Can You Measure Your Supply Management Goals?

By Joe Sandor

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Today's procurement leaders aim to be their suppliers' Customer of Choice, to deliver a Sustainable Competitive Advantage, and to be an Indispensable Business Partner. If those are going to be meaningful goals, there need to be metrics we can apply to measure our progress.

By now, all major multinational companies understand that their cost structure is dominated by what they spend on purchased goods and services. Further, an increasing number of firms recognize the opportunity from the sheer size of outside spend relative to the cost of goods sold (COGS) plus the historically limited attention to the supply function. When these two factors—size and neglect—are combined, it becomes evident that improved supply management may be the best way to improve overall competitiveness. Accordingly, supply management leaders are articulating grand visions for supply management that I refer to as "illustrative goals." The most common are:

1. be the Customer of Choice (CoC);
2. deliver an absolute and Sustainable Competitive Advantage (SCA); and
3. be an Indispensable Business Partner (IBP).

I call these goals illustrative for three reasons. First, no one ever really expects them to be completed or the goal to be fully reached. Second, there is rarely a "hard number" attached to them. Third, they seem to have the flavor of a moral platitude as opposed to a well-defined objective—like cod liver oil, they must be good for your organization.

Although few organizations assign a metric to track their success, these illustrative goals have grown steadily more ambitious as supply management has increased its scope and organizational influence. Still, for these goals to be more than moral platitudes, we must be able to measure our progress.

In celebrating my 40th year in supply management, I want to examine the way I believe we should measure progress against some current, long-range, illustrative goals routinely espoused by private sector supply management leaders. In addition to my own musings around overarching supply management objectives, I've also included some of the experience passed on by three icons of the supply management world; R. Gene Richter, Wayne Vaughn, and Dave Nelson.

Three Illustrative Goals

Let's start by defining the three illustrative goals.

1st Illustrative Goal: Customer of Choice—Supplier Relationship Management (SRM)

SRM is essentially a set of organizational processes and attitudes intended to enhance collaboration with suppliers for the mutual benefit of the buying and selling firms. The best examples of successful SRM extend beyond individual buyer/supplier relationships to include entire supply networks. When done properly, open and trusting collaborative processes achieve better results than can be achieved through traditional combative price negotiations and unilateral bullying. As the U.S. auto industry learned, beating up a supplier on price might make supply managers feel as if they are doing their jobs, but the resulting cheap price may end up costing the organization more in the long run than the initial savings. Simply put, combative negotiation is seen as a zero-sum activity while collaboration is non-zero-sum. Some examples are shown in Exhibit 1.

At the most basic level, non-zero-sum collaboration (collaboration that adds shared network value) rests on the simple concept that two heads are better than one.

EXHIBIT 1

Combative Negotiation Vs. Collaborative Negotiation

Zero-Sum (moves network costs with little, no, or negative revenue impact or network profitability)	**Non-Zero-Sum** (eliminates or reduces network costs, improving network profitability and/or enhancing revenue)
Extend Payables	Reduce waste & network total cost of ownership
Combative negotiations	Reduce inventory
Hold harmless clauses	Reduce lead-time & enhance flexibility
Transferred warranty obligations	Improve manufacturability & design
Imposed performance fines	Accelerate continuous improvements
Extracted concessions	Increase speed to market
Redundant audits	Advance innovation

Source: Joe Sandor, The Eli Broad Graduate School of Management at Michigan State University

The recent explosion of interest in SRM reflects our increasing reliance on external constituencies (usually suppliers of some type or another) as firms buy more than they make or do, along with the growing recognition that outsiders may have more knowledge and better perspective than insiders.

Think of collaboration in terms of a working relationship continuum between buyer and suppliers Tier-1 through Tier-n for the four "Cs" in the following hierarchy:

- **Level 1: Communicate.** Tell one another what we want.
- **Level 2: Coordinate.** Better sequence events for greater efficiency.
- **Level 3: Cooperate.** Support one another for mutual benefit.
- **Level 4: Collaborate.** Work together in ways that earn preferential treatment from others that delivers Sustainable Competitive Advantage to all parties.

