In reading the title of this Guide Book I suspect your curiosity might have been piqued by the term *next generation*. Specifically, pertaining to supply management you may be wondering both “What does next generation mean?” and “Why is a next generation needed?” Both of these questions will be answered in detail in the ten sections of this Guide. In general, although Next Generation Supply Management builds on current supply management practice, it dramatically changes many of those practices by introducing strategies, metrics, skillsets and tools more aligned with today’s business needs.

Before getting into what Next Generation Supply Management is, it might be helpful to describe what it is NOT, as follows:

- It is not streamlining traditional practice. So, while *online auctions* may have streamlined different phases of commodity sourcing, they didn’t really introduce anything new. “Three-quotes-and-a-cloud-of dust” becoming “three-keystrokes-and-a-cloud of dust” doesn’t really represent change. And, in my opinion, online auctions were largely misapplied by companies looking for a sourcing process *silver bullet*.

- It does not further separate buying personnel from primary knowledge of supplier operations. As a buyer in the 1980s I spent a lot of time in my suppliers’ factories learning about how they manufactured our parts, gaining a first-hand appreciation of both their strengths and weaknesses. Today it is not unusual for buyers to have never been on-site at some suppliers, even some they consider *strategic*. This has led to a knowledge gap regarding suppliers’ capability that needs to be addressed—and is—with Next Generation Supply Management.

- It is not a re-packaging of current practices into something consultants can “sell” as the “next big thing.” While I work as a consultant, I am of the opinion that most seldom offer clients anything new. Why? Consultants don’t innovate—they repack. I have a significant pride about and investment in the purchasing profession but believe it has lost relevance in executive circles over my career. For the profession to regain its previous standing, innovation is needed to increase and make visible the function’s financial impact.

You may disagree with the above opinion but at a minimum I think we can agree that while over the last generation there have been significant changes in manufacturing strategies and metrics, there has been little fundamental change in procurement practices. This should be seen as a “red flag” by all purchasing professionals and is the reason for my having written this Guide.

I welcome any feedback or questions you may have and can be reached either through my company website or my business email which are included at the end of this Guide.

I’d also like to thank the editors of *IndustryWeek* for recognizing its potential value and making it available to industry.

If you like what you read, be aware that I am in the process of outlining a book on the subject and expect it to be available in 2017.

*Paul D. Ericksen*
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Management by the Numbers

Many companies set purchasing department performance goals that lead to sub-optimal business results. Do you work at one of these companies?

A young colleague I once mentored telephoned me one day to tell me about a job he had just landed with a high-tech company. In his description of that company he told me that their internal slogan was, “We always hit our numbers.” He asked me what I thought of this. Hmm.

Managers in most companies are given numeric performance goals— their numbers— by which they will be personally measured. These numbers are set with the thought they will be leading indicators of company financial performance. So, the thinking goes, if managers can hit their numbers the company should thrive.

The numbers assigned to managers often tell a larger story about specific companies relative to how employees are managed and how individual functions are regarded. For instance, companies that assign extreme performance goal numbers typically do so in the hope that employee effort will be increased. Sometimes this is the result, at least over the short term. At other times the result is reduced morale and dampened effort because employees perceived them as unattainable. Extreme performance numbers assigned to a particular function— such as purchasing— can indicate executive management feeling that the area in question has been under-managed. My personal observation is that setting extreme goals is rarely successful as an ongoing strategy.

A bigger issue relative to management by the numbers is whether the goals are targeted on the best leading indicators of ongoing company financial success. Specifically, are companies setting purchasing department performance goals— either for employees or suppliers— that, should they be attained, will lead to Lean Supply Chain Performance? In my experience this is typically not the case.

The “big three” purchasing performance metrics have always been supplier quality, on-time delivery and price. In other words, purchasing personnel are measured on whether they source with suppliers capable of producing usable products, as needed and at the lowest price. You might ask, “What can be wrong with such an approach? Aren’t these the three performance areas where purchasing can best contribute to overall company financial health?”

My answer to this question is that managing to these three traditional metrics does not lead to Lean Supply Chain Performance, which should be an overriding business goal of all purchasing functions. If they were the correct focus then it would be reasonable to expect that most if not all supply chains should be performing Lean-ly since purchasing personnel have had a focus on these metrics for decades, if not generations.

Over those same decades and generations purchasing department performance metrics have remained static while business and manufacturing have seen dynamic changes. For instance, the Toyota Production System and Lean either weren’t widely practiced or didn’t exist a generation ago. Doesn’t this change in business context merit a review of the adequacy of purchasing performance metrics? The answer obviously should be “yes.”

Supplier quality, on-time delivery and pricing are important, but they are not primary metrics of supplier performance. In other words, non-Lean suppliers are able to game the system to produce Lean-looking results through what are considered wasteful processes. So, these three metrics should be seen as necessary but not sufficient. The next obvious questions are, “Do we know the additional performance metrics that are needed to produce Lean Supply Chain Performance?” and “Can we convince executive management to adopt them?” The answers to these questions are “yes” and “yes” and will be covered in later sections of this Guidebook.

You may be wondering how my young colleague did at his new company—the one that “always hit their numbers.” Within a couple of years he was looking for a new job and shortly thereafter his former employer went broke. And though it was true that until its demise the company did “always hit its numbers” the unfortunate reality was that their performance goals were set in the wrong areas.

Most performance goals are not set such that their achievement will drive a company out of business. But, unfortunately most companies do set performance goals that lead to sub-optimal business results— particularly in purchasing. Do you work at one of these companies?
Metrics that Facilitate Improved Supplier Performance

Quality, on-time delivery and price do not correlate directly to supplier operational efficiency and because of this come up short for management of suppliers. Why? Because they don’t tell customers how suppliers achieve their performance, a foundation of Next Generation Lean Supply Management.

In the last section an assertion was made that a focus on customer-established quality, on-time delivery and price performance targets hadn’t produced optimal supplier operational effectiveness. This point represents a bit of heresy within the supply management profession since these three metrics are what can be characterized as the holy trinity of supplier performance metrics. Certainly, if such traditional metrics are going to be questioned, additional elaboration is needed. Please bear with me.

Original equipment manufacturers (OEMs) as well as many of their upper-tier suppliers have, over the last generation, transitioned away from fabrication to almost a sole focus on assembly. As a result, the greater portion of OEM cost-of-goods-sold has changed from being generated internally to primarily coming from purchased material. This implies that supplier operations are now the greater part of an OEM’s extended enterprise. In the past OEMs could concentrate on those aspects of supply chain performance that kept their own operations efficient—quality, on-time delivery and price—and be reasonably assured that this focus would keep suppliers competitive. With the greater impact of purchased material on cost, OEMs need a deeper understanding of supplier Lean-ness if they want to maintain competitive supply chains.

The following question gets to the nub of the issue:

“Have the traditional quality, on-time delivery and price supplier performance metrics produced Lean supply chains?"

The obvious answer to this question is “no.” Why? Because as previously explained, suppliers can game the system such that they are able to hit their given quality, on-time delivery and price performance targets through wasteful means yet still be viewed as top performers by their customer. How is this so? Here are a few examples:

- Intensive sorting can ensure that (most) parts delivered to their customers do not have defects. Yet, the resulting high quality performance is no indication that a supplier has adequately targeted and controlled manufacturing.
- Large built-ahead stocks of inventory can ensure on-time delivery of customer orders. In this scenario, high on-time delivery results do not assure that a supplier has high order fulfillment agility.
- Cutting or eliminating margins—or investment, for that matter—can help maintain price competitiveness, at least for a while. Suppliers that defer necessary investment tend to require customer crisis intervention (fire-fighting) over the long run.

Suppliers are able to look good in the eyes of their customers because these three performance bogeys are secondary metrics. Secondary metrics measure results but do not give insight into how those results were obtained. OEM focus on secondary supplier performance measures may have been adequate when the greater influence on cost was internal operations and the key factor to overall competitiveness was keeping their own manufacturing operations running efficiently. The increased impact of purchased parts on overall cost-of-goods sold means that supplier operational efficiency needs increased attention.

Quality, on-time delivery and price are not directly related to supplier operational efficiency and so come up short in delivering Lean Supply Chain Performance. Why? Because they don’t tell how suppliers achieve their performance. Again, they do not prevent gaming the system from coming into play.

What is needed is a primary metric that relates supplier performance to supplier operations. Most OEMs today do not use such a primary metric of supplier performance and so are, in effect, “operating in the dark” relative to supplier performance and improvement.

How should this metric gap be addressed? Are the traditional metrics to be discarded? Of course not. Supplier impact on OEM internal operations—as indicated by secondary metrics—remains important. In Next Generation Supply Management, however, quality, on-time delivery and price are considered necessary but not sufficient pieces of supplier data. What is also needed is
knowledge of whether supplier performance is the result of Lean or through waste.

Luckily, over the last two decades such a primary metric has been developed in academia and proven out through use by a handful of forward-thinking OEMs. I will share this metric and explain how it can be applied in conjunction with the holy trinity later in this Guide. Rather than leaving you completely in suspense, however, I’ll give a hint on the essence of this new metric by ending with quotes from two Toyota executives:

Taiichi Ohno, considered the father of the Toyota Production System:

“All we are doing is looking at the timeline from the moment the customer gives us an order to the point when we collect the cash. And we are reducing that time by removing the non-value-added wastes.”

Osamu (Simon) Nagata, chief administrative officer, Toyota Motor-North America:

“Time is the shadow of waste.”

Manufacturing Critical-path Time: A Measure of True Lead-Time

Manufacturing critical-path time (MCT) is the time it takes a manufacturer to satisfy both anticipated and unanticipated demand through normal processing. It is a primary metric of supplier performance since it gives insight on how performance was achieved.

Hopefully you are now convinced of the case for the need of a primary metric of manufacturing effectiveness in the assessment of supplier performance. The teaser quotes at the end of the last section hint at the type of metric that is needed. From these quotes—the first by Taiichi Ohno (father of the Toyota Production System), and the second by a past executive vice president of Toyota’s Supply Management function—it was fairly obvious that the metric to be proposed was going to be a time-based one.

Manufacturing critical-path time (MCT) is a measure of “true” manufacturing lead-time. It is defined as:

The typical amount of calendar time from when a customer creates an order, through the critical-path until the first, single piece of that order is delivered to the customer.

Saying this in a different way, MCT is the time it takes a manufacturer to satisfy unanticipated demand through normal processing. The phrase “normal processing” implies many things, including that the customer order is:

- Not treated as a “hot” job by being given priority to the detriment of other work already in the schedule.
- Not fulfilled through the use of pre-built, pre-positioned WIP or finished product inventory.

It is common sense to think that the longer it takes to deliver an order the more the potential for waste reduction. It also is appropriate that a new metric for Lean involves “time” since this has always been at the root of the Toyota Production System, which is from where Lean was derived. One question that does arise is, “Why is there a need to propose a new metric for lead-time?”

Talking to people about lead-time can seem like a discussion on the 10th floor of the Tower of Babel. Individual perspectives lead to different takes on what lead-time means. For instance, when marketing personnel are asked by customers to quote lead-times what is the basis of their quote? Is the lead-time number they provide in any way related to the physics of the factory floor or is it more based on what the marketing rep thinks it needs to be to get a customer order? On the other hand, a quote that includes an MCT value is both definitive and based on actual capability.

In addition to having a standard definition for lead-time, there’s another fundamental reason for adding a lead-time metric to Lean. This can perhaps be best explained by asking the question, “How do you quantify the status of a company’s Lean-ness?” There is currently no straightforward way to answer that question, which often leads manufacturers to the question of wondering “when will we get there?” i.e., be Lean.

Manufacturing Critical-path Time can be used to answer this question. The shorter the MCT, the leaner you are. Build-to-demand is a term often characterized as describing order fulfillment “nirvana,” i.e., being able to satisfy an order without pre-built inventory or other types of waste. The shorter a job’s MCT, the closer a manufacturer is to being build-to-demand capable. The closer a company is to build-to-demand capable, the Lean-ner that company is.
The use of Manufacturing Critical-path Time opens the door to more effective strategies for Lean implementation. MCT reduction potential is a great way to prioritize available Lean activities. Those activities that offer greater opportunity for reducing your “true” lead-time should be done first. You might ask why. The following two points offer convincing arguments for this:

1. **Lean activities today tend to be treated as isolated events.** Because of this, it can be difficult to consolidate the impacts of individual Lean activities to a level that gets them recognized and/or appreciated at the executive level. MCT reduction as an over-riding Lean strategy prioritizes manufacturing improvement activities that will most impact order fulfillment effectiveness. I can guarantee that if you can tell the executives of your company that your supply management work has maintained or increased company Customer Fill Rates at the same time allowing for reduced levels of pre-built, pre-positioned finished goods Inventory, you’ll have their attention.

2. **Lead-times can represent a competitive advantage.** If you are able to guarantee better support of unanticipated demand/un-forecast orders than your competitors, you will increase your success at getting and retaining customers. Having a definitive metric of lead-time will only raise the level of appreciation of Lean throughout both your internal organization and your potential customer base.

In closing, a justification has been laid out of the need for MCT (“true” lead-time) as a new manufacturing efficiency metric and stated that this metric will deliver increased insight into order fulfillment capability. And because of this, it can provide OEM customers insight into the Lean-ness of their suppliers. This is a fairly bold assertion. In the next section I’ll review documented results of firms applying MCT reduction to internal operations as well as original equipment manufacturers who have applied it in the management of their supply chain which provide strong support for this assertion.

**Where’s the Beef? Industrial Justification for Next Generation Supply Management**

Actual industry data justifies adopting Manufacturing Critical-path Time as a primary metric for supplier performance. As such, it should be the center-piece of understanding supplier operational capability.

Perhaps you’ve been persuaded by the arguments I’ve made that adoption of a new, primary metric of supplier performance is needed for Next Generation Supply Management. And maybe, just maybe, you’ve bought-in to the proposal outlined in the last section that Manufacturing Critical-path Time (MCT) should be adopted as that metric. Perhaps, though, you’re still wondering whether this is just an opinion from another Ivory Tower observer—everyone has opinions and many don’t reflect reality—or whether industrial experience exists that backs up the concept. In other words, you may be asking, Where’s the Beef?

This section will summarize three “beefy” MCT industrial case studies. The first involves an original equipment manufacturer (OEM) that wanted to start selling products through Big Box stores. The OEM realized that in this, supply chain flexibility would be the key to a competitive advantage since it would allow for support of Big Box short-fuse order fulfillment requirements without the need for enormous amounts of pre-built inventory—which were what industry competitors already selling through Big Box stores relied on.

To increase supply chain flexibility the OEM initiated a supplier development effort that focused on the reduction of “true” supplier lead-times, i.e., MCTs. Over a seven-year period the average MCTs of suppliers who supplied parts for the product targeted by the OEM for the introduction of its brand into the Big Box channel were reduced from about 90 days to just over two weeks, i.e., a 78% reduction. This allowed the OEM to successfully launch its Big Box marketing initiative. But that wasn’t the whole story.

Like many OEMs, this one routinely measured and evaluated supplier quality, delivery and price. Over the
seven-year supplier MCT reduction effort the OEM noticed that performance by impacted suppliers in these three traditional metric areas improved to the point that they were out-performing suppliers of all other products produced by the company. In fact, over that seven-year period:

- On-time delivery in parts per million defects went from over 2,000 to less than 500.
- As-delivered quality percent defective was reduced from about 9 to 2.
- Suppliers were more successful in meeting the OEM’s annual continuous improvement price reduction goals.

Additionally, one participating defense prime reported that the delivery and quality performance of their 21 suppliers who had participated in the program had improved 56% and 26%, respectively.

The final case study was documented in a February, 2005 article titled “Improving Asset Management and Order Fulfillment at Deere & Company’s C & CE Division,” which was published in Interfaces. The slant on this case study was slightly different—which makes it all the more important to understanding what Next Generation Supply Management is all about. Acknowledging that “a responsive supplier chain with a manufacturing cycle time (MCT) of three weeks or less” was required, the article reported impacts of:

- Reduced and avoided inventory of $890 million, which translated into $107 million of sustained shareholder value-added.
- On-time delivery to dealers was improved from 63% to 92%.
- Service level to end-customers was maintained at 90%.

Here, an OEM supply chain strategy of short MCTs delivered a reduced need for finished goods inventory while supporting maintained and/or improved customer fill rates. These are executive-level financial exhibit impacts we’re talking about here! And that’s on top of any other resulting supplier performance improvements (quality, delivery and price).

In conclusion, actual industry data has been laid out that justifies adopting MCT as a primary metric of supplier performance and I think it’s safe to say the three case studies presented represent “a lot of beef.” Further, a sense is provided for exactly what is implied by the phrase Next Generation Supply Management. Specifically, Next Generation Supply Management describes a procurement function that has a recognized role in impacting executive-level financial metrics “above and beyond” that of material variance, i.e., piece-price. And MCT plays a critical role in giving visibility to these impacts.

Elaboration on this topic will be the focus of the next section of this Guide and should provide a very interesting read for procurement professionals who today have a primary focus on delivering annual price reductions—isn’t that just about everyone?
Should Procurement have A-Seat-at-the-Table?

The essence of procurement needs to be changed such that its impact on company financials is seen as more than just through annual piece-price reductions, and through this ensure that procurement executives earn A-Seat-at-the-Table.

The last section concluded with the suggestion that the next few sections could prove very interesting, particularly to purchasing professionals who have a primary mission of delivering piece-price reductions. Since I believe that this piece-price directive covers just about everyone working in supply management today, this section could generate considerable angst.

Why? Because with this being the fifth section to this Guide you’ve now been provided with enough background to understand that Next Generation Supply Management points to a need for revising current procurement practices. And without these changes, supply management will never have A-Seat-at-the-Table.

What does this phrase imply? To answer that I’d ask you whether at your company the procurement function has a voice in decisions regarding strategic direction, financial goals, and how those directions and goals will be pursued. If the answer is “yes”, congratulations. At your company, Supply Management does have A-Seat-at-the-Table.

On the other hand, maybe your company’s procurement function is relegated primarily to delivering the piece-price reductions needed to support the business plans designed by the executives of the other functional areas, i.e., those who do have A-Seat-at-the-Table? I imagine that at least for some of you, the posing of this question will be a bit awkward since you’ll end up concluding that in your company the procurement function is not considered part of the “A-Team” but rather is considered a secondary and tactical afterthought.

Let me relate an example that will illustrate what I’m getting at.

A colleague of mine worked at a company where procurement reported up through product design. He was once at a company social gathering when he overheard the vice-president of product design say to another company executive:

“You know, when you get down to it, all you really have to do if you are in purchasing is figure out where you can get the best price. That shouldn’t be so hard. My wife does that every time she goes shopping.”

You may think that this comment reflects one “outlier” perspective. Having worked in industry for almost four decades I can assure you that this sentiment is fairly prevalent among non-purchasing executives. In the minds of many of our colleagues from other functional areas the role of purchasing is simply to “go shopping” for the lowest price. This attitude is particularly common, I’ve found, among accountants.

You might ask, “How can this be? Don’t these people understand the financial impact above and beyond piece-price that procurement can deliver to an organization’s bottom line?”

Unfortunately, the answer to this is usually a resounding “No!” And even more distressing, you’ll likely find that many procurement professionals are also neither aware of these other potential procurement-related financial impacts nor how to deliver them.

Why? Because they see themselves strictly as Buyers and have allowed themselves to become boxed-in by the prevailing attitude that the procurement function only delivers financial impact through piece-price reduction. Consequently, to hit their performance numbers, these procurement professionals must focus their every effort in pursuit of a solitary objective of getting supplier “cost downs,” and are not open to considering and advocating complementary/ supplemental strategies within their organization. This may be okay for a person actually holding down a Buyer position—personally, I don’t believe this, but can understand someone taking this stance—but it certainly is not okay for a person in a position of Supply Management authority. Particularly if—as I do—you care about the advancement of the procurement profession.

To get out of this box the procurement profession needs to “drive a stake in the ground” and say:

From here on out we will contribute to the company’s bottom line through a balance between piece-price reduction and other strategies, and—just as importantly—
will be recognized for this increased contribution.

In other words, the procurement function will expand its focus such that it earns A-Seat-at-the-Table.

Part of driving that stake in the ground is applying a different label for what we do, hence, the coining of the phrase Next Generation Supply Management. It is agreed that over the last couple of generations the essence of business has changed substantially. Over the coming years it will be up to the people and leaders in purchasing profession to change the essence of procurement such that its impact on company financials is seen as more than annual piece-price reductions. Are you up to this task?

The Piece-Price Reduction Trap

Procurement has much more to contribute to a company’s bottom line than just piece-price reduction.

As laid out in the last section, the purpose of calling out the name Next Generation Supply Management is to initiate a change of perception—prevalent among many executives today—that procurement’s sole ability to contribute to a company’s bottom line is through piece-price reduction. Facilitating such a transformation will be difficult but not impossible. Why will it be difficult? The only real executive level financial exhibit currently tied to procurement is material variance, i.e., piece-price. Based on this, how can our functional area break out of the piece-price reduction box? It can do so by voicing the counter-arguments in the same language that created that “box” in the first place, i.e., executive-level financial exhibits.

Citing non-piece-price positive impacts on executive level financials can be an effective strategy for raising the stature of the profession, but only if it can be shown that procurement should be given credit for improvements that today are typically assigned to other functional areas. In other words, turf wars may be required to overcome traditional mindsets. But, as they say, “nothing ventured, nothing gained.” The good news is that data is available to support these mindsets and, eventually—though it may take time—data usually wins out over opinion.

Let’s start with a discussion of finished goods inventory.

The sole purpose of the costs incurred in manufacturing and holding pre-built finished goods inventory is to maintain acceptable customer fill rates. What is customer fill rate? Most companies do not want to lose sales due to lack of product availability. A customer fill rate metric measures what percent of the time—when a customer wants pay you for a specific product—the company is able to deliver the product and accept the money.

Recognizing that they do not have “build-to-demand” capability, most companies rely on a certain amount of pre-built finished goods to ensure that they will be able to support high variability (in both volume and mix) of customer demand. Companies I’ve worked for have had customer fill rate percentage goals in the high 90s.

The levels of pre-built product required to support acceptable customer fill rates is usually industry specific. In some types of markets customers are willing to wait weeks or months for the product they want, reducing the amount of finished goods inventory needed by a manufacturer to acceptably fulfill demand. In other types of markets customers expect immediate satisfaction or, at most, product availability in days. In these industries significant amounts of finished goods inventory may be required to support customer fill rate goals. Often the costs associated with holding these finished goods inventories are “owned” by a company’s marketing organization, primarily because marketing is responsible for the warehouse where they are stored. Consequently, any reduction in these “costs” is usually credited to marketing.

In one of the Where’s the Beef case studies a company was discussed which was able to reduce need for $890 million in finished goods inventory yet maintain targeted customer fill rates. This case study pointed out a primary reason the finished goods inventory reduction was possible was “a responsive supplier chain with a manufacturing cycle time (MCT) of three weeks or less.” In fact, the build-to-demand capability of the company had increased significantly as “true” supplier lead-times (MCTs) had gone down and, as a result, customer fill rates were maintained with less finished goods inventory. The case study then went on to point out that this finished goods inventory reduction resulted in an annual recurring savings of $107 million!

Over my career I’ve had responsibility for significant annual “spends.” And I’ve done pretty well in delivering annual piece-price reductions, hopefully in the right way, i.e., through facilitating lower supplier costs. But
I will admit to never in any single year delivering $107 million in piece-price reductions! Not even close. Having personal knowledge of this case study, I can tell you that the “traditional” piece-price reductions delivered that year for the studied products—while meaningful—were magnitudes below the savings associated with the reduction in finished goods.

So here we have a case where the procurement function was primarily responsible for delivering an exceptional financial benefit to a company through a means other than piece-price reduction, i.e. working with suppliers to reduce their MCTs. In a company where the purchasing organization focuses solely on piece-price reduction, elimination of finished goods inventory and its associated costs won’t be done. And the $107 million wouldn’t have been delivered to the example company’s bottom line.

I will bring up one possible glitch to the story. Remember, at this company marketing “owned” finished goods inventories. When the need for it was reduced they wanted the credit for the positive financial impact. After all, the inventory was stored in their warehouse! So, turf war indeed! In this case it was easy to show that Procurement was responsible for the savings since supplier “before” and “after” MCTs could both be documented and shown to be the reason for needing less finished goods in support of customer fill rates. Regardless, it behooves purchasing professionals to anticipate the need—and to prepare your case—for receiving the credit deserved for making such non-piece-price related positive financial impacts.

After the above discussion it almost goes without saying that a reduction in Raw Material can also be achieved by working with suppliers on MCT reduction. Similar to finished product, raw material inventory has a purpose, namely, to ensure that factory operational efficiency will not be negatively affected by lack of purchased parts. Current practice is for pre-built levels of purchased parts to be held either by the consuming factory, their supplier, or both. With reduced supplier MCTs, levels of raw material safety stock can be reduced without negatively impacting a consuming factory’s operations since suppliers have increased build-to-demand capability.

A possible turf war issue may be that in many companies raw material is “owned” by manufacturing, not procurement. After all—factory management will say—it is stored in their factory! Again, having facts on hand to show the actions that led to the “safe” reduction in raw material inventory should deliver the deserved credit for this savings to procurement.

The dollars saved in the above discussions are real; they have the same positive impact on company financials, dollar-to-dollar, as reductions in piece-price. And they have the added benefit to greatly outweigh the savings available through piece-price reduction. The sole issue then becomes: Does the procurement function in your company have the flexibility to focus efforts on cost reduction strategies other than piece-price?

The Overseas Sourcing Decision

Knowledge of Manufacturing Critical-path Times can help you make smarter decisions when it comes to using overseas suppliers.

It can be difficult to discuss overseas sourcing without introducing emotion into the debate. But that’s what procurement people need to do. And knowledge of supplier Manufacturing Critical-path Times (MCTs) can help you do it.

First, let’s talk terms. What was initially described as overseas sourcing later came to be known as low cost country sourcing—a label advocated by its supporters and, in my opinion, introduced to bias the debate. For instance, how could anyone logically argue against wanting to source from a “low cost country?” The reality is that while overseas sources tend to be “low piece-price,” whether they are truly “low cost” remains a moot point. In order to remain impartial let’s agree to more accurately describe the overseas sourcing phenomenon that started in the 1990s for what it is: low piece-price country sourcing.

Don’t get the impression that I’m against sourcing overseas. I’m not, and over my career I have done a significant amount of it. I am in favor of doing whatever it takes to have a positive impact on the business. What I am NOT in favor of, however, is blindly following popular trends in a lemming-like manner, something I believe a fair share of procurement organizations did over the last two decades relative to low piece-price country sourcing.

There are times when it is the right decision to source with overseas sources and there are times when it is not. MCTs bring focus to overseas sourcing decisions since it helps to more clearly define associated costs.

Some will probably argue that a Total Acquisition Cost
(TAC) computation is the only thing needed to compare low piece-price country suppliers to domestic sources. After getting to this point in this Guide you should understand that the length of a supplier’s “true” lead-times—their MCTs—ties directly into (at least) two types of financial impact not tracked in Material Variance:

1.) Inventory, both raw material and finished goods, needed to support customer fill rate goals.

2.) Revenue related to suppliers’ ability to support un-forecasted customer demand.

In addition there are all sorts of other Indirect costs tied to the infrastructure required at original equipment manufacturers (OEMs) to support supplier non-performance, i.e., scheduling, expediting, quality, etc.

Since these are not tracked in Material Variance they are seldom included in TAC formulas. While the Indirect costs I cite above are real and can be significant, for the remainder of this section I will focus on the insight that MCT delivers on a supplier’s capability to support un-forecasted demand.

MCT isn’t just a lead-time metric of office and shop floor operations. It also includes the time needed to deliver products to a customer’s point-of-use. Most low piece-price countries are overseas and because of the suppliers located in them have longer MCTs due to logistics. You might argue that adding logistics time to MCT isn’t a fair to overseas suppliers. The fact is that sourcing overseas—low piece-prices or not—decreases supplier ability to support the order fulfillment needs of domestic OEMs because it typically adds weeks, if not months, to MCTs. If by sourcing with a lower MCT domestic supplier an OEM is un-able to reap profits associated with fulfilling un-anticipated—incremental—demand then, logically, it makes sense to say that sourcing with a longer MCT low piece-price country supplier will likely expose an OEM to a certain amount of revenue loss, depending on the inaccuracy of the underlying forecast.

Should this potential loss of revenue be taken into account in your sourcing decisions? Absolutely. How to do this, then, becomes a critical issue. As previously stated, OEM TAC formulas tend to focus on things like logistics cost, currency risks, etc., both because they can be tied directly to Material Variance (again, currently the primary metric used to measure Supply Management function performance) and can easily be quantified. On the other hand, Supply Management is seldom formally measured on whether its suppliers are able to support order fulfillment outside of what was forecast. I’ve only heard of one company who takes lead-times into account in its TAC formula, i.e., they add 1% to a quoted price for every week of supplier MCT. Good for them!

But what about you and the sourcing decisions you need to make? What do you do to quantify the risk of lost revenue that longer MCT suppliers can expose your company to? You use common sense and follow a couple simple rules:

• The shorter your product’s selling season, the greater the risk of incremental revenue loss by sourcing with long MCT suppliers. To understand this, all you need to do is think about toy availability during the Christmas sales season. Most toys come from overseas low piece-price country suppliers and, as a consequence, when marketing forecasts underestimate demand it is not unusual for a popular toy to be sold out shortly after Thanksgiving. Due to the short holiday selling season, those overseas sources can’t resupply their customers before the end of their selling season. And these customers find that the additional demand seldom lasts—dying out soon after Christmas—meaning that the potential additional sales are lost forever. Think of how much more money toy sellers could make if they would source high-side demand potential toys with short-MCT suppliers, i.e., ones that could react to and satisfy unanticipated short-fuse demand?

• The greater the record of error in a company’s forecast history—in both volume and model mix—the more the risk to incremental revenue by sourcing with long MCT suppliers. The shorter a supplier’s MCT, the greater the odds that it will be able to compensate for customer forecast error and satisfy demand. Note: New product introductions are particularly susceptible to forecast error, as are brand introductions through new marketing channels.

• Even though MCT is not a precise measurement, MCT comparison between potential sources is important. If there is a part MCT difference between suppliers exceeding single digit percentages it should be pretty plain that piece-price should not be the only primary sourcing decision factor.

Of course, the safer approach in selecting sources is for supply management professionals to focus on those factors that can be directly quantified to Material Variance, i.e.
since these often end up becoming the basis of personal and department performance metrics. If you are good at delivering low piece-prices, this strategy (using baseball terms) may occasionally deliver competitive advantage “singles”—and perhaps even some “doubles”—which will be incrementally good for your company and (possibly) for your career.

But if you are willing to take some professional risk and along the way want to position the Procurement function for A-Seat-at-the-Table, you’ll introduce concepts similar to those outlined above to your organization and include evaluation of low piece-price country supplier MCTs in your sourcing decisions. In doing so you will have the potential to deliver competitive advantage “doubles,” “triples,” “home runs” and even the occasional “grand slam” as your company reaps the windfall-type profits associated with satisfying unanticipated incremental demand.

The Extended Enterprise and Next Generation Supply Management

The decision to treat strategic suppliers as part of your extended enterprise comes down to weighing the costs/risks associated with changing sources vs. the cost of assisting current suppliers to improve performance.

Even though I only met him once, one of my professional role models was Thomas Stallkamp who, along with Bob Eaton and Robert Lutz, made up the executive “triumvirate” responsible for Chrysler’s financial successes in the 1990s. Stallkamp was father of the extended enterprise approach to supply management. In fact, the term extended enterprise became so important to Chrysler that in 1999 they obtained a trademark for it, as follows:

Extended Enterprise: Extending business relationships by providing process management consultations and workshops to... suppliers and supplier tiers in order to reduce cycle time, to minimize system cost and to improve the quality of the goods or services provided by the suppliers.

Unfortunately, after the Chrysler-Daimler Benz “merger” Stallkamp and other top Chrysler executives got pushed aside by their German counterparts and many of the strategies they had championed—including extended enterprise supply management—were abandoned. Probably related to this, numerous business school case studies have been written on how Chrysler fared under Daimler Benz management and they all pretty much agree that things didn’t go well.

I personally was excited by Chrysler’s extended enterprise approach to supply management because it offered a new strategy for achieving business impacts that the more staid, traditional procurement practices were falling short on. I see Next Generation Supply Management as the natural evolution of what could have resulted had extended enterprise remained the basis of Chrysler’s supply chain strategy.

Next Generation Supply Management extends Stallkamp’s initial supplier support concept to the following:

Under this approach, strategic suppliers to original equipment manufacturers (OEMs) are no longer just given tactical performance goals and expected on their own accord to achieve them. Instead, OEMs collaborate with and assist them—as needed—in their continuous improvement efforts.

This may seem a bit benevolent. And when I first started implementing this derivative of Stallkamp’s extended enterprise approach, it did meet with resistance for exactly that reason. I distinctly remember a discussion with a high-level executive where I worked who didn’t support the idea because as he told me (and anyone else who would listen), “We pay our suppliers good money for their product. That should be enough.”

At the time I wasn’t at a level where I was in a position to argue with him. And, intellectually, he was right. But I was looking for a solution to the real world problem where suppliers weren’t hitting performance goals on their own and the company I worked for was locked into them as sources. The key here is how to define the term strategic.

I’ve seen dozens if not hundreds, of attempts to define this term as it relates to suppliers and supply management strategies. The definition for strategic supplier in Next Generation Supply Management is non-traditional since—as is typical with most current definitions—it does not
Where Should Supply Management Report in an Organization’s Hierarchy?

Today’s reporting structures often relegate the procurement function to a tactical, second-class organizational position.

The question of whether procurement should have a Seat-at-the-Table is directly related to the question of organizational structure. Consequently, the issue presented in the title of this section is one that is loaded with emotion. Perhaps the best way to both defuse this emotion and determine optimal procurement function reporting structure is by identifying and eliminating those that should definitely be avoided. Even if this process does not result in a “last man standing” scenario, it should certainly increase the probability of a good outcome!

The Piece-Price Trap section set the stage for discussion of the #1 reporting relationship to be avoided: namely, Supply Management reporting to Finance. Let’s face it, chief financial officers already have their tentacles into the conduct of virtually every functional area in an organization through the financial exhibits they impose, monitor and report on. This in itself greatly limits the flexibility on both how these other areas are managed and their resulting business impact.

You only need to think about how Finance penalizes Operations for reducing lot sizes to understand what I’m getting at. These restrictions only get worse—particularly for Supply Management—if your functional area actually has to report to Finance.

To help make my point I’ll reference a column by IW editor-in-chief Patricia Panchak, Did Finance Gut Manufacturing? That’s quite a thought-provoking title, which I’m sure raised the hackles of any financial person reading it. Panchak has never been afraid of sticking her nose directly into important issues, controversial or not, and I praise her here once again for doing so.

That title could just as easily have been posed as, “Did Finance Gut Supply Management?” The primary exhibit Finance uses to measure supply management productivity is Material Variance, which is essentially a stand-in...
measure for **piece-price**. As was laid out in “The Piece-Price Trap,” having an exclusive focus on piece-price will never land Supply Management A-Seat-at-the-Table. But this is exactly the strategy that Finance would have Supply Management pursue. Panchak’s column demonstrates this by quoting Marty Thomas, senior vice-president of Operations & Engineer Services for Rockwell Automation:

“If you have Strategic Sourcing reporting to Finance, what do you get? You get purchase price reduction. What else do you get? Nothing. You get purchase price [reduction] at all costs. You don’t get lead-time [reduction]; you don’t get order quantity [reduction]; you don’t get on-time delivery; and, you don’t get quality. You get purchase price reduction. You get what you deserve.”

This quote hardly needs any elaboration. It is a classic description of the smothering impact that a finance function bias can impose on Supply Management practice. Recognize that Thomas isn’t even a purchasing professional, yet sees and remarks on this negative impact.

Panchak poses the question, “Has our focus on financial metrics held back manufacturing business success?” and goes on to cite two manufacturing authorities that answer that question with an empathetic YES.

I’ll piggyback on her words again by relating them to Supply Management, i.e., “Has our focus on Material Variance held back Supply Management contributions to business success?” Re-read the section on **Should Procurement Have A-Seat-at-the-Table?** and you’ll be hard pressed to argue that it hasn’t. The bottom here line is this: If you want to work for a Supply Management function with the freedom to have the maximum positive impact on your business, don’t hire on to one that reports to the Finance function. So, I think we can all agree that Supply Management should not report to Finance.

Another reporting relationship Supply Management should try to avoid like the plague is the one reporting to Product Engineering. Why? First, but (probably) not foremost is the bias that many engineering executives have regarding Procurement being nothing more than glorified “shopping.” As I related in Section 5, an OEM engineering vice-president I once knew said at a social gathering, “When you get down to it, all you really have to do if you work in Purchasing is figure out where you can get the best price. That shouldn’t be so hard. My wife does that every time she goes shopping.” It is an understanding that bears repeating since it is so baldly wrong yet so prevalent among Design executives.

In my experience this attitude is fairly prevalent among design executives which discount virtually every other financial impact Procurement can have outside of Material Variance. But it gets worse. When Supply Management reports through Product Engineering, engineers tend to more frequently “rainbow” the sourcing process by working directly with specific suppliers on development of new and/or revised products, essentially limiting negotiating leverage. This would be similar, I suppose, to the previously cited engineering VP telling his wife not only to buy him a new pair of “wingtips” but also telling her who to buy them from and then adding, “But dear, make sure you get a really good deal.”

Of course, Supply Management impacts much more than piece-price and removing competition from the sourcing process not only diminishes the impact Procurement can have on pricing but introduces all sorts of associated risks. For instance, is the firm that Product Engineering has worked with financially viable? Further, does it have the manufactoring wherewithal to transition its prototyping capability to a production basis in support of forecast order fulfillment needs? Again, I think we can also all agree that Supply Management should not report to Product Engineering.

What about Operations? Should factory Operations have oversight over the procurement function? Next Generation Supply Management views OEM and suppliers all as part of a single value stream. Consequently, OEM manufacturing operations are seen as no-more-and-no-less than all other outside links in the order fulfillment chain. Granted, important links, but links nonetheless.

Many OEM organizations have Supply Management reporting up through the factory Operations. This usually results in a primary focus on **internal** constraints. In other words, they look inside at what they are able to produce and expect suppliers to jump to match it—jumping through hoops, if need be. Quite often the schedule “loaded” by the consuming OEM factory is either not feasible across all outside sources or requires additional expense for specific suppliers to support. The issue then becomes what functional department has the best visibility to all bottlenecks—whether internal or external—and can correspondingly put together a schedule that can both maximize alignment with demand and minimize waste?

Supply Management, of course, is best positioned to do just that since they have visibility to overall value stream constraints. It is important to understand that today’s
prevailing organizational structure—where Supply Management reports to factory Operations—harkens back to the day when the largest portion of a company’s cost-of-goods-sold was generated internally with purchasing costs being more of an afterthought. Think about how roles have reversed over the last 60 years. Purchased content today usually accounts for well over 50% of an OEM manufacturer’s cost-of-goods-sold with internal manufacturing costs having become the afterthought.

In one of my past materials manager positions I convinced the general manager—whom I reported to—that Supply Management should manage factory scheduling. During my tenure in that position there were significantly fewer schedule interruptions than over any previous period and the factory did as good a job as was ever done in supporting customer fill rates. In addition, suppliers were not asked to jump through those hoops or incur additional costs to support our schedules. I’m a realist and doubt that you’ll find many general managers today that are willing to have factory Operations report to their Supply Management function. But the cost-of-goods-sold role reversal and the order fulfillment risk exposure cited above create a “bully pulpit” for purchasing managers to propose this, and that Supply Management report directly to the general manager. And with this Supply Management will be better positioned to earn A-Seat-at-the-Table.

Supply Management Strategies to be Avoided

Giving common broad-brush performance goals to all suppliers can actually lead to counter-productive results. This section will focus on a widely applied traditional supply management practice that is actually counter-productive to effective Supply Management. Before I get specific, let me remind you that suppliers need to be assigned to different supplier categories and those different strategies should be employed in the management of those categories. Because of this, recognize that the comments that follow may apply more to some supplier categories and less to others.

OEM broad-brush strategies generally do not support progressive supply management. I’ll use one such broad-brush practice—the setting of annual across-the-board price reduction goals—as an illustrative example. I understand that such across-the-board goals are generally set by management as an average target for overall material price reduction. Too often, however, they are translated into common individual supplier price reduction expectations to Buyers—the people charged with delivering supplier price reductions.

You might ask, what is wrong in putting a common price reduction goal in front of all suppliers? I’ll try to answer this question in two ways. First, I’ll do so by showing that it doesn’t make sense from a logical point-of-view. Second, I’ll show how it can actually lead to counter-productive results.

The Illogic of Across-the-Board Price Reduction Strategies

Let’s start by reviewing the ABCs of price setting. Prices are set based on “cost” and “margin.” If a supplier is unable to lower its cost through waste elimination, price reduction negotiations become a “zero-sum game,” with OEMs being “winners” when they get lower pricing and suppliers being “losers” when they have to reduce profitability. I don’t know about you, but if someone approaches me with a zero-sum proposition I generally fight like the dickens to make sure I don’t end up on the losing side. I’m pretty sure most suppliers do, too.

Cost reduction, on the other hand, is a more sustainable strategy for price reduction since it increases the size of the profitability “pie,” allowing OEMs to get lower prices and suppliers to maintain/increase margins. To have rational goals for supplier price/cost reduction, however, you need to have a handle on the waste each supplier has available for cutting. In previous sections I pointed out that Manufacturing Critical-path Time (MCT) can be a great tool for assessing available supplier waste.

Setting common broad-brush cost reduction goals across all suppliers, then, makes no sense whatsoever unless all suppliers have comparable waste available—to be reduced—and/or similar margins available—to be pared. Having the same price reduction goals for Lean vs. inefficient suