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Balanced Purchasing

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Most executives recognize the importance of their company's "extended enterprise" of suppliers. However, few feel comfortable that their company is extracting the maximum value from the supply base. Many worry that efforts to rationalize the supply base and create long-term partnerships might ultimately come back to haunt them.

In many cases, the worriers might be right. From our vantage point, the key is to strike the optimal balance between a sense of cooperation and a commitment to competitive pricing based upon world-class cost. In other words, the challenge is to insure that a company both creates and retains the value generated through these long-term relationships.

The framework for achieving the most desirable balance between competitive pricing and cooperation can be viewed in the accompanying chart (46K GIF). Labeling the horizontal axis "Commitment to Competitive Pricing" reinforces the customer's objective to continually create value in managing the "extended enterprise" in order to serve the end consumer. Using "Commitment to a Cooperative Relationship" as the vertical axis underscores the fact that more value can often be created by working together than independently. Companies like Toyota clearly demonstrate that a commitment to competitive prices need not preclude a commitment to a cooperative relationship.

The bottom left-hand quadrant, labeled "Unleveraged Purchasing," reflects the old days, before executive management fully recognized the importance of purchasing. In this quadrant no real attempts are made to leverage purchasing and supplier capabilities. Buyers were clerks and/or expediters relegated to processing purchase orders. This model is still evident in some industries and at smaller companies.

The top left-hand quadrant reflects the philosophical shift in many purchasing organizations over the past decade: I labeled it "Trust-Based 'Partnership.'" A "trust will prevail" attitude assumes that by simply working with suppliers cooperatively, money will magically fall to the bottom line. Unfortunately, "trust" is a woefully inadequate substitute for competition: it is naove and unactionable. Public corporations are required to maximize their return to shareholders--not to customers.

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Rather than "trust," goal congruence is the first step in insuring that supplier-partners behave in the best interest of the customer. Additionally, successful cooperative relationships demand clear, aggressive targets to insure that the joint collaboration pays off. This is analogous to the evolution of Total Quality Management over the past decade. Truly successful T.Q.M. efforts--like Motorola's 6 Sigma concept--go beyond "sloganeering" by setting quantitative, actionable goals to assure bottom-line results.

The bottom right-hand quadrant is one that often emerges when the cost pressures in an industry mount. The label for this quadrant, "Darwinian Rivalry," underscores that this model drives survival of the fittest among the supply base. It insures that companies overwhelm their competition or die out. However, such a system is inherently unstable since every "species" (or, in this case, company) attempts to seek overall dominance. No one is safe from attack--including the customer--unless the company maintains a clearly dominant position. More important, since the competitive environment is "unmanaged," improvements tend to be evolutionary rather than revolutionary.

The top right-hand quadrant is the promised land to which many companies aspire. It is where suppliers feel well supported but simultaneously driven to be competitive. Clearly such a model should capture the most value by leveraging the benefits of both cooperation and competition. However, the challenge is insuring that the objectives are achieved simultaneously and are not allowed to become "tradeoffs." The label, "Managed Synergy," reflects the symbiosis of collaboration while underscoring the need to maintain control of the relationship and insure competitiveness.

The first step toward driving to the upper right is to accept that competition and cooperation can coexist. This requires a paradigm shift comparable to the cost-versus-quality mindset of the early 1980's. It took many years (and lots of battles) to convince executives that cost and quality were not inherently in conflict.

However, acceptance that "Managed Synergy" is achievable is only a start. Many executives will rightly question whether it can be sustained. It too can be an unstable arrangement. However, unlike the Darwinian quadrant, where the instability is unmanaged, this instability is a function of the skill of the customer company in managing the balance.

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Finding the right balance starts with truly understanding how much value is being created--whether through cost reduction or reducing total systems cost. Next, supply relationships should be structured to insure that the suppliers are motivated to work with the customer to capture the opportunities. Sharing value creation provides the motivation.

Quantifying value creation is a nascent science. Some companies have become quite good at understanding cost reduction-based value creation through detailed modeling of supplier costs. However, "open-book costing" is often merely a new game that suppliers have learned to play well. It takes real skill and a true sense of cooperation to insure that the "open book" is the real book. Quantifying reductions in total systems costs that are often internal to the customer company is also difficult. However, it is achievable through rigorous analysis and a deep understanding of how "process changes" drive quantifiable reductions in total cost.

Understanding how consumers value new functionality is an even greater challenge. Only a few innovative companies, namely some Japanese automotive and electronics makers, excel at this technique--and even then only for key systems and/or major subassemblies.

Ultimately, negotiations determine what is "equitable sharing." Such negotiations can be--and should be--hard fought, with each company attempting to capture as much value as possible. However, given a common understanding of how much value is created--and a recognition that the relationship is built upon mutual dependence, goal congruence and a long-term perspective--an "equitable" solution can emerge. If the negotiations lead to a hoarding of information and more emphasis on retaining than creating value, the balance has been lost.

Although the task of balancing the tension between competition and cooperation in supplier relationships is tricky, it can be done. More to the point, it must be done, because such a capability will likely emerge as a major competitive differentiator in the decade ahead.