2nd Illustrative Goal: Deliver Sustainable Competitive Advantage (SCA)

Collaboration results are closely linked to the second illustrative goal of delivering a Sustainable Competitive Advantage. Goals one and two share relationship outcomes: Is the result of the collaboration innovative, unique, exclusive, differentiated, desired by customers, difficult to copy, confer an absolute cost advantage, and is it sustainable? Absent these desired outcomes, the buyer/supplier relationship probably does not deliver genuine strategic advantage. Now, this definition severely limits the use of the word collaboration. Such collaboration provides the RIGHT good at the RIGHT cost (the costs that best motivate and reward a given supply network). Exhibit 2 illustrates the difference in positioning, activity, and outcome between the typical "6 Rights" of holistic supply management.

3rd Illustrative Goal: Be a Destination Function and an Indispensable Business Partner

I like to position the goal to be a sought-after, Indispensable Business Partner as part of supply management talent enhancement. To a large extent, talent determines how well the above 6 Rights are realized. Differential talent combines commercial supply management expertise and cross-functional/cross-supplier network integration acumen. The need to attract, develop, and retain supply management talent has always been a key objective for exemplar supply management organizations. Rigorous processes are used for skill gap identification and closure. Identifying, monitoring, and tracking high-potential employees have become commonplace among winning firms, as has defining explicit cross-functional assignments for advancement. All organizations can improve their talent management processes and the best firms are continually vigilant in staying ahead of the talent maturity curve (Exhibit 3).

What's striking about talent management today is the view that senior supply management heads clearly regard

EXHIBIT 2

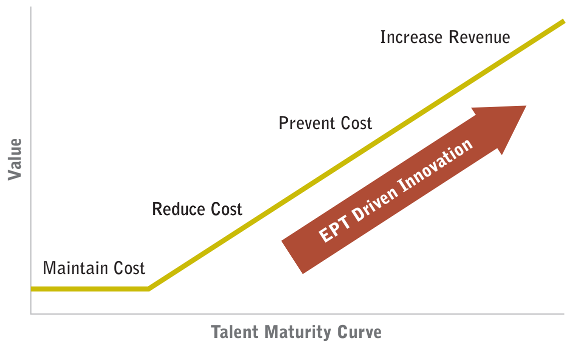
6 Rights of Holistic Supply Management

	Right Quantity, Place, Time & Price	Right Thing & Cost
Focus	Efficiency	Effectiveness
Knowledge	Accurate: react and exploit	Create: predictive & value-driven
Process	Implement Best Practices	Shape Demand
Relationships	Coordinate/cooperate	Collaborate
Outcome	Required to stay in the game	Game changer to win the game

Source: Joe Sandor, The Eli Broad Graduate School of Management at Michigan State University

EXHIBIT 3

Supply Management Talent Transformation



Source: Joe Sandor, The Eli Broad Graduate School of Management at Michigan State University

talent as the critical enabler of their other two illustrative goals—Customer of Choice and Sustainable Competitive Advantage. In the process, supply talent management is being articulated in a profoundly different way. In the past, sets of skills were matched to such needs as analysis, process, systems, quality, and negotiations—the skills required to perform commercial operations and technical/ market assessments. Now, the emphasis has expanded to include integrative skills that not only tackle cost but address the value of a firm's products and services to its customers. Thus, supply management leaders see the desirability of their people by other functions in the organization as proof of talent enrichment.

One way to look at the "business partner role" is through a value/cost ratio. Traditional supply management talent skills attack the denominator, while business partnership talent focuses on the numerator. Being an Indispensable Business Partner demands boundary spanning skill to become gateway functions that link supplier networks to firm problems and opportunities in ways that drive innovation and accelerate new product development. Nowadays, there is an additional expectation that supply managers can simultaneously attack and create. Both require interaction with multiple stakeholders inside and outside of the firm to effectively orchestrate cost leadership and revenue enhancement.

Developing Appropriate Measurements

Now that we understand them, can we measure our progress toward these three illustrative goals? I contend that we can. For instance, to understand how well suppliers perceive their relationship and accordingly extend preferential treatment to their best customers, ask suppliers. To understand if supply management is delivering an absolute, Sustainable Competitive Advantage, look at the firm's financial statements and assess the quality of supply management process execution. To understand the role of talent to supply management's illustrative goal to become an Indispensable Business Partner, ask key internal stakeholders. The next three sections elaborate on these straightforward notions.

