

SUPPLIER SELECTION & MANAGEMENT REPORT

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Best Practices To Effectively 'Right Size' Your Supply Base & Lower Costs

Purchasing and supply managers who want to reduce costs and leverage value from their supply base are increasingly focusing on a base strategy to determine the optimal number of suppliers—what many procurement professionals call “rationalization.” The concept defines an “appropriate” number of suppliers that will enable the supply management organization to achieve lower prices through leveraged volume, standardized service, and lower costs to manage transactions and the supply base. Further, since it will be easier to monitor supplier performance, and since these suppliers have been identified as “key,” it is reasoned that the relationships can grow, fostering integration, trust, value-added services, and innovation.

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TRW 'Sees' Global Spend Through Its Self-Designed Portal

Spend visibility is a challenge under the best of circumstances, even in a single facility with just one ERP and sourcing/procurement system. Just imagine then the complexity of gathering accurate and complete spend data in a corporate entity that has grown primarily through acquisitions, gaining multiple ERP/MRP systems, plants, and purchasing personnel across the globe.

That's the situation that confronted TRW Automotive Inc. (Livonia,

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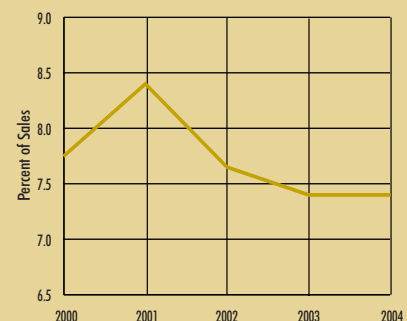
5 Ways to Tie Your Benchmarks Into Corporate Strategy

As purchasing and supply management gains status and becomes more strategic, there must be a re-evaluation of its performance metrics.

The more traditional measures around lowest total cost of ownership and savings, continuity of supply, and supplier performance and quality have to be augmented and expanded to reflect the pro-

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Logistic Costs "Flat" Despite Global Sourcing and Extended Supply Chains see page 4



(Source: Establish, Inc./Herbert W. Davis and Company)

5 Steps That Will 'Win' Supplier Support For Reverse Auctions

Since the advent of strategic sourcing and reverse auctions, traditional buyer/supplier interactions and relationships have changed—and not always for the better, as many **SSMR** readers can attest. In fact, previous negative experience in a reverse auction has turned off many good suppliers to participating in future bidding events.

To help bring these and other suppliers back, a new whitepaper, *Getting Suppliers Onboard With the Strategic Sourcing Process* (lasta.com, Inc., Carmel, Ind.; www.iasta.com) offers a five-step approach that can trigger the process. "It's not a panacea to winning all your ideal supplier participants, but it's a good place to start," the paper states. Here's how:

1. Structure the RFQ. It's essential that the RFQ is complete, well-written and contains critical information outside of just part or service specifications to allow suppliers to get a better sense of the buyer's

philosophy and outlook on supplier management. This might include:

- A good overview of the company and its supplier development programs.
- A statement that describes the company's philosophy on the strategic sourcing process and perhaps most important, a reiteration of the factors that the buyer considers to be important when making award decisions. Particular emphasis should be made that lowest bidder does not necessarily win the bid and anybody that submits bids below "cost" will not be considered for future business with the buyer.
- A discussion on when, how, and why the buyer uses reverse auctions and other negotiation strategies. This helps explain whether the company takes a partnering view toward their suppliers or a transactional "beat them with a hammer" approach.

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It's also critical to provide some history behind the part or service as well as an explanation of why it is now up for bid. In the case of direct materials or industrial MRO, it is also important to include good, clear drawings, with no markings or identifiers of incumbent suppliers.

For build-to-print parts it is critical to include specific descriptions of tooling requirements, including age, drawings, conditions, etc.

By providing this insight, it will help suppliers develop a total cost understanding of working with the buyer over the course of the contract. And, the more comprehensive the initial RFQ, the more likely suppliers will want to participate and respond.

2. Provide context to the supplier to win their participation and enthusiasm. The buyer must provide an explanation, either within a printed document, over the phone, or in person, of what it will take to move the part/product to a new supplier. Be as specific, and honest, as you can.

For example, what is the buyer hoping to achieve? Is it a certain percentage savings? Is it improved quality and lower defect rates? Is it better fill rates and on-time delivery?

3. Focus on non-price factors as well as price factors. Structure the RFQ and the sourcing event to include other critical data besides unit cost. This might include quality information, such as internal and customer PPM data, sigma levels, on-time delivery, or fill rates which are either examined separately or weighted into the overall price (or lowest bid).

In the case of highly complex events with thousands of line items or lanes, it might make more sense to use a non-traditional format such as optimization which enables suppliers to bundle bids and factors rather than relying on a fixed price.

4. Constantly communicate with the supply base. Over-communicate if you need to. Develop strong working relationships with suppliers and identify and address their concerns.

A poor or non-response from a supplier could mean that the supplier is gun-shy or has had a negative experience with reverse auctions, not that they're not qualified to bid. Take the time to find out and see if you can overcome their concerns.

Be sure to provide rapid responses (24-hour response) to any and all supplier concerns. Pull out all of the stops to understand why they might be hesitant to participate.

5. Clarify how the technology vendor who is managing the bidding process is to be paid. If you're working with a technology vendor or services provider who is managing the bidding process for you, ensure they're up front with the supply base about how they are getting paid.

There are often misconceptions about the buyer/partner relationship. Many suppliers believe that the buyer will mark-up a fee on top of their bid. It's important to be frank and clear about the economic interests that everyone involved in the process has. □

Coming in future issues of
SUPPLIER SELECTION & MANAGEMENT REPORT:

- Purchased Price Index as a Key Performance Indicator
- Global Sourcing Due Diligence—Where Purchasing Is Falling Down
- **EXCLUSIVE 2005 SSMR SURVEY:** What Practices Are Purchasing Professionals Finding Most Effective?
- Trust In The Supply Chain—Can It Really Happen With Your Critical Suppliers?
- Performance-Based Contracts: How to Develop Performance Criteria and Define Success Factors

Logistics Benchmarks Provide Insight Into Critical Cost Information

The current interest in global sourcing and markets, along with the outsourcing of manufacturing, has resulted in an emphasis of the supply chain and the procurement process. Within this context, purchasing and supply management professionals are casting a watchful eye on logistics costs, particularly the components of transportation, warehousing, and inventory carrying costs.

A reliable resource for this benchmark data is the *Logistics Cost and Service 2004* report, compiled annually by Establish, Inc./Herbert W. Davis and Company (Fort Lee, N.J.; www.establishinc.com). Cost levels for the past two years have remained the same, a situation not unlike the early 1990s.

“Nevertheless, logistics costs today are substantially lower than they were 25 years ago,” William H. Drumm, president (william.drumm@establishinc.com), ac-

knowledges. Cost as a percent of sales is down 30%, and that performance has probably “added two or three percent to the gross profit of corporations,” he shared at the 2004 Annual Conference of the Council of Logistics Management (Oak Brook, Ill.; www.clm1.org).

Logistics costs 2004 level with 2003.

For the average company in the Establish/Davis trend group (those companies that have participated in the survey for two or more years) total logistics cost for 2004 was about level with 2003. For example, cost as a percent of sales revenue is down only 0.4%, while cost per hundredweight shipped is down 4.2% (see Table 1).

When looking at logistics cost by functional area (see Table 2), these costs average 8.37% of sales for the entire database, including manufacturers, wholesalers and retailers. These same costs expressed as dollars spent per hundred pounds delivered to customers come to \$75.54 per hundredweight.

Relationship between costs appears to be shifting. The relationship between these costs has been fairly constant over many years, Herbert W. Davis (herbert.davis@establishinc.com) observes. Transportation has typically been about 40% with warehousing and inventory at 20% each, with about 10% of the total split between order processing and administration.

“This year’s numbers indicate a trend away from the long-term split,” he notes. Warehousing and inventory this year total 50% compared to 39% for transportation, a significant shift.

Logistics costs, by value of the product and company size, makes a difference. Logistics costs vary greatly between product groups, enough of a variation to make individual comparisons to the overall database numbers misleading. Generally, companies distributing expensive product have a lower cost when expressed as a percentage of the sales revenue. Some examples:

Table 1. Logistics Cost Change — 2004 Versus 2003

	% of Sales	\$/CWT
Transportation	-2.8%	-4.3%
Warehousing	+0.7	-3.5
Order entry/customer service	-9.0	-12.3
Administration	-5.0	-5.9
Inventory	+0.2	-3.0
Total	-0.4%	-4.2%

(Source for both tables: Establish Inc./Herbert W. Davis and Company)

Table 2. Average Company — 2004 Database

	Cost In	
	% of Sales	\$/CWT
Transportation	3.28%	\$22.90
Warehousing	1.93	16.78
Order entry/customer service	0.47	5.36
Administration	0.38	4.04
Inventory carrying	2.30	26.67
Total logistics costs	8.37%	\$75.54

- Manufacturers of chemicals and food products usually have a product value of under \$1.50 per pound and experience logistics costs of around 10% of sales or more.
- Fully processed products like packaged dinners, beverages, canned goods, or low-value industrial products made of steel or aluminum have a sales price around \$2 to \$5 per pound and a logistics cost of 7% to 9% of sales.
- Producer of computers and electronic components have products with a value of more than \$15 per pound, and these companies are experiencing a logistics cost of 3% to 4% of sales.

When ranked by total sales revenue, large companies have lower logistics cost than smaller companies. This usually applies up to the point where a company reaches the \$1.5-billion level.

"At that point, we usually see a dis-economy of scale, meaning that as companies get very large, they sometimes lose the ability to control and manage the logistics function," Drumm offers.

Small companies, obviously, have difficulty competing with larger companies. "If you are a \$200-million company experiencing logistics costs of 11 percent of sales, then you had better have a logistics strategy good enough to overcome the five percent sales advantage of your \$1-billion competitor," Drumm declares.

Long-term cost trend down, except warehousing, where costs are higher. Compared to 1980, inventory carrying costs and transportation are both down substantially. "Over this period we have seen a substantial downsizing of distribution center networks, as more goods are shipped from manufacturing plants, and companies have fewer larger warehouses using improved technology," Drumm states.

However, he also points out that warehousing costs are up, principally since 1995. Prior to 1995, warehousing costs were level or down compared to 1980. A major factor in the recent rise in warehousing costs is the sharp rise in value-added services, frequently mandated by large customers.

Generally, these costs are not reimbursed, Drumm explains. "As a result logistics incurs the cost without receiving any corresponding revenue," he offers. "Another cause could be the increased use of third-party logistics services."

For further information, or to participate in future logistics cost surveys, contact William H. Drumm, president, Establish, Inc./Herbert W. Davis and Company, 2200 Fletcher Avenue, Fort Lee, NJ 07024; william.drumm@establishinc.com. □

TRW's Self-Designed Portal

CONTINUED FROM PAGE 1

Mich.; www.trw.com), and which they solved with an internally developed supplier portal that overlays the various ERP systems. "With over 200 manufacturing operations, it's difficult to keep tabs on them and to have visibility on what's happening within them for performance as well as spend," Denise A. Clarkson, director, advance sourcing, e-procurement, procurement planning (denise.clarkson@trw.com), noted.

"You can get the spend visibility through spreadsheets, but we decided to have a portal gather this information," she explained. It's also designed to facilitate seamless communications between TRW Automotive and its suppliers.

How TRW gains spend visibility with its portal. "Our Web-based portal has been in operation since 1998, was internally developed, and we call it the Vendor Information Network," she explained at *Procure-*

Con 2004 (Worldwide Business Research, LTD, New York; www.wbresearch.com). "It's a centralized information system that provides spend visibility and enhances decision-making. It has grown from basically a spend management system to a supply-based management system to manage the suppliers as we go global on it," she said.

TRW maintains a network of over 200 manufacturing facilities, technical centers, sales offices and joint ventures located around the world. In the direct spend area, its major purchases are in metals, castings, chemicals (plastics, resins, rubber), electro-mechanical and electronics. They have about 3,000 direct suppliers with about 400 representing 80% of TRW's direct spend.

"The portal interfaces with each of the ERP/MRP systems, of which we have many, for all plants globally," Clarkson offers. The information comes in from the plant ERP/MRP system on a monthly basis into the supplier portal.

"We pull up the purchase order, the part number and the quantity received along with the amount we're paying for those components," she explains (see Diagram below). They have a supplier master that provides all of the details about the supplier, as well as a part master.

Achieving spend visibility. The "system" allows spend visibility across the locations to provide the detail by supplier, commodity, product line, manufacturing region, and the components being pur-

chased. All of the details that are on the PO are pull up into the portal based on receipts.

A spend summary is produced for the commodity team from which they develop their strategies as well as negotiating plans for the suppliers.

"A future enhancement is to link our actual spend with our forecast database," Clarkson notes. "The biggest challenge for us with all of this data is keeping it clean."

Supplier mapping defined. TRW Automotive has taken measures to assure that suppliers with multiple facilities in several global locations are identified only once in reporting on their performance as a global organization.

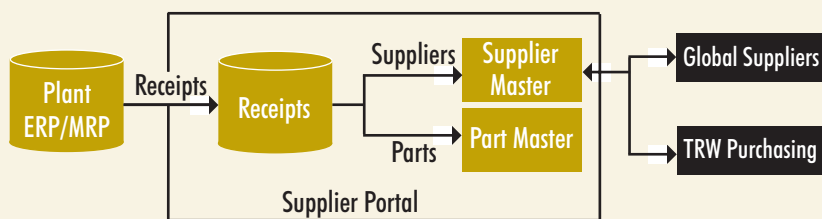
They have adopted a master mapping rule for each facility in a country, so there is one master code in the system identifying all of the production from a supplier's plants in that specific country. A supplier with facilities in additional countries, it, too receives a master code for that country.

For the total visibility for that supplier, they have created a parent code, which matches all of the individual master codes attributed to that supplier in the individual countries. The parent code enables TRW Automotive to count the supplier only once, and to report on their performance as a global organization.

Supplier scorecard for performance metrics. In addition to spend visibility, TRW Automotive has a scorecard tool in the portal that contains the performance metrics for all of the suppliers.

Data is automatically updated each month, and the initial scorecard for each supplier views the quality targets, current performance, certification status, and peer ranking. The supplier status indicates overall standing with

TRW Automotive's Portal-ERP/MRP Interface



(Source: TRW Automotive Inc.)

TRW (good standing, new business hold, bid suspension, top focus, inactive). And, there is trend data which is based on a best fit line for the most recent six months. Green (positive), for example, indicates decreasing PPM, increasing the supplier's Q-Score.

When suppliers do not achieve a minimum performance target, the system automatically generates an e-mail message to the quality manager at the supplier. The commodity manager also receives a message.

TRW Automotive has implemented cross-functional sourcing, so the commodity team will review the situation then make a recommendation which they take to purchasing senior management. The recommendation concerns what to do with the supplier long term and whether to change its status.

Tracking system for quality concerns/issues. Another tool within the portal is an interactive system between TRW's incoming inspection group and the suppliers. It is a distribution and tracking system for quality concerns and issues from TRW personnel that also allows suppliers to respond with a corrective action plan.

Basically, plant personnel with a quality issue will input the information into the concern tracking system, which then sends an e-mail to both the supplier and TRW purchasing, communicating that a problem exists. The supplier logs onto the portal and replies back to the concern with its corrective action plan.

Benefits of aggregated spend and performance visibility. Clarkson shared the following benefits that have been achieved since the implementation of the supplier portal solution:

- **Consolidation of total purchase volume.** "It gives us a better negotiating position with our suppliers based on

our volume of purchase," she explains. "We achieve savings not only for our larger plants, but for the smaller plants as well as the visibility has improved."

- **Similar and identical components.** "In some cases we buy the same part in three different locations, and may be paying three different prices," Clarkson notes. "Through the enhanced visibility we can go back and re-negotiate with our supplier based on the detailed information we now have on that component."
- **Supplier consolidation.** "This may not fit everyone's business practice," she allows, "but within TRW we're trying to consolidate to a world-class group of suppliers. As we consolidate we're bundling and moving the spend to our strategic suppliers across the board."
- **Increase supplier utilization.** "As we consolidate and move business, we will increase supplier utilization," Clarkson offers. "Studies we've performed have shown that most of our suppliers are underutilized. As we give them the opportunity to bid on new business the potential is to increase their utilization."
- **Improve overall quality.** "As we get the visibility over all of our spend, we need to make sure we have quality within the organization," she states. "We need to drive zero PPM across all of our plants, and not just the ones that have high volume. All suppliers should treat all TRW plants as equals."
- **Reward for performance.** "We have set targets for all of our suppliers and we will reward them as they achieve those targets throughout the year," Clarkson declares. □

NEWS BRIEFS

SSMR TIP OF THE MONTH: STRENGTHEN RELATIONSHIPS WITH KEY SUPPLIERS

"Initially we held individual meetings with our six current key suppliers to frankly discuss our supply/service needs over the next twelve-to-eighteen months," a purchasing manager at a midsize manufacturing concern told **SSMR**. "We also spoke of our objective to reduce costs and increase service/quality levels for our internal customers and clients, and we also shared as many details as we could about our business including trends and forecasts."

Additionally, they asked the suppliers about their business, their perception of the buying organization as a customer and which initiatives they were undertaking to reduce costs.

"We also developed an annual business plan with each supplier, which included cost and efficiency objectives, revised contract terms and conditions, and a provision for periodic reviews and interventions," she outlined. As a result, they are on pace to save approximately \$400,000 this year. In addition, they have been able to move some order processes online, consolidate invoicing, and gain favorable payment terms.

FRICTIONLESS COMMERCE LAUNCHES FRICTIONLESS SRM 2005

Frictionless SRM 2005 (Frictionless Commerce, Cambridge, Mass.; www.frictionless.com) contains enhancements to the software's DNA core and user modules available for spend analysis, supplier profiling, sourcing, contract management and supplier performance management. The software focuses not only on negotiation and contracting-based functionality, but on all facets of supply base management.

Enhancements to Frictionless SRM's modules include: contract management (document version control, revision tracking and user-defined contract document phases); spend and compliance (full, multi-dimensional analysis for ad hoc reporting); vendor management (SRM activity planning to define standard events, tasks and activities); and enterprise sourcing (collaborative scoring with RFx events and weighted bidding during auction events). The entire suite is available in simplified Chinese, French, German, Italian, Japanese, Spanish and English for both buy-side and sell-side users.

USE "EXTREME CAUTION" WHEN PURCHASING GOODS FROM FOREIGN SUPPLIERS

"Make sure all the entities you are doing business with are legitimate, and check all the U.S. Government lists, like Denied Parties, Unverified, Office of Foreign Asset Control Sanctions, State Department, to make sure the party and individuals you are engaging are not on these lists," warns Thomas A. Cook, managing director, American River International Ltd. (Melville, N.Y.; tom@worldest.com). "It is part of purchasing due diligence in checking out foreign suppliers," he declares in *Mastering Import & Export Management* (co-authored with Rennie Alston and Kelly Raia; AMACOM, New York; \$85).

Another point he advises purchasers to consider: "calculate the anticipated 'landed cost' as it is imperative to make sure you are competitive in comparison to local purchasing or from other sites." Cook shares, "Too many times we've seen importers begin to import a product, raw material, or component from a foreign supplier then get hit with duties, taxes, and inland charges, which make the transaction cost prohibitive."

NEWS BRIEFS

THOMASNET.COM ANNOUNCES INTEGRATION OF THOMAS REGISTER

Thomas Industrial Network, Inc. (New York), an online provider of Internet sourcing and marketing solutions for industrial buyers and sellers, announced the integration of Thomas Register of American Manufacturers (ThomasRegister.com) into its new Website, www.ThomasNet.com.

The new site brings together Thomas Register and Thomas Regional Buying Guides into one industrial search engine that enables industrial buyers to find exact products and companies they need. The Website offers: local search, industrial focus, and in-depth content, industrial specific, with detailed technical information. For information, contact Linda Rigano, (lrigano@thomasnet.com).

TOP PURCHASING PROS KNOW THEIR INTERNAL CUSTOMERS' NEEDS

"Often the reason an internal customer wants to do the job of the supply management professional is because the customer doesn't know what a supply manager does or how," charges James T. Phillips, C.P.M., A.P.P., procurement supervisor, Utah Department of Transportation (Salt Lake City, Utah; jamesphillips@utah.gov).

"Meeting with and working with the customer can often remove the mystery of what we do," he advised at the 89th Annual International Supply Management Conference (ISM, www.ism.ws). "Sharing the vision of the customer also will help reduce resistance to allowing you to carry out the procurement function."

Phillips also advises: Spend time at the customer's location, seeing what they do and how they do it. It can help to answer

questions and show ways value can be added to the services you offer."

SUPPLYWEB 9.0 RELEASED, IMPROVES SUPPLY CHAIN EFFICIENCIES, FUNCTIONALITY

Infor Global Solutions (Northville, Mich.; www.infor.com) introduced SupplyWEB 9.0, the latest version of its open-platform supply chain management tool that gives users access to their global supply chains from anywhere in the world.

New features allow participating partners within the supply chain to view, collaborate, and share key, value-added information, using exception-based alerting for key or unexpected events, and track supplier metrics and performance.

WORLD-CLASS PROCUREMENT SPENDS MORE ON TECHNOLOGY

World-class procurement executives spend 27% more than their peers on technology, despite the fact that they spend dramatically less on procurement operations overall, states the *Book of Numbers* research into procurement practices and performance metrics (The Hackett Group, an Answerthink company, Atlanta; www.thehackettgroup.com).

The research also finds that increased spending and improved leverage of existing technology investments are key strategies that enable world-class procurement executives to shift spending away from transactional activities and towards work that provides higher strategic value and improves effectiveness. One example: world-class procurement executives allocate 36% more of their overall procurement resources to decision support and risk management than typical companies.

Corporate Strategy

CONTINUED FROM PAGE 1

curement department's growing stature and importance within the corporate organization.

Sharing this view is Debra D. Bell, who leads the procure-to-pay solution efforts within Hewlett-Packard's BPO Group (debra.d.bell@hp.com), who comments,

"Companies are better recognizing and measuring the strategic impact the procurement organization has on competitive advantage, cash management, speed-to-market, employee productivity, overall service delivery, and Sarbanes-Oxley compliance. Ultimately customer satisfaction and pricing/profitability are directly affected by the procurement organization's ability to perform and deliver," she maintains.

New metrics must be aligned to corporate strategy. One essential ingredient that is emerging almost universally, is the opinion that process, department, and functional metrics all must somehow reflect overall corporate strategy. For example, Nick Little, assistant director, executive development programs, The Eli Broad Graduate School of Management, Michigan State University (littlen@bus.msu.edu) commented at the 89th Annual International Supply Management Conference (ISM, www.ism.ws): "It is critical to tie corporate and business unit strategy back to both the desired behaviors and the measures employed."

Kate L. Vitasek, managing partner, Supply Chain Visions (Bellevue, Wash.; kate@scvisions.com), also insists that metrics be aligned to strategy. "That's really your foundation, and if you're measuring and aren't supporting your strategy, then you're

probably going in the wrong direction of where you want to go," she explains.

Five steps to developing a successful metrics program. Vitasek has developed a methodology (Validating the Value Add) that creates a culture for employees to turn data into information and take action to drive improvement. Her program includes the following steps:

1. Clearly define the company objectives. Companies need to determine their goals and strategies, otherwise you end up with competing sub-optimal metrics. Articulate the corporate objective, such as "I want a five percent profitability bottom line, how can you in purchasing impact that?"

Link operational and functional tactics back to the strategic objective. Then make sure your people understand that strategy and what their role is in helping to achieve that strategy.

2. Develop the validating value-add statement. "Challenge the procurement department to come up with their VVA statement, essentially how they add value to achieve the corporate goal," Vitasek explains. Create value-add statements that are substantially under your team's or area's control and contain measurable performance goals. For example: "Our team adds value by maintaining 99.21% or better accuracy on material procurement."

Clearly linking a tactical measure to a broader objective will help purchasing and supply professionals understand on what to focus.

3. Measure the progress against VVA. Once clear expectations have been set, measure the progress against the goal. Summarize data so that results are obvious, make it easy to see if goals are being met, and include historical data to track trends, are some tips she offers.

Metrics all must somehow reflect overall corporate strategy.

How Does Your Performance Measurement Program Measure Up?					
	Poor Practice	Inadequate Practice	Common Practice	Good Practice	Best Practice
Metrics Aligned and Driven by Corporate Goals	<ul style="list-style-type: none"> ● KPIs poorly defined with weak link to goals. 	<ul style="list-style-type: none"> ● KPIs required to achieve company goals clearly defined. 	<ul style="list-style-type: none"> ● KPIs required to achieve company goals clearly defined and measured. 	<ul style="list-style-type: none"> ● KPIs defined, performance measured, and targets set. Top 10 list (or similar) drives functional behavior and goals. 	<ul style="list-style-type: none"> ● Each KPI clearly defined with actual; target gap analysis and improvement plan. ● Embedded metrics hierarchy to associate functional metrics to Top 10 List and provide drill downs as needed (e.g. nested measures red/yellow/green).
Process Focused Metrics	<ul style="list-style-type: none"> ● Financial measures are the primary measures of performance. 	<ul style="list-style-type: none"> ● Functional and financial metrics used; Metrics may be driving sub optimization. ● No clear linkage between functional metrics and their financial leverage. ● No measure of perfect order maintained. 	<ul style="list-style-type: none"> ● Elements of process metrics are collected but not actively aligned to drive process behavior. 	<ul style="list-style-type: none"> ● Clear understanding of financial impact of metrics across all levels. ● Elements of process metrics are actively in place and are viewed from a process perspective on a regular basis; indexing such as perfect order index is performed on an ad hoc basis. 	<ul style="list-style-type: none"> ● Active indexing such as the Perfect Order Index measure used with key metrics with root cause drill down readily available through linkage. ● Measures are used to agree process improvement with customers.
Balanced Scorecard of Performance Measures	<ul style="list-style-type: none"> ● Financial measures are the primary measures of performance. ● Little or no access to data to calculate performance measures. 	<ul style="list-style-type: none"> ● Each functional department or work team measures the performance of its own process. ● Poor data integrity causes mistrust of metrics. 	<ul style="list-style-type: none"> ● Each functional department or work team measures the performance of its own process. ● Common definitions for all metrics exist and there is little gaming. ● Fairly good data integrity. 	<ul style="list-style-type: none"> ● Process metrics and results metrics are balanced to prevent sub optimization. ● Functional measures are aggregated to form a companywide view with a linked dashboard in place. 	<ul style="list-style-type: none"> ● A balanced scorecard of customer operational and financial measures is used to make informed decisions and track performance. ● Improvement targets and plans are in place to support each measure.
Measurement Process and Culture	<ul style="list-style-type: none"> ● Metrics are used sporadically—either functionally or individually. 	<ul style="list-style-type: none"> ● Metrics are reported on a regular basis often used only by a few individuals. ● Some manipulation/gaming of metrics to support desired results (e.g. on time fill rate to commit vs. request). 	<ul style="list-style-type: none"> ● Metrics are posted and communicated company wide (e.g. intranet, etc.). ● Reports are “seen” not used by the majority of employees. ● Reports are not used by most managers to drive the business. 	<ul style="list-style-type: none"> ● Metrics are used as part of regular review meetings for all functions to drive business improvements. ● Data is turned into information to make decisions. ● Metrics reports are used by key employees/managers to drive the business. 	<ul style="list-style-type: none"> ● Metrics are used as part of regular review meetings across all functions/all levels (e.g. linking strategy to shop floor metrics to ensure all employees marching to the beat of one drum). ● Metrics are used to drill down and change the process to get results. ● Metrics are visible and posted and part of the culture.

(Source: Kate L. Vitasek)

The main focus should be that employees can easily understand and track their performance against the company's objective. Further, Vitasek recommends measuring more often. "By measuring on a more frequent basis, you can see if your action has had an impact faster, and obtain near real-time results," she states.

4. Build Pareto of reasons for not meeting the goal. Essentially establish a process for root cause analysis and development of corrective action plans.

"Determine and understand why you are not meeting your goals," she mentions. For example, create a Pareto chart (80/20) to show where to focus your efforts. The obvious problem is usually not the root cause, and in order to keep the problem from recurring, the team must drill-down to find the underlying reasons for the problem. A good technique is to ask "Why?" five times.

Often your failures are caused by another department, and the Pareto chart will provide some factual ammunition and a direction to follow.

5. Take action: Fix the problem. All of the work performed up to this point means nothing if you don't do something with it. "Taking action will help to drive change to improve your performance," she notes. "By sharing your VVA data it helps to mitigate emotions and finger-pointing, and explore all actions to solve the problem."

Taking a cue from a client, Vitasek provides an example: "Purchasing is in the process of determining which suppliers have slipped, and are actively issuing corrective actions for suppliers with late shipments, and we're also ensuring all supplier statement of work/contracts have receiving goals outlined."

As another aid, Vitasek provides a self-

audit matrix (see page 11) from which **SSMR** readers can evaluate their performance measurement program and determine where they should focus their improvement efforts.

A new perspective on the supplier scorecard. One tool that greatly enhances the performance management process is the balanced scoreboard, in which there's the integration of other performance dimensions beyond a purely financial view. For example, Aberdeen Group (Boston; www.aberdeen.com) studies have shown companies with formal performance measurement programs were able to improve supplier performance by 27% and enterprises that shared the performance data with suppliers generated 61% greater improvements in supplier performance than enterprises that only used this information internally.

It is observed that almost all best-in-class firms scorecard, and the best-of-the-best are now experimenting with predictive analytics. The objective is to spot inflection points and KPI correlations that identify capacity issues, lead time variability, financial viability, or quality issues long before they would show up on a quarterly scorecard. "They are evolving the scorecard into a forward-looking risk management instrument," Beth Enslow, vice president, enterprise research (beth.enslow@aberdeen.com), observes in her recent study, *The Supplier Performance Management Report*.

She also reveals how companies can improve their scorecarding processes by:

- **Using smaller time buckets.** Measure and report supplier performance in real time or on a monthly basis. Companies that measure suppliers quarterly or annually often miss seeing declining (or improving) perfor-

mance before it impacts their ability to satisfy the end-customer.

- **Getting granular.** Companies that track and share performance and problem history at a geographic location, trade lane, and product family level can pinpoint performance issues across suppliers, logistics partners, and even their own receiving facilities, and determine how to fix them.
- **Looking in the mirror.** Don't point the finger at your suppliers without looking internally first and checking whether any processes have changed.
- **Linking to customer-facing metrics.** Create KPI trees that link primary KPIs across processes. This will help supply managers understand the linkages of their metrics to those of their customer-facing peers, and help to break down functional silo behavior.
- **Being a KPI "user," not just a "collector."** KPIs should be used to identify performance improvement opportunities and create joint action plans, and not be simply a static report card. □

'Right Size' Your Supply Base

CONTINUED FROM PAGE 1

While the "rationalization" process often results in fewer suppliers, there are exceptions where the ideal number of suppliers is not less, but for better risk mitigation, increased capacity, or superior customer satisfaction, more suppliers are required. This is acceptable.

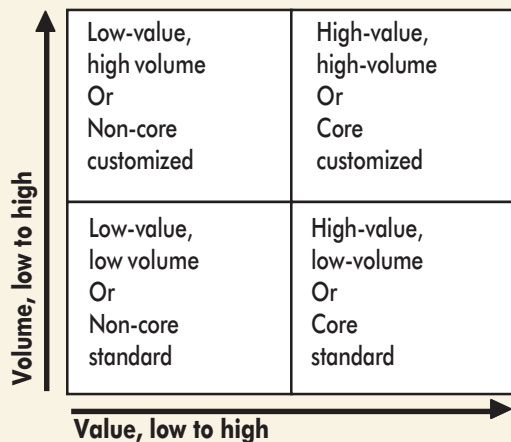
Best practices for rationalizing the supply base. A recent *Critical Issues Report* ("Supply Base Rationalization") from CAPS Research (Tempe, Ariz.; www.capsresearch.org), details a series of the best practices, which can assist purchasing and supply management personnel to put in place an effective supply base rationalization process. **SSMR** summarizes the major points described in the full report, which can be downloaded from the CAPS Research website. Among the accepted best practices to consider:

- **Get buy-in.** Buy-in or support from all parties involved (executive management, internal customers or users, other business units, and suppliers) is critical. For example, executive management support will be necessary if there are capital investments to acquire, and human resources issues to resolve. Both also must be ready to assist with the cultural changes that will accompany the rationalization initiative.

Additionally, internal users who are affected by a supply base rationalization effort do not always accept it in a positive manner. Therefore, the key is to educate them on the reasons for the rationalization, particularly the total cost of ownership approach to sourcing.

Other business units can play a role in the success of supply base rationalization. For example, finance can help validate the savings realized from the initiative, inter-

Four-Quadrant Matrix for Supply Base Rationalization



(Source: CAPS Research)

pret the return on investment for technology, or capture data for the initial spend analysis.

- **Accumulate spend data.** Often the first step in a supply base rationalization initiative. This includes gathering data on: volume spent for various categories or commodities; total number of suppliers for each category or commodity; volume spent with various suppliers; and price detail for given items and services.

This data can be used initially to determine where to focus supply base rationalization efforts. The categories that comprise the largest percentage of spend or have the largest number of suppliers might be better places to start than low-volume categories.

The report notes that it is not necessary to have data on 100% of the spend, nor must the data be perfect at this stage. In order to use the information and make improvements, it is better to “get something done” in some areas rather than worry about having every bit of accurate information.

- **Segment spend categories.** Examine the collected data in terms of various spend categories. Depending on the category of spend, the strategy about how many suppliers, which suppliers, and what type of relationship to have with those suppliers will differ.

The report suggests segmenting spend categories with a two-by-two matrix (see the figure on page 13). The four quadrants represent the categories of: low-value/low volume; low-value/high-volume; high-value/low volume; high-value/high-volume.

Since the customer requirements and the supply market will be unique in each quadrant, various supply strategies are appropriate. For example, in the low-value/high-volume quadrant (MRO products and

services) it might be decided that fewer suppliers will enable volume leverage to result in lower prices. In the high-value/high-volume category (critical production materials) continuity of supply might be a significant driver, resulting in a strategy with business dispersed between several suppliers.

- **Select appropriate number and specific suppliers.** There are a number of ways to first tackle the amount of suppliers. Some organizations list all the suppliers within a category and draw a line after the top 10 or 50, or halfway down the list, depending on the length of the list. Others determine the spend and then draw a line at 80% of the spend.

These actions do not define the supply base going forward, but can be a first attempt at seeing where potential cuts can be made, the report explains. The ideal supply base, however, can begin to emerge by thinking critically and making decisions based on the following considerations:

—**What are the objectives for each spend category.** The decisions about how many and which suppliers to retain will be based on the priorities and goals for each category. For example, in a critical spend area, the objectives might be related to innovation. These factors will also come into play when it is time to measure and evaluate supplier performance. Therefore, suppliers should be chosen based on the criteria on which you plan to measure them.

—**What are the capabilities and capacities of the suppliers.** This is particularly critical when the buying organization is a large global firm. Is there even a single supplier that could provide all your requirements? Even if spend is segmented to various suppli-

ers by region or division, how large a percent of any one supplier's business do you want to be?

—**How many suppliers can you effectively manage.** The goal of supply base rationalization is not merely to change the number of suppliers just for the sake of doing so. The strategic benefits of supply base rationalization are realized when the buying firm is able to work more closely with the retained suppliers, strengthening the relationship, fostering continuous improvements, and finding ways to add value throughout the supply chain. However, the number of suppliers ultimately chosen will be limited by how much of these resources the buying team is able to dedicate to the effort.

—**What are the benefits of competition.** There are arguments for retaining more suppliers for the sake of competition. First, internal users can find a perceived value in having choices; this can be particularly important if compliance is an issue. Second, competition among the supply base can help to ensure continuous value-add and lower costs.

—**What enterprise strategies must the supply base strategy conform to.** Many firms have initiatives around minority-owned, women-owned, small-business, and local suppliers. Objectives can be related to percent of spend; developing these suppliers; a desire to reflect customer communities; the fact that suppliers also might be commercial customers; or even regulatory requirements. These enterprise ideals must be taken into account when rationalizing the supply base.

Some final thoughts. While the trend has been for buying organizations to re-

duce their number of suppliers, supply base rationalization also encompasses the idea that the current supply base is too small and suppliers need to be added. More suppliers may be required if there are capacity issues with current suppliers, if risk factors necessitate alternate sources of supply, if a greater value is placed on customers having more choices, or for objectives around small-businesses, local-business, or diversity-owned suppliers.

Further, there is no "right" number of suppliers which purchasing and supply management strive to achieve. Not only is each firm and commodity category unique, but based on the market, the suppliers' capabilities, and unique customer requirements, there is no way a single formula or number will be correct for all firms, or even a single firm over time.

The cost savings of supply base rationalization are an undeniable and obvious first level perk. However, to realize the full potential of the initiative means developing solid communication, establishing trust, monitoring performance, and providing suppliers with feedback. □

SSMR CALENDAR

DEMAND PLANNING AND FORECASTING COURSE: Chicago; April 28-29; Toronto; Sept. 22-23; Chicago, Oct. 27-28; Orlando; Dec. 1-2. For more information and to register, call 800-258-3862 or visit www.oliverwight.com/courses.html.

SUPPLY CHAIN PARTNERING COURSE: Philadelphia; June 15; Chicago; Oct. 27; Orlando; Dec. 1. For more information and to register, call 800-258-3862 or visit www.oliverwight.com/courses.html.

STRATEGIC PURCHASING MANAGEMENT COURSE: Philadelphia; June 15-16; Orlando; Dec. 1-2. For more information and to register, call 800-258-3862 or visit www.oliverwight.com/courses.html.

SUPPLY CHAIN MANAGEMENT STRATEGY — THE UNIVERSITY OF TENNESSEE: Knoxville, Tenn.; July 11-13. For more information or to register, please visit <http://TheCenter.utk.edu> or call Bric Wheeler at 1-865-974-8759.

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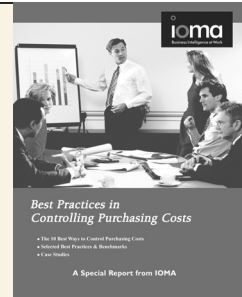
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