td>Co-location</td>
<td>Supplier certification</td>
</tr>
<tr>
<td></td>
<td>Supplier continuous improvement</td>
</tr>
<tr>
<td></td>
<td>Joint improvement efforts</td>
</tr>
</tbody>
</table>

Differentiating factors: Reactive versus Strategic Supplier Development

<table>
<thead>
<tr>
<th>DIFFERENTIATING FACTORS</th>
<th>STRATEGIC SUPPLIER DEVELOPMENT</th>
<th>REACTIVE SUPPLIER DEVELOPMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary Situation/Question</td>
<td>Are resources available to develop supply base?</td>
<td>What is needed to correct specific problem?</td>
</tr>
<tr>
<td></td>
<td>Where should resources be allocated for best cost/benefit?</td>
<td></td>
</tr>
<tr>
<td>Primary Objective</td>
<td>Continuous improvement of supply base</td>
<td>Remedial</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Correction of supplier deficiency</td>
</tr>
<tr>
<td>Scope</td>
<td>Supply base</td>
<td>Single supplier</td>
</tr>
<tr>
<td></td>
<td>Supplier development program</td>
<td>Supplier development project</td>
</tr>
<tr>
<td></td>
<td>On-going</td>
<td>Ad hoc</td>
</tr>
</tbody>
</table>

Figure 10.6 Approaches to supplier development.

Figure 10.7 Strategic versus reactive supplier development.

Figure 10.8 shows some of the other major differences between reactive and strategic supplier development approaches. Strategic supplier development approaches focus on allocating resources for supplier improvement with the objective of continuously improving the supply base in the long term. This process is undertaken by an executive-level assessment
of critical commodities and suppliers, followed by a focused improvement carried out by a commodity or development team.

Respondents were asked (using an open-ended question) to identify the five most important circumstances, events, or requirements that would be classified as drivers for supplier development. Table 10.1 shows the percentage of respondents within a specific classification (strategic or reactive) that identified the associated driver. For example, 16 of the 50 firms classified as “strategic” identified the goal of developing a strategic partnership as a key driver of their development efforts. The “Diff” column represents the difference between the two groups.

By examining the upper and lower quartiles of the differences between strategic and reactive companies’ key drivers (shaded areas), the differences in the focus of their development efforts emerge. Firms employing a strategic approach to development are more likely to be driven by the proactive need for strategic partnering, technology development, and a focused effort to improve performance of high-volume critical commodities that have a major impact on the business. Reactive firms are more likely to be applying “remedial” approaches for suppliers that represent an immediate crisis or “burning platform.”

Respondents also identified the total number of suppliers currently involved in development programs by choosing the category that best described their situation. Table 10.2 indicates that strategic companies

<table>
<thead>
<tr>
<th>DIFFERENTIATING FACTORS</th>
<th>STRATEGIC SUPPLIER DEVELOPMENT</th>
<th>REACTIVE SUPPLIER DEVELOPMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Selection/Prioritization Process</strong></td>
<td>Portfolio analysis</td>
<td>Supplier “self selects” by being in non-conformance</td>
</tr>
<tr>
<td></td>
<td>Pareto analysis of commodity/supplier</td>
<td>Problem-driven</td>
</tr>
<tr>
<td></td>
<td>Market driven</td>
<td></td>
</tr>
<tr>
<td><strong>Time Frame</strong></td>
<td>Long-term</td>
<td>Short-term</td>
</tr>
<tr>
<td><strong>Drivers of Supplier Development (examples)</strong></td>
<td>Supplier integration</td>
<td>Delivery dates missed</td>
</tr>
<tr>
<td></td>
<td>Supply chain optimization</td>
<td>Quality defects</td>
</tr>
<tr>
<td></td>
<td>Continuous improvement</td>
<td>Negative customer feedback</td>
</tr>
<tr>
<td></td>
<td>Value-added collaboration</td>
<td>Competitive threat for buying firm</td>
</tr>
<tr>
<td></td>
<td>Buying firm’s competitive strategy</td>
<td>Production disruptions</td>
</tr>
<tr>
<td></td>
<td>Customer/market driven</td>
<td>Change in make/buy decision</td>
</tr>
<tr>
<td></td>
<td>Competitive advantage</td>
<td></td>
</tr>
</tbody>
</table>

Figure 10.8 Strategic versus reactive supplier development (cont’d).
became involved in the development of a wider segment of the supply base (in a majority of cases, 50 or more suppliers). Reactive companies generally focused on a smaller group of suppliers. These summary statistics lead us to believe that reactive companies are in some cases still in the process of “rightsizing” their supply base, in eliminating poorly performing suppliers.

A manager at Chrysler noted the following:

Supplier development has been talked about for a number of years at Chrysler, but in my opinion, this was largely lip service. Only recently has the company actually implemented development as a formal activity. Up to now, 80 to 90 percent of supplier development has been reactive in nature, and 10 to 20 percent, strategic. Chrysler’s objective is to reverse this ratio, so that 60 percent is strategic and 40 percent, reactive. This can be achieved by anticipating (proactively) problems before they occur by getting involved in advanced quality processes early in the new product development cycle.
Supplier development is any activity undertaken by a purchaser to improve a supplier’s performance or capabilities to meet the purchaser’s short- and long-term supply needs. Organizations rely on a variety of activities to improve supplier performance, including sharing technology, providing incentives to suppliers for improved performance, instigating competition among suppliers, providing capital, and direct involvement of personnel with suppliers through activities such as training (Krause and Handfield, 1999).

Direct involvement of personnel is undoubtedly the most challenging part of supplier development. Not only must internal management and employees be convinced that investing company resources in a supplier is a worthwhile risk, but the supplier must also be convinced it is in its best interest to accept direction and assistance. Even if a mutual understanding of the importance of supplier development is reached, there is still the matter of making it happen. Effective supplier development requires the commitment of financial, capital, and human resources, skilled personnel, sharing of timely and accurate information between the purchaser and supplier, and timely performance measurement.

### Table 10.2 Strategic Company Involvement

<table>
<thead>
<tr>
<th>Number of Suppliers Currently Involved in Development Programs</th>
<th>Strategic (n = 47) Percentage</th>
<th>Reactive (n = 34) Percentage</th>
<th>Diff. Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>0–5</td>
<td>10.6</td>
<td>17.6</td>
<td>−7.0</td>
</tr>
<tr>
<td>6–10</td>
<td>8.5</td>
<td>8.8</td>
<td>−0.3</td>
</tr>
<tr>
<td>11–15</td>
<td>6.4</td>
<td>17.6</td>
<td>−11.2</td>
</tr>
<tr>
<td>16–20</td>
<td>6.4</td>
<td>0.0</td>
<td>6.4</td>
</tr>
<tr>
<td>21–25</td>
<td>10.6</td>
<td>8.8</td>
<td>1.8</td>
</tr>
<tr>
<td>26–30</td>
<td>4.3</td>
<td>11.9</td>
<td>−7.6</td>
</tr>
<tr>
<td>31–50</td>
<td>8.5</td>
<td>8.8</td>
<td>−0.3</td>
</tr>
<tr>
<td>&gt;50</td>
<td>44.7</td>
<td>26.5</td>
<td>18.2</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Note: The “Diff” column indicates the difference between the two groups.

### 10.12 Supplier Development: A Strategy for Improvement
Supply Market Intelligence

10.12.1 Strategic Supplier Development Process

As noted earlier, the primary differentiator between the strategic and reactive approach is a focus on identifying critical commodities and suppliers requiring development, with the driver being a strategic intent to improve the overall performance of the supply base. The following section describes a process model developed to describe activities used by leading-edge companies in deploying a proactive, strategic approach to supplier development.

In the process shown in Figure 10.9, we differentiate between executive-level and commodity-team-level decisions. The initial steps in the process (steps 1 and 2) are typically carried out by an executive-level team and are often driven by a corporate-level procurement/supply strategic plan. The remaining steps, involving specific commodity and supplier development approaches, are typically formulated, implemented, and monitored by a cross-functional commodity team, and often involve dedicated supplier development personnel.

Once a development project has been initiated, progress must be monitored and tracked over time. Moreover, an ongoing exchange of information is needed to maintain momentum in such projects. This can be achieved by creating visible milestones for objectives, updating progress and, in turn, creating new or revised objectives based on progress to date. Project planning may require modifications to the original plan, additional resources, information, or priorities depending on events.

Figure 10.9 Strategic supplier development process.
Both strategic and reactive firms used formal supplier certification or supplier recognition programs in their development efforts. Approximately 69 percent of the strategic firms and 73 percent of the reactive firms use formal supplier certification or supplier recognition programs. However, the results in Table 10.3 show that strategic companies achieved higher performance relative to prior performance levels for their most successful development initiative, and were better able to identify suppliers requiring improvement in areas such as cycle time, quality, total cost, delivery, customer services, and responsiveness.

In all cases, strategic firms achieve a wider range of benefits more frequently than reactive firms. This may indicate that strategic firms are focusing development efforts across the supply base and are better at actively identifying, with supplier involvement, all of the issues that need to be addressed using a systematic approach.

Leading companies have successfully maintained momentum through a variety of mechanisms, including supplier participation on supplier councils, internal and external newsletters, and communication of key results via supplier performance reports.

Table 10.3  Supplier Performance

<table>
<thead>
<tr>
<th>Performance Area</th>
<th>Strategic (n = 50) Percentage</th>
<th>Reactive (n = 34) Percentage</th>
<th>Diff. Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Order fulfillment cycle time</td>
<td>74</td>
<td>50</td>
<td>24</td>
</tr>
<tr>
<td>Inventory turns</td>
<td>66</td>
<td>47</td>
<td>19</td>
</tr>
<tr>
<td>Inventory obsolescence</td>
<td>50</td>
<td>32</td>
<td>18</td>
</tr>
<tr>
<td>Logistics performance</td>
<td>56</td>
<td>38</td>
<td>18</td>
</tr>
<tr>
<td>Process productivity</td>
<td>62</td>
<td>44</td>
<td>18</td>
</tr>
<tr>
<td>New product/process/service development time</td>
<td>64</td>
<td>47</td>
<td>17</td>
</tr>
<tr>
<td>Quality</td>
<td>90</td>
<td>76</td>
<td>14</td>
</tr>
<tr>
<td>Product/service cost</td>
<td>88</td>
<td>74</td>
<td>14</td>
</tr>
<tr>
<td>Employee satisfaction</td>
<td>38</td>
<td>24</td>
<td>14</td>
</tr>
<tr>
<td>On-time delivery performance</td>
<td>84</td>
<td>71</td>
<td>13</td>
</tr>
<tr>
<td>Total supply-chain costs</td>
<td>68</td>
<td>56</td>
<td>12</td>
</tr>
<tr>
<td>Customer satisfaction</td>
<td>64</td>
<td>53</td>
<td>11</td>
</tr>
<tr>
<td>Technology continuity</td>
<td>44</td>
<td>35</td>
<td>9</td>
</tr>
</tbody>
</table>

Note: The “Diff” column indicates the difference between the two groups.
In 1997, another research effort was carried out by Robert Handfield and Daniel Krause and funded by the Center for Advanced Purchasing Studies (CAPS) and the Center for International Business Education Research (CIBER). The primary thrust of this study was to compare buying firms' supplier development efforts across countries and across industries. Specifically, the research sought to compare buying firms' supplier development efforts in the United States to buying firms' supplier development efforts in the United Kingdom, Japan, and South Korea in the automotive and electronics industries. The focus of the research was on the following question: What are firms in the United States, United Kingdom, Japan, and South Korea in the automotive and electronics industries doing to effectively improve their suppliers’ performance to world-class levels? These industries were chosen because they are generally characterized by high rates of competition, high rates of technological change, and high levels of reliance on suppliers. The firms participating in this research are shown in Table 10.4.

### Table 10.4 Firms Participating in CAPS Research

<table>
<thead>
<tr>
<th>Automotive:</th>
<th>Electronics:</th>
</tr>
</thead>
<tbody>
<tr>
<td>BMW (United States)</td>
<td>Hewlett-Packard (Scotland)</td>
</tr>
<tr>
<td>Chrysler Corporation (United States)</td>
<td>Hitachi (Japan)</td>
</tr>
<tr>
<td>Daewoo (Korea)</td>
<td>IBM</td>
</tr>
<tr>
<td>Honda of America (United States)</td>
<td>(United States/United Kingdom)</td>
</tr>
<tr>
<td>Honda Motor Corporation (Japan)</td>
<td>Intel (United States)</td>
</tr>
<tr>
<td>Hyundai (Korea)</td>
<td>LG (Korea)</td>
</tr>
<tr>
<td>Isuzu (Japan)</td>
<td>NCR (United States)</td>
</tr>
<tr>
<td>Kikuchi (Japan)</td>
<td>NEC (Japan)</td>
</tr>
<tr>
<td>Kia (Korea)</td>
<td>Samsung (Korea)</td>
</tr>
<tr>
<td>Lean Enterprise Research Center</td>
<td>Siemens (Korea)</td>
</tr>
<tr>
<td>(United Kingdom)</td>
<td>Solectron</td>
</tr>
<tr>
<td>Nissan (Japan)</td>
<td>(United States/United Kingdom)</td>
</tr>
<tr>
<td>Plastics Engineering (United Kingdom)</td>
<td>Sony (Japan)</td>
</tr>
<tr>
<td>Prince Corporation (United States)</td>
<td>Scottish Enterprises</td>
</tr>
<tr>
<td>Rolls Royce (United Kingdom)</td>
<td>(United Kingdom)</td>
</tr>
<tr>
<td>Rover (United Kingdom)</td>
<td>Sun Microsystems</td>
</tr>
<tr>
<td>Unipart (United Kingdom)</td>
<td>(United Kingdom)</td>
</tr>
<tr>
<td>Varity Perkins (United Kingdom)</td>
<td></td>
</tr>
<tr>
<td>Welsh Development Agency</td>
<td></td>
</tr>
<tr>
<td>(United Kingdom)</td>
<td></td>
</tr>
</tbody>
</table>
This international research was driven by the need to better understand supplier development in a global context. With the advent of this global era, the rallying cry of organizations has now become: “To compete globally, buy globally!” A common term that is used to reflect this change is *localization*. Localization refers to the capability of an organization to identify and develop a supply base in the markets in which it sells or produces. This strategy is employed for a number of reasons, such as the following:

- Cost of transportation prohibits importing from current supply base in home country.
- Government regulations in the Triad regions (NAFTA, EC, and AFTA) require higher levels of domestic content.
- Companies need to capture superior supplier capabilities in the areas of cost, quality, speed, or technology regardless of where the supplier is located.
- The need to configure products or services to meet local customer needs.

Whatever the reason, many organizations are seeking to develop a globally aligned world-class supply base that not only enables localization of product or service requirements, but can create a competitive advantage in terms of cost, quality, delivery, and technology.

Unfortunately, a great number of barriers lie in store for the purchasing executive seeking to deploy a global supplier development initiative. Although many of the processes for developing a local supply base are well documented, the processes required to deploy this strategy in a global environment are often not well understood.

In the CAPS report, the authors provide a process model that can aid managers in developing world-class suppliers in all corners of the world. The model is illustrated with best practices derived from case interviews and is supported with additional insights from a survey questionnaire. The model is broad enough to be applied to any industry (product or service related), yet must be interpreted and adapted to the reader's unique industry and organizational characteristics. The description of the process model is followed by three cases that provide further insights into the supplier development process. A summary of the results from this research report is provided here.

The primary purpose of this study was to investigate supplier development in terms of its use for companies that are striving to build an integrated and globally aligned network of suppliers. In doing so, the researchers sought to define the processes companies use to build a
globally aligned network of suppliers. Some background questions that were used to initiate the study included:

1. Why is supplier development important? What are the drivers of these efforts? What is the ultimate goal of firms' supplier development efforts?
2. How do supplier development initiatives differ in various international regions?
3. Do supplier development efforts vary based on the goal of the effort?
4. How do buying firms and suppliers benefit from supplier development?
5. What are specific barriers to supplier development in an international context?

The focus of this research report is a model that resembles the process being followed, as a whole, by a group of case-study companies striving to build a globally aligned network of suppliers. The model is depicted in Figure 10.10. Certainly not all the case-study companies had achieved a globally aligned network of suppliers. In fact, not a single case-study company had successfully completed all of the steps in the process model across their entire supply base. Some companies had completed the process in selected regions of their supply base. Most of the interviewees noted that such a network represented the ultimate objective for their organization as they managed and sought to improve their unique set of suppliers.

Building the supplier development process model required a broad view of the case companies' practices and a clear idea of which companies were best at accomplishing a particular step within the model. This report incorporates descriptions of companies' best practices to illustrate the specific steps in the model. Although the researchers would remind the reader that no company had successfully negotiated every step in the model provided in Figure 10.10, many of the companies made similar statements about where their supplier development activities must culminate: a globally aligned supply base.

10.13.1 Key Findings

Before purchasing organizations become involved in supplier development, other supply base management practices such as supplier evaluation and supply base rationalization should already have been deployed. In addition, the company should be able to demonstrate effective internal processes and capabilities. Asking suppliers to adopt practices and techniques
that the buying firm itself has not adopted will only result in a loss of
credibility with suppliers.

The model in Figure 10.10 depicts the three major stages in developing
a globally aligned supplier network. The four stages incorporate a number
of intermediate steps:

10.13.1.1 Step 1: Identify Strategic Supply-Chain Needs

The first step involves the identification of a need for improved supplier
performance. This need should be explicitly identified and aligned with
demander requirements and new product development targets. Such
needs are driven by customers’ product-specific demands in areas such
as cost, quality, delivery, technology and similar objectives, and broader
needs in the areas of competitive priorities, global competition, and supply
base deficiencies. It is important that cross-functional executive input
occurs at this stage of the process because the objective here is to identify
the overall business needs in terms of cost reduction goals, technology
road maps, global market expansion plan, and so on.
10.13.1.2 Step 2: Search for Competitive Suppliers
This stage involves a worldwide search for competitive suppliers based on the criteria established in step 1. Once a targeted global region is identified, a focused search in the region of interest is carried out. This targeted search is often facilitated and carried out in conjunction with local government agencies or partners within the region.

10.13.1.3 Step 3: Establish Performance Metrics and Assess Suppliers
Companies typically established a performance measurement system to assess and track suppliers’ performance over an extended period. Ideally, this should be a real-time system providing immediate feedback to the supplier.

10.13.1.4 Step 4: Rationalize the Supply Base
As a function of the search and assessment, suppliers that are clearly not capable of meeting the company’s needs are eliminated and the supply base is optimized. The outcome of this strategy is a pool of suppliers that are potentially capable of meeting the purchasing organization’s need for products and services.

10.13.1.5 Step 5: On-Site Risk Assessment by Cross-Functional Team
Step 5 represents the first step in a series of true “supplier development” processes. Once a pool of suppliers has been identified, performance metrics are established in the following areas: cost, quality, delivery, cycle time, product and process technology, engineering capabilities, and management skills. A detailed risk assessment of suppliers by a cross-functional team of specialists is performed. This team should spend several days with each supplier, and should note suppliers’ deficiencies and weaknesses as well as their strengths.

10.13.1.6 Step 6: Problem Solving to Eliminate Suppliers’ Deficiencies
This step involves remedial action to correct suppliers’ deficiencies. In effect, this brings suppliers’ performance up to the minimum level necessary to
serve the firm as a supplier. Once all immediate problems are resolved, the outcome is a supply base that is capable of meeting current requirements. In some cases, suppliers are deficient, but the deficiency does not interfere with immediate production requirements. For example, suppliers may lack effective measures or engineering capability, or they may have process inefficiencies. These problems are noted and targeted for improvement on a longer-term horizon.

10.13.1.7 Step 7: Establish Open Relationship through Feedback and Information Sharing

This step precedes proactive development of the supplier’s capabilities and is initiated by establishing an open dialogue with the supplier’s top management. It is here that the “future-action-required” items (from step 5) are revisited and brought to management’s attention.

10.13.1.8 Step 8: Systematic Supplier Development through the Use of Direct-Involvement Activities, Incentives and Rewards, and Warnings and Penalties

Techniques for supplier improvement projects may include kaizen breakthroughs, process mapping, inventory reductions, training, total preventive maintenance, and other joint projects. These techniques are complemented by the use of award programs and increased business for the best suppliers, which serve as incentives for improved performance. Other techniques include introducing competition for the company’s business and taking business away from poor performers.

At this step, a different combination of approaches may need to be adopted, depending on the specific set of circumstances with any given supplier. This is particularly true when dealing with global suppliers in different parts of the world. The same supplier may have a very different set of issues at a U.S. plant as against a German or Japanese plant, requiring a completely different approach. One manager we interviewed at BMW emphasized this:

In the case of BMW in the United States, a very different approach was required. In Germany, the plants are established, and they have a group of suppliers who have a given level of understanding with respect to what we want. Here, however, communication with domestic suppliers requires sharing and a hands-on-support attitude. We have to spend time asking them,
“What is your corrective action plan, and we will check on you from time to time.” We need to suggest possible ways to put solutions in place — Which actions are more beneficial in a start-up phase?

At Honda, a similar issue was noted by one manager we interviewed in Japan:

Unfortunately, there are very few cases of truly global suppliers. For instance, R&D is very efficient in Japanese suppliers, but these same suppliers may not be effective at R&D in a different location. Thus, it is very seldom that they find a supplier that can supply multiple locations, yet locating these suppliers is one of Honda’s most important development strategies. Finding good suppliers to serve both the United States and Japan is not a problem; few suppliers, however, have truly global capabilities.

10.13.1.9 Step 9: Maintain Momentum
Appropriate incentives for improvement should be developed to ensure that the improvement effort is not limited to a single process. The supplier must be encouraged to maintain a momentum for improvement and to make continuous improvement a part of the company philosophy. The outcome of a successful development strategy is a self-reliant supplier who can initiate its own improvement projects based on performance feedback from the focal purchasing organization.

10.13.1.10 Step 10: Supplier Integration in New Product/Process Development
Development continues with the integration of suppliers into the purchasing organization’s supply-chain network. This process may begin as the supplier provides input into the development of new products, processes, and services through mechanisms such as colocation, “guest engineers,” and sharing of technology road maps.

10.13.1.11 Step 11: Establish Performance Improvement in Second-Tier Suppliers
As an ongoing dialogue between the two organizations develops, mapping of the “extended enterprise” should include an assessment and potential development of second-tier suppliers, suppliers to first-tier suppliers.
10.13.1.12 Step 12: Establish Integrated Supplier Network

Over time, the focal supplier will become part of the organization’s global supplier network, may be responsible for supplying multiple global locations, and may participate in global growth opportunities. As more suppliers achieve this capability, the final objective is to achieve a globally aligned supplier network. It should be noted that even the most advanced organizations interviewed in this study were yet to achieve this level of integration. Thus, this objective remains a benchmark for organizations to strive for in the future.

This is a highly challenging goal. Some of the challenges noted by a manager at Honda include:

- How much has Honda done to challenge the “mother” supplier to transfer technology to its “children”?
- How to get the mother company to communicate value analysis and cost reduction ideas to their children?
- How to enable the global network to communicate cost reduction opportunities, yet not use them exclusively to their advantage when they do so?
- How to get Honda associates to force their local supplier to go back to the mother company and get help from a guest engineer or other form of expertise?

Some of the critical issues to consider in making this happen include:

- Intensive negotiation and joint understanding and commitment at the top-management level in the supplier.
- Participation by top management within Honda.
- A common investment for multiple locations. For example, Siemens supplies air bag control units to Honda’s plants in both Europe and the United States to minimize the investment in tooling. However, the control units are actually produced by the supplier’s Mexican plant. Because the units are small, they can easily be shipped to both the United States and Europe.
- Emphasizing competition; if a supplier already provides Honda with parts in, say, the United States they certainly have a leg up over other suppliers in being considered for supplying Honda’s new facility. This is because they already know what the expectations are.
- Honda places great value on a supplier’s ability to improve; for example, if a supplier has provided defective products, but immediately takes countermeasures to prevent it from happening again, this is considered a “plus” by Honda.
We conclude with a final metaphor shared by a Japanese manager regarding the importance of supplier development in Honda’s competitive strategy:

Every new product cycle is like a 110 meter hurdle race. The hurdles are the same for all of the racers, yet some are able to master them better than others. They include factors such as quality problems, lack of trust, cycle time, FMEAs, customer requirements, new technology, etc. The finish line represents the product release. In every race, there is always a winner. The winner ultimately captures market share, profits, satisfied customers, etc. Generally, the winner is the one who is able to leap (i.e., manage) all of the hurdles and run (i.e., deploy the strategy) quickest. However, once the race is over, the racers continue to jog around the track getting ready for the next 110 meter race, which represents another chance to win. Although you did not win this time around, by the time you go around the track again next time, you may be a contender. One way of positioning supplier development is to understand what are the best practices at each of the hurdles that can turn contenders into winners. As the race continues, priorities will shift according to the nature of the hurdle.

### 10.13.2 Results of Supplier Development

The results of supplier development initiatives, although often difficult to identify and define, vary in scope and degree of success. Results can be largely grouped into three separate categories: improvements in suppliers’ performance and capabilities, improvements to the relationship between the buying company and the supplier, and improvements in the buying firm’s competence in managing suppliers. Some of the results reported by companies surveyed in the United States are shown in Table 10.5.

### 10.14 Supplier Development Efforts That Sometimes Do Not Work

Evidence indicates that supplier development projects work — at least some of the time. Although there is no guarantee that supplier development efforts will be equally successful, on average the development process produces worthwhile results. This does not mean that barriers to successful supplier development do not exist. In fact, other studies have found these barriers to be very real. The following subsection describes
some of the techniques and tools used by leading-edge companies to address the problems or barriers that may contribute to reduced supplier development effectiveness.

### 10.14.1 Overcoming the Barriers to Supplier Development

The barriers to supplier development fall into three categories: (1) buyer-specific barriers, (2) barriers that focus on the interface between the purchaser and the supplier, and (3) supplier-specific barriers. Companies use a variety of approaches to overcome barriers to supplier development. In general, these approaches fall into one of three categories:

- **Direct-involvement activities** ("hands-on"): Companies often send personnel to help suppliers. These efforts are characterized as hands-on activities in which buying-company representatives are directly involved in correcting supplier problems and increasing capabilities.

- **Incentives and rewards** ("the carrot"): Companies also use incentives to encourage suppliers to improve, largely on their own. For example, a purchaser may increase order volumes if improvement takes place within a specific time or hold annual award ceremonies to recognize the best suppliers.
Warnings and penalties ("the stick"): In some cases, companies may withhold potential future business if a supplier’s performance is poor, or a lack of improvement is evident. Purchasers may also use competition to provide a competitive threat to a poorly performing supplier.

In many cases, organizations employ a combination of these three strategies to elicit improvement as quickly as possible, applying the strategies judiciously in response to a particular supplier’s needs. The following subsections address barriers that are internal, external, or interface based, and provide examples of how leading companies overcome these barriers.

10.14.1.1 Buyer-Specific Barriers

A buying company will not engage in supplier development if management does not recognize the need or the benefits from the supplier development effort. Moreover, if purchasing personnel have not consolidated purchased volumes with fewer suppliers, the size of the company’s purchases with any particular supplier may not justify the investment. In addition, there is sometimes a lack of executive support for financing supplier development efforts.

10.14.1.1.1 Barrier: The Buying Company’s Purchase Volume from the Supplier Does Not Justify Development Investment

10.14.1.1.1.1 Solution: Standardization and Single Sourcing — Parts standardization is a way to increase volume orders with suppliers, which may help justify a development effort. For example, IBM’s Networking Hardware Division, which produces customized networking solutions for customers, is constantly striving to increase parts commonality. Currently, over 50 percent of purchased components for major hardware projects contain unique items. If IBM personnel believe customized components will provide a market advantage, they will continue to use it. However, standardization remains an important way to leverage worldwide purchases.

Concurrent with the drive to standardize parts, many purchasing managers plan to reduce their supply base, wherever possible, to achieve economies of scale. Daewoo Corporation, for example, uses single sourcing wherever possible, relying on two or more suppliers only in situations with high potential for labor disputes. Similarly, NCR, Doosan Corporation of Korea, Honda of America Manufacturing, and Rover are currently using, or are planning to move toward, single sourcing.
10.14.1.1.2 Barrier: No Immediate Benefit to Supplier Development Is Evident to the Buying Organization

10.14.1.1.2.1 Solution: Pursue Small Wins — Varity Perkins, a producer of diesel engines used in automotive and construction vehicles, found its initial supplier development efforts to be relatively unsuccessful. This resulted in lowered expectations internally and dampened enthusiasm for future efforts. However, Varity personnel realized that part of the problem was that they were trying to accomplish too much. Thus, the company focused on a smaller group of suppliers for kaizen (continuous improvement) efforts to gain a series of small wins. Varity’s kaizen approach achieved incremental improvements that ultimately gained renewed commitment from internal parties.

10.14.1.1.3 Barrier: Importance of Purchased Item Does Not Justify Development Efforts

10.14.1.1.3.1 Solution: Take a Longer-Term Focus — Solectron, a contract manufacturer in the computer industry, has a competitive strategy that relies heavily on its supply-chain management competencies. The company looks beyond the price of purchased inputs and examines how its most important suppliers affect the quality and technology of its products. Solectron expects its suppliers to provide designs offering integrated solutions that their engineers can use in future product designs. Total costs and long-term strategic impact help justify investments in suppliers.

10.14.1.1.4 Barrier: Lack of Executive Support within the Buying Organization for Supplier Development

10.14.1.1.4.1 Solution: Prove the Benefits — Support for supplier development is gained when management becomes convinced that company performance can improve if supplier performance improves. For companies that spend nearly 80 percent of the cost of goods sold on purchased inputs, such an argument is easy to make; for companies with lower percentages, the argument may be more difficult. Although a specific relationship between supplier improvement and increased profits may be difficult to prove, somebody within the purchasing organization must demonstrate that outcome. Managers also note that efforts to optimize their companies’ supply bases combined with part standardization can free up resources over the long term, making supplier development more acceptable. In addition, the total-cost approach to supplier performance
measurement should also prove to be an effective communication tool for demonstrating the effect of poor supplier performance. Many companies view supplier development resources as additional overhead costs rather than investments in supply-chain performance.

10.14.1.2 Interface Barriers to Supplier Development

Barriers may also originate in the interface between the purchaser and supplier in areas such as communication, alignment of organizational cultures, and trust. A reluctance to share information about costs and processes is one of the more significant interface barriers to supplier development.

10.14.1.2.1 Barrier: Supplier Is Reluctant to Share Information on Costs or Processes

10.14.1.2.1.1 Solution: Create a Supplier Ombudsman Position — Honda of America (HAM) has supplier ombudsmen who deal with the “soft side of the business,” primarily the human resource issues that are not associated with cost, quality, or delivery. Because an ombudsman is not involved in contract negotiations, suppliers are often much more willing to talk with the ombudsman, who often acts as a liaison between the two companies. One ombudsman emphasized that it takes time to build trust with suppliers, and this period varies with different suppliers. If a supplier approaches the ombudsman with a problem that is the result of poor communication or misunderstanding between Honda and the supplier, the ombudsman communicates the supplier’s perspective within Honda while maintaining as much confidentiality as possible. Over time, suppliers have come to trust the ombudsman, and appear to be more willing to share information with the company.

10.14.1.2.2 Barrier: Confidentiality Inhibits Information Sharing

10.14.1.2.2.1 Solution: Confidentiality Agreements — Perhaps one of the biggest challenges in developing suppliers is sharing confidential information, especially when dealing with suppliers in high-technology areas. Thus, many companies require nondisclosure agreements and even exclusivity agreements (i.e., the supplier provides a specific product to only one purchaser) in development efforts, especially when dealing with technologically advanced products that contribute to the buying company’s competitiveness. Nondisclosure agreements can benefit both parties.
Ethical behavior on the part of the buyer will also support the open sharing of information with suppliers.

10.14.1.2.3 Barrier: Supplier Does Not Trust the Buying Organization

10.14.1.2.3.1 Solution: Spell It Out — The driving forces behind the kaizen events at Varity Perkins indicate that the company will not run a kaizen without a signed agreement between the company and supplier. Although some procurement personnel at Varity Perkins prefer a gentleman’s agreement, kaizen leaders believe the only way to gain a supplier’s trust is to have the terms written and signed, especially when conducting the first few supplier development events. In one instance, it took Varity Perkins eight months to convince a supplier to consider a kaizen workshop because the supplier felt that a similar event with a different company failed to yield any improvements. The trust problem was compounded because Varity Perkins previously had a reputation for “arm’s-length” relationships with suppliers, manifested by frequent switching of suppliers based on price. The company has moved aggressively to reverse this perception through a revised purchasing philosophy emphasizing cooperative relationships with suppliers.

10.14.1.2.4 Barrier: Organizational Cultures Are Poorly Aligned

10.14.1.2.4.1 Solution: Adapt New Approach to Local Conditions — When setting up production in South Carolina, Bavarian Motor Works (BMW) quickly realized it would have to change its supplier development approach to conform to North American supply conditions. BMW uses a “process-consulting” approach to supplier development in Germany, which involves analyzing suppliers’ processes and telling them what is wrong. This approach works well in a mature supplier relationship, in which the supplier intuitively understands what the customer wants because the parties have worked together over a number of years. In the United States, however, a very different approach was required.

When BMW started production in the United States, suppliers had difficulty in understanding what was required of them in terms of quality and continuous improvement. This misunderstanding resulted in strained relationships. Consequently, BMW spent a great deal of time communicating its expectations with suppliers. Eventually, BMW published a supplier partnership manual that clearly delineates supplier responsibilities and expectations. The company also held supplier seminars to present
their “road map to quality.” These efforts have helped align expectations and create a shared culture toward improvement.

10.14.1.2.5 Barrier: Not Enough Inducements to Participate Are Provided to the Supplier

10.14.1.2.5.1 Solution: “Designed-in” Motivation — Although Solectron is now generally able to offer large order volumes to suppliers, that was not always the case. To gain supplier cooperation in the low-volume years, Solectron emphasized that a supplier could become “designed in” to its products and thus have a greater potential for future business.

10.14.1.2.5.2 Solution: Financial Incentives — Hyundai Motor Company uses financial incentives as one motivational tool for suppliers to improve. The company rates supplier performance from 1 (highest) to 4 (lowest). Class-1 suppliers receive cash, class-2 suppliers receive payment in 30 days, class-3 suppliers receive payment in 60 days, and class-4 suppliers receive no new business. Because suppliers know how Hyundai evaluates their performance, they can take the steps necessary to ensure higher levels of performance.

10.14.1.3 Supplier-Specific Barriers

Just as buyers sometimes fail to recognize the potential benefits from supplier development, a lack of recognition may also keep the supplier’s top management from committing to the effort. This lack of commitment may result in a failure to implement improvement ideas or to provide the necessary technical and human resources to support the development process.

10.14.1.3.1 Barrier: Lack of Commitment on the Part of Supplier’s Management

10.14.1.3.1.1 Solution: Implement after Commitment — Varity Perkins’ managers state that they will not engage in a supplier development project with a supplier unless the supplier is fully committed to the process. A buyer from Varity Perkins arranges an initial contact meeting with the supplier’s managing director to obtain direct involvement. To secure commitment, Perkins quality managers educate the managing director at the supplier about the impact of the improvement efforts. They explain the process then ask him or her to participate in one of the weekly internal
improvement events at Perkins. If the managing director is positive about the experience, a kaizen awareness session for the supplier's senior management takes place at the supplier's facility. Varity Perkins asks the supplier to commit its workforce to the project, which typically involves eight to ten operators for one week.

10.14.1.3.2 Barrier: Supplier’s Management Agrees to Improvements but Fails to Implement the Proposals

10.14.1.3.2.1 Solution: Supplier Champions — JCI Corporation, a first-tier supplier to the automotive industry, has instituted a supplier champions program (SCP) designed to ensure suppliers who are proficient in areas that are important to JCI’s customers. JCI initiated the program because many of the suppliers who had attended JCI’s training sessions failed to implement the tools and techniques that JCI had provided. The SCP identifies what suppliers’ personnel need to implement after they return from training. The program designates a supplier champion, an employee at the supplier unit who understands JCI’s expectations and demonstrates a high level of competence. A certification process requires that the champion submit to JCI a number of examples of actions that the supplier has taken to improve. These actions might include process-flow mapping, failure mode effects analysis, quality control planning, best practice benchmarking, and process auditing.

10.14.1.3.3 Barrier: Supplier Lacks Engineering Resources to Implement Solutions

10.14.1.3.3.1 Solution: Direct Support — HAM has invested a significant number of resources in its supplier support infrastructure, which this chapter has highlighted in the earlier sections. Of the over 300 people in HAM’s purchasing department, 50 are engineers who work exclusively with suppliers. In one case, a small supplier did not have the capacity to cope with volume, resulting in quality deterioration. HAM sent four people to the supplier for ten months at no charge, with additional services offered on an as-needed basis. The supplier improved and now is a well-established Honda supplier.

10.14.1.3.4 Barrier: Supplier Lacks Required Information Systems

10.14.1.3.4.1 Solution: Direct Electronic Data Interchange Support — At NCR Corporation, a manufacturer of ATMs, managers note that timely and accurate information is critical to decision making and, ultimately, to
Supply Market Intelligence

improved performance. An important focus of their supplier development efforts has been to get suppliers to make a commitment to electronic data interchange (EDI) with a significant amount of money committed to getting suppliers online. NCR provides direct help to suppliers producing lower-level components who do not have resources to get online. In addition, NCR provides training for suppliers and will help make recommendations on hardware and software.

10.14.1.3.5 Barrier: Suppliers Are Not Convinced Development Will Provide Benefits to Them

10.14.1.3.5.1 Solution: Let Suppliers Know Where They Stand — Varity Perkins revamped its supplier evaluation system to show suppliers where they could improve. Previously, the company sent a report to suppliers once a quarter that assessed quality, delivery, and price competitiveness performance. Perkins did not use the data in any manner and suppliers did not take the assessments seriously. When revamping the system, the measures were changed to capture the impact of supplier performance on daily operations.

Varity Perkins measured delivery performance using a weekly time bucket for performance, and average on-time performance was 90 to 95 percent. With a daily time bucket, performance dropped to 26 percent on time. Since the introduction of the new measure, daily on-time delivery has improved to 90 percent. The supplier's history, its performance compared to Varity's other suppliers, and the deviation from mean performance for each performance area also appear on the modified report. The report also uses more graphics to make the data more meaningful.

This system has become the foundation for the company’s supplier development program. By allowing suppliers to view their performance relative to competitors, the company expects that suppliers will see the potential benefits of participating in supplier development activities.

10.14.1.3.6 Barrier: Supplier Lacks Employee Skill Base to Implement Solutions

10.14.1.3.6.1 Solution: Establish Training Centers — JCI Corporation realized that some suppliers lacked the skills required to implement improvement ideas. With this problem in mind, JCI built a facility dedicated to providing training to internal groups, suppliers, and customers. Hyundai has also established a domestic training center that provides supplier personnel with training in areas such as specialized welding. The suppliers and Hyundai share the cost of this effort equally. The Korean government
also supports these training centers by providing tax benefits for building training centers and making the training fees shared by Hyundai and suppliers tax exempt.

10.13.1.3.6.2 Solution: Provide Human Resource Support — Hyundai Corporation recognizes that smaller suppliers with limited resources cannot consistently recruit and retain the most skilled engineers. Therefore, the majority of Hyundai’s improvement efforts focus on smaller suppliers. Hyundai selects engineers from its own shops to spend time with suppliers. The engineers “live” at the suppliers, performing time and motion studies, teaching layout design, and improving productivity. Suppliers are consistently encouraged to learn, apply, and eventually teach themselves and second-tier suppliers the transferred knowledge.

10.15 Can You Trust the Concept of Trust in Supply-Chain Relationships? What Does It Mean to Trust?

One of the most misunderstood and ripe areas for research in the area of supply-chain relationships is that of trust. Trust (as well as its cousin, collaboration) seems to be the single most discussed element in making supply chains function effectively and efficiently. Barber notes that:

*In both serious social thought and everyday discourse, it is assumed that the meaning of trust and of its many apparent synonyms is so well known that it can be left undefined or to contextual implications.* (Barber, 1983:7)

This observation is corroborated by the evolution of trust in the fields of industrial economics, organizational behavior, marketing, and organizational theory. Of all the elements critical to managing supply chains, trust is one of the most commonly cited elements, yet one of the most difficult to measure.

A comparison of the various definitions of trust across research disciplines shows that trust can be grouped into eight conceptual paradigms (shown in Table 10.6). In paradigm one, the authors posit that trust is a cognitive predictability or reliability of another party. The second paradigm addresses the competence of a party as a component of trust. In the third paradigm, a recognition of trust as an altruistic faith or goodwill felt toward another party is proposed. The fourth paradigm relates the concept of vulnerability to trust. Paradigm number five specifies that loyalty-based
trust exists when a partner consistently goes beyond the call of duty. The sixth conceptual paradigm recognizes that multiple components of trust exist, which are defined by cognitive (reliability or task) trust and affective (altruistic) faith trust. The seventh body of theory adopts some of the most recent definitions of trust that combine vulnerability and the notion of affect- and cognition-based trust. The final conceptual paradigm combines these different perspectives into a concept we define as nonpartisan trust. Nonpartisan trust assumes that the actors do not focus solely on the trustworthiness of the other party but consider their relative vulnerability, as well as the cognition and affect-based trust demonstrated by themselves and the other party. In the following subsections, we identify each of these representative paradigms, which are drawn from the marketing, organization theory, sourcing, and organization behavior literature streams (see Table 10.6).

**10.15.1 Reliability**

Reliability can be broken down into several elements. Reliability is dependent on prior contact with a party, or experience. Repeated interaction over time leads to levels of confidence, consistency and, finally, trust. Reliability then leads to predictability, which is confidence in future actions. Although reliability is important, what motivates reliability is often more important. Reliability must be based on integrity or honesty to be

<table>
<thead>
<tr>
<th>Body of Theory</th>
<th>Definition</th>
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<tbody>
<tr>
<td>1. Reliability</td>
<td>Time and experience are critical elements in evaluating trust</td>
</tr>
<tr>
<td>2. Competence</td>
<td>Experience and wisdom displayed by partner</td>
</tr>
<tr>
<td>3A. Goodwill (openness)</td>
<td>Confidence that you can share information or problems with the other party</td>
</tr>
<tr>
<td>3B. Goodwill (Benevolence)</td>
<td>Accepted duty to protect the rights of your partner</td>
</tr>
<tr>
<td>4. Vulnerability</td>
<td>Being unprotected or exposed while including an element of uncertainty or risk</td>
</tr>
<tr>
<td>5. Loyalty</td>
<td>A partner is not just reliable but performs well in extraordinary situations</td>
</tr>
<tr>
<td>6. Multiple forms of trust</td>
<td>There is more than one type of trust</td>
</tr>
</tbody>
</table>
effective. Reliability based coercion or stress eventually creates a suboptimal relationship or total breakdown.

A series of definitions define trust in terms of a firm or person's reliability or expectation of performance. Deutsch (1958) created one of the first definitions of trust, which accepted the extreme position that for trust to be present, expected loss must be greater than expected gain. Authors after Deutsch extended trust as an expectation to include situations in which expected gain is greater than loss. Reliability can often be confused with predictability. Reliability primarily addresses a party's past behavior, whereas predictability actually takes past behavior and other information to address probabilities of future performance. Reliability and predictability are closely related terms, and definitions addressing either term fall into this body of theory. Firms or people who meet a threshold level of predictability can by definition be trusted. This paradigm is best described by the following definition:

Trust is a range of observable behaviors and a cognitive state that encompasses predictability (Rossiter, Charles, and Pearch 1975).

What this means in simple terms is that trust is not something that occurs overnight, but is built up over time through repeated interactions and acts of good faith. For example, a long-term customer relationship may be based on a continuous discussion of problems that occur and are resolved over time. I recall at a meeting between a senior vice president of purchasing and a senior vice president of marketing from two companies with a ten-year history of a solid business relationship. The vice president of marketing noted that the reason the relationship worked is that, “whenever there was a problem or conflict, I was able to march over to his office, shut the door, lay it out on the table, and work it out! Sometimes it took a few hours, but when I came out, we both felt better about the situation.”

10.15.2 Competence

Competence is one’s perception of the ability of a party to meet commitments. Competence-based trust can be broken down into three key areas. First is specific competence, which is trust in the other's function or area. Second, interpersonal competence is the ability of a person to work with people or people skills. Finally, business sense, addresses a person's experience, wisdom, and common sense. A key result of this research is that to trust a supply-chain partner, you have to have some confidence
that they are able to do the work effectively. For a procurement manager, this might mean visiting a supplier and evaluating them to ensure that they have the facilities, people, and knowledge to carry out the contract.

10.15.3 Goodwill

This was first defined by McAllister (1993), and is identified with a heavy dependence on openness between people and emotional investment in the relationship. Affect-based trust could almost be confused with interpersonal or personal trust because personal issues creep into the relationship in terms of problem solving, listening, and sharing. A key distinction between cognitive and affect-based trust is that whereas cognitive-based trust may or may not exist at the interpersonal level, affect-based trust almost always exists only at the interpersonal level. The importance of interpersonal relations is recognized to be an important element of trust (McAllister 1993; Granovetter 1985).

Beyond reliability or predictability, trust can also be defined in terms of a faith in the goodwill of others. This faith recognizes the importance of interpersonal relations as an important element of trust. This new type of goodwill-based trust evolved from discussion and research on benevolence, integrity, and honesty as key ingredients to trust. For instance:

Trust is a faith in the moral integrity or goodwill of others, which is produced through interpersonal interactions that lead to social-psychological bonds of mutual norms, sentiments and friendships in dealing with uncertainty (Ring and Van de Ven, 1994).

Faith enables people to go beyond the available evidence and feel secure that a partner will continue to be responsive and caring. Feelings of faith begin with past experiences that show how much our partner cares (Rempel and Holmes, 1985).

10.15.4 Vulnerability

A key breakthrough in the use of the term trust is the relationship between vulnerability and trust. Vulnerability is a key issue because trust without some kind of vulnerability simply cannot exist. If a party chooses a course of action that involves no vulnerability, then the firm has simply made a rational decision. One of the first definitions to include vulnerability was provided by Deutsch (1958), who stated that trust involved choosing a course of action even if the probability of failure was greater than 50 percent.
Others believed that trust goes beyond expectation outcomes under uncertainty to expectation outcomes under vulnerability. Vulnerability projects a feeling of being unprotected or exposed while including an element of uncertainty or risk. If there is no uncertainty or risk, then the party is freely giving the other party something. If both firms are not exposed to risk, then they are simply making a rational decision based on probabilities.

Trust is the mutual confidence that no party to an exchange will exploit another's vulnerabilities (Sabel, 1993:1133).

Trust is a risk relationship that increases the trustor’s vulnerability (Zand, 1972).

Trust is a particular level of the subjective probability with which an agent assesses that another agent or group will perform an action, both before he can monitor such an action and in a context in which it affects his own action. For trust to be present there must be the possibility of disappointment or betrayal (Gambetta, 1988: 217).

The discussion on vulnerability uncovers a key distinction that must be made between trust and trusting behavior. Trust can exist without action, but trusting behavior is the action taken based on trust in another party. Lorenz discusses how vulnerability is a key component of trusting action:

Trusting behavior consists of action that (1) increases one’s vulnerability to another whose behavior is not under one’s control and (2) takes place in a situation where the penalty suffered if the trust is abused would lead one to regret the action (Lorenz, 1988: 197).

A paradox was uncovered by Rempel and Holmes (1986), who wrote that to be able to trust, one must be willing to take the risk of trusting another party. To be a party to trust, one must take this risk.

10.16 Dependence: Too Much Is Never a Good Thing

Dependence has been observed two ways. First, dependence may be defined in terms of a relationship between one party (usually supplier) and another party (usually buyer). Second, the power one party has over another may be due to dependence, usually due to a high percentage of a supplier’s output going to one buyer. Wal-Mart, Carrefours, The Home
Depot, and other retailers come to mind. Several authors including Lascelles and Dale (1989) have addressed the issue of dependence from a volume perspective. They hypothesize that the more a buyer buys from a supplier, the more likely the buyer will be able to influence the supplier (see Table 10.7).

Dependence of a party on another means that one party will have power over another. Treleven (1987) notes that in markets with limited numbers of suppliers there is less leverage for buyers in negotiating with suppliers. Resource dependence theory also notes that when power between parties is in relative balance (high uncertainty), organizations will attempt to create negotiated environments.

Clearly, the interplay of trust, dependence, and power is an issue that all companies will have to manage for some time into the future. If companies are serious about deploying supply-chain management, skills in managing the interplay of relationships and forming bonds that go beyond the traditional boundaries will be key to success. One example of how this power is being wielded is Wal-Mart’s request that all suppliers have RFID tags on pallets by January 2005. There are many other examples.

10.17 Conclusions: Lessons Learned about Relationship Management

A theme that underlies these examples is that many of the barriers to supplier development are related. It appears that as companies work toward solving one barrier, they make concurrent progress toward solving other barriers. We can learn several lessons from studying supplier development successes and failures:

1. Managerial attitudes are a common and difficult barrier to overcome: A purchasing executive at HAM noted that although quality problems always have a solution, the attitudes of suppliers’ managers must be right before a problem is truly solved. Suppliers are sometimes not willing to accept help in the form of supplier development, perhaps because they are too proud or because they do not see the value in improving quality or delivery performance. Management attitudes significantly affect the success of supplier development efforts.

2. Realizing a competitive advantage from the supply chain requires a strategic orientation toward supply-chain management and the alignment of purchasing objectives with business unit goals: Supplier development plays a major role in helping create competitive
<table>
<thead>
<tr>
<th>Author(s) and Year</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>Treleven (1987)</td>
<td>In situations with fewer suppliers, buyers have fewer opportunities to exploit suppliers.</td>
</tr>
<tr>
<td>Mohr &amp; Spekman (1994)</td>
<td>Interdependence is correlated with relationship performance.</td>
</tr>
<tr>
<td>Emerson (1962)</td>
<td>Power and dependence have a reciprocal relationship.</td>
</tr>
<tr>
<td>Cadotte &amp; Stern (1979)</td>
<td>The power dependence relationship determines the amount of interdependence between parties.</td>
</tr>
<tr>
<td>Lascelles and Dale (1989)</td>
<td>The volume of business with a supplier influences the ability of a buyer to impact a supplier.</td>
</tr>
<tr>
<td>Frazier, Spekman and O’Neal (1988)</td>
<td>Coercive use of power can damage a relationship.</td>
</tr>
<tr>
<td>Dwyer, Schurr and Oh (1987)</td>
<td>Power is a function of dependence of parties on one another.</td>
</tr>
<tr>
<td>Noorweir, John and Nevin (1990)</td>
<td>Voluntary restraint from the use of power improves the relational exchange norms of a relationship.</td>
</tr>
<tr>
<td>Williamson (1975)</td>
<td>Power asymmetries will always be exploited.</td>
</tr>
<tr>
<td>Heide (1994)</td>
<td>The more dependent a supplier is, the greater the use of explicit contracts.</td>
</tr>
<tr>
<td>Etgar &amp; Valency (1983)</td>
<td>The greater the dependence that is present, the more vulnerable the weaker member is.</td>
</tr>
<tr>
<td>Heide (1994)</td>
<td>The higher the degree of interdependence, the greater the commitment exhibited by both parties.</td>
</tr>
<tr>
<td>Lusch &amp; Brown (1996)</td>
<td>The greater the dependence of a buyer on a supplier, the more likely the buyer is to have a long-term orientation.</td>
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advantage while aligning purchasing and business goals. A strong purchasing mission statement helps promote this strategic emphasis and alignment. Consider the following purchasing mission statement from an automobile parts manufacturer in the United Kingdom:

We are committed to procure goods and services in a way that delivers our aims and objectives of becoming the most successful auto parts business in the world.

The company pursues this mission through (1) development of a world-class supplier base; (2) obtaining the highest-quality, most cost-effective goods and services in a timely manner; and (3) establishing long-term relationships with suppliers who strive for continuous improvement in all areas.

3. Relationship management is critical to supplier development success: Buyers can strengthen their relationships with their suppliers through supplier development activities. Besides the development of trust, the participants within a supply chain can begin to understand each other’s needs and requirements. Ideally, supplier development will lead to the recognition that a codependency exists between the buyer and seller. Successful supplier development requires a cooperative relationship between the buyer and seller.

Pursuing supplier development activities directly with suppliers is not an easy task. The objective, of course, is to transform suppliers in such a way that continuous improvement becomes an integral part of each supplier’s capabilities. This is achieved only over time, and only by those companies that are patient and tenacious enough to make supplier development an important part of their supplier management processes.

Relationship management and supplier development are the critical elements that take the strategic sourcing effort to its logical conclusion. As we noted earlier, strategic sourcing and market intelligence allows you to determine whom you want to establish the relationship with, as well as to fix the expectations. However, the real work occurs when it comes to managing the relationship and realizing the predicted benefits. One executive noted that the greatest improvements are made after the ink on the contract has dried. Only then can you begin to work together in a mutually beneficial fashion and drive real improvements in cost, technology, delivery, and quality through to the end customer.
10.18 Checklist

- Establish final KPIs for strategy.
- Transition project to RM and contract administrator.
- Build change-management plan.
- Add change-management section to position paper.
- Execute plans.
- Measure and manage supplier performance.

10.19 Results

Final agreement with all stakeholders
Strategy executed and communicated

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