How to Measure Customer of Choice (CoC) Illustrative Goal

If networks, rather than firms, compete, it follows that the most competitive network is the one that works most collaboratively with its suppliers and customers from mother earth to end consumer. That concept underpins the Customer of Choice (CoC) goal: Supply management leaders believe that supplier collaboration and supplier loyalty drive revenue growth, reduce costs, enhance innovation, and mitigate risk. Understanding how relationships work, developing trust and openness, and measuring the quality of supplier perceptions are thus seen as vital components for the long-term health and success of the firm and its extended networks.

Most buyers honestly believe that they are superior customers, and that their suppliers and other potential suppliers covet their business over others. As a result, they think they are their supplier's CoC. As mentioned earlier, the desire to be the CoC, to delight suppliers, and to earn preferential supplier treatment, is becoming the new mantra for enlightened supply management executives.

But, in my experience working with numerous firms, candid supplier feedback tells a different story. Maybe we don't know what we don't know:

- only 5 percent of all customers receive preferential treatment;
- 75 percent give allocation preference to top customers (top not necessarily biggest);
- 82 percent give most preferred customers first access to new products and technologies;
- "key account" does not necessarily mean preferred;
- perceived willingness to collaborate secures preference over time; and
- low-cost-to-serve customers are as attractive to suppliers as low-cost suppliers are to buyers.

Suppliers learn to tell buyers what they want to hear. Often, what the buyer wants to hear is at odds with what the seller actually believes. Sellers are justifiably suspicious. As one example, witness large multinational company buyers who are unilaterally extending payables and demanding across the board price reductions independent of underlying costs.

As mentioned earlier, if a company wants to know if it is the CoC for its suppliers, the logical thing to do

R. Gene Richter, IBM, SPS & Internal Customer Approval, Top 2 Metrics

R.Gene Richter is a supply management icon. He is the only three-time winner of the *Purchasing Medallion of Excellence* Award (Black & Decker, Hewlett-Packard, and IBM). The prestigious, annual awards for supply management excellence from ISM/MSU are named in Richter's honor.

When Richter spoke to my MBA class at the University of Chicago, he was asked about his greatest achievement at IBM. He could have said his team played a large part in saving IBM from bankruptcy. Or, he could have referenced the over $9 billion in savings his team achieved in five years. Instead, Richter said that his greatest accomplishment was persuading IBM's CFO, CEO, and Board that the two most important activities of supply management were achieving industry leading supplier perception and getting solid internal customer approval and recognition for the value his function delivered. He felt that there was no better way to measure ultimate supply management success. If supplier perception and user approval are strong and improving, Richter said, genuine competitive advantage will follow.

Wayne Vaughn, Harley-Davidson Integrated Plating Services (IPS) Team

When Wayne Vaughn, head of Harley-Davidson's Integrated Plating Services, spoke to my MBA class at Michigan State University, he described Harley's superb supplier relations by recounting how Harley made a quantum leap in chrome. The jewel-like shine and performance quality of chrome is an enormously important and significant product differentiator for Harley-Davidson motorcycles. But, unless something different was done, Harley would not meet demand, quality, or complexity needs for platted chrome parts starting in 2001. Vaughn responded by issuing a challenge to key stakeholders: These included Harley's engineering, operations, styling personnel, and three principal suppliers. With the help of a neutral facilitator, the IPS group developed and executed shared accountability and action plans.

The accomplishments of the IPS team were phenomenal. They not only conquered daunting production problems, they also achieved quality improvements that were considered impossible. In the process of solving capacity issues in the supply base, more robust risk mitigation, production planning, best practice sharing, and warranty reductions were instituted. Profound new knowledge was created. The list of achievements was staggering. But, according to Vaughn, the most important enablers were near total network visibility and genuinely shared commitment.

Dave Nelson, Honda Head of Supply Management

Dave Nelson, another supply management icon, is still going strong despite having "retired" as head of supply management for TRW, Honda, John Deere, and Delphi. He is one of the world's best-recognized supply management thought leaders and chairman emeritus of the Institute of Supply Management.

When Dave Nelson spoke to my MBA class at the University of Chicago, he challenged the widely-held accounting convention that savings are greater than avoidances. But are they really? Nelson asked the class what savings opportunities would exist if you perfectly launched the model year, specified all of the components, configured material flow, and managed inventory.

According to Nelson, the answer was essentially the difference between Honda and Toyota versus GM, Ford, and Chrysler. While the Big Three were claiming significant savings, the Japanese automakers were diligently meeting target costs. What's more, Japanese firms operating in the U.S. as well as their U.S. suppliers were highly profitable while the domestic automotive industry was inching closer and closer to bankruptcy. In other words, savings are often nothing more than fixing a mistake that shouldn't have been made in the first place. Nelson's real takeaway: Preventing cost requires collaboration while savings only needs a hatchet.

is ask the suppliers. The best way to get honest supplier feedback is through anonymous third party administered surveys. But, what questions, which suppliers, and how frequently should the supplier perception survey be administered? Again, the recommendations regarding these three questions come from my experience and not any study.

First, appropriate stakeholders should be tasked with the development of the supplier perception survey questions. Establish a cross-functional survey core team. The quality of the survey along with the organization's ability to learn from it in ways that add value to both the buying firm and its suppliers is partly shaped by internal "buy-in." An introductory notification should alert suppliers of the survey's purpose and timing. This announcement should be personalized, thanking them in advance for their interest and participation. Ideally, this letter should be sent under the dual signatures of the CEO and CPO.

As in most things, keep the survey simple. Don't exceed 40 questions; 20 is a good target. The more questions you ask, the lower the response rate. Try to construct a survey that will be completed in an average of 10 minutes: Survey geeks have loads of advice on question development. Five-point scales seem to work fine and answers can also include trending direction. Finally, it should be anonymous.

At the least, survey questions should address the following areas:

- trust and openness;
- perceived working relationship quality;
- perceived process quality (technology, administration, IT);
- communications (transparency/honesty, accuracy, timeliness, and adequacy);
- actions that help;
- actions that hurt;
- supplier willingness to invest on behalf of buyer;
- supplier perception of buyer's concern for supplier's gross margin;
- ability to present one face;
- rewarding excellent performance;
- commitment to provide on-going preferential treatment to each other;
- Customer of Choice/degree of preference;
- potentially trending questions; and
- comments (either open-ended, directed to a question or a specific topic, or both).

Next, who should participate? The answer to that question is essentially a question of whose opinions matter. Obviously, the feelings of "key" suppliers matter. Some firm's may, however, define "key" so narrowly that there are too few suppliers surveyed. My rule of thumb is to create a survey invitation list that selects the top 20 percent of suppliers in number that represent around 80 percent of the total spend. It's difficult to do meaningful comparisons and data segmentations without a decent number of respondents. Finally, the survey should achieve a minimum 50 percent response rate. Under 50 percent response rate indicates poor administration, wrong or too many suppliers, inadequate lead time and notice, and/or too cumbersome a survey instrument.

How often should supplier perception surveys be done? There are always trade-offs in survey frequency. If the survey occurs too often there may not be enough time between surveys to do anything meaningful that would or could move the perception needle. Also, survey fatigue can limit responses if done too frequently. On the other hand, if the supplier perception survey occurs only rarely and irregularly, this is a clear signal to suppliers that the buyer is not particularly concerned with their perceptions. Yearly survey frequency is the best option for most firms. Survey results should be shared at a high level with suppliers. It is also a good idea to position survey results as a major agenda item for annual supplier meetings. Regardless, maintain a regular drum beat for the supplier perception survey even if it is every other year.

And, obviously, show suppliers as well as internal stakeholders that the survey results matter. What's done as a result of the survey is more important than idiosyncrasies of the survey instrument, audience, and timing.

How to Measure a Supply-Driven Sustainable Competitive Advantage (SCA) Illustrative Goal

Measuring the illustrative goal of delivering a Sustainable Competitive Advantage (SCA) is easy for one reason and hard for two. It's easy because the metrics are well established and credible. It's hard because it is difficult to separate and quantify supply management's contribution to overall firm performance and it requires steady process faith distinguishing between activities and achievements. As previously stated, supply management leaders believe there is a strong link between superior supplier relationships and competitive advantage. Therefore, a supply-driven SCA ought to reduce the firm's total cost of ownership and increase the firm's revenue and innovation (add value) as shown in Exhibit 4.

The easy metrics for SCA are overall firm numbers like stock price, earnings per share, and price earnings ratio. Supply management positively affects costs and revenues as follows:

1. Revenue grows while costs remain the same.
2. Revenue grows while costs go down.
3. Revenue remains the same while costs go down.
4. Revenue goes down but costs decrease more and faster.

A firm improves its stock price and P/E ratio versus the relevant peer group directly as a result of one of

EXHIBIT 4

Directional Hypotheses for Relationships

Source: Joe Sandor, The Eli Broad Graduate School of Management at Michigan State University those supply driven results. Now, the sticky part—how much credit (or blame) can supply management claim? Remember the old saw, success is more often achieved when we pass credit and take blame.

Translating supply management results into the language of finance is necessary but not sufficient. Sustainable competitive value in the context of supply management is the result of structured process execution. So long as supply management organizations continuously improve their talent, enhance supplier relationships, and increase their internal customer approval, they will also improve their relative contribution to firm performance over time in both the cost and value arenas.

Although the criteria for process evaluations can vary by spend pool, general components are similar to well-known lean diagnostics and business process engineering (or re-engineering) activities. Time and space aren't sufficient to cover the wide range of these features. But, the point is fairly straightforward. We know how to build and evaluate processes. All that's required is the managerial mindset that adds and/or elevates robust and ongoing evaluation of commodity team performance as our SCA metric.

How to Measure Supply Management's Status as an Indispensable Business Partner (IBP) Illustrative Goal

The metrics recommended for internal approval are similar to those for supplier perception. In this case, we don't ask suppliers, we ask the supply management's customers how well their needs are being served. According to results of various studies, along with the griping supply management folks seem to constantly do, it's believed that less than half of the internal stakeholders understand or appreciate the value of supply management. Most supply management leaders feel this lack of internal customer appreciation prevents them from properly staffing or training. Clearly, supply management leaders must do a better job of communicating their value (and/or provide more value) in order to secure appropriate resources to execute their mission.

In addition to results from an internal customer approval survey, we could also look at some data covering the extent to which supply management personnel are sought by other functions; poached by other companies; increasing in relative Hay points; and seeking and obtaining advanced degrees or certifications. But, these indicators are anecdotal. A structured survey is a better metric.

Here are several internal customer approval survey suggestions. Ask key internal stakeholders to rate supply management effectiveness against a list something like the following:

1. Supply management people are knowledgeable in their commodities—suppliers and industry cost structures—and are regarded as an effective gateway for supplier ideas.
2. Supply management people treat me and our suppliers professionally and ethically.
3. Supply management understands my business needs and selects suppliers that meet my requirements.
4. Supply management negotiates effectively with our suppliers.
5. Supply management manages supplier relations effectively, thus delivering superior delivery, cost, technical support, and supplier innovation.
6. Supply management routinely benchmarks best practices and uses this information to enhance the value delivered by our suppliers.
7. Supply management helps me meet my business objectives.
8. Supply management processes and systems improve my productivity and are user-friendly, up-to-date, and appropriate.
9. Supply management provides accurate and timely data to support my business.
10. Supply management effectively engages all significant internal stakeholders in strategic sourcing, planning, and execution.

Finally, ask for advice by allowing survey respondents to provide comments. There are lots of ways to do this. Here is a version of one of my favorites: If the supply management department could make one change this coming year that would make your life easier, what would it be? Finally, open-ended, unstructured comments are often illuminating.

Everything Gets Better

The three observed illustrative goals—being the Customer of Choice to Suppliers, delivering an absolute Sustainable Competitive Advantage, and developing talent that is considered indispensable by internal customers—are powerfully connected. These holistic illustrative goals require new metrics, or at least a more outward focus to existing metrics. The interconnection and similarity of these expanded goals require an evolving and expansive set of complimentary metrics. Look closer still, and what really matters with regard to supply management performance is superior talent development to drive enhanced supplier perception and internal customer approval.

These goals are overarching to the extent that all of our historic measurements, such as quality, inventory, delivery, design, and cost are directly correlated. When supply managers pull these three levers correctly, everything gets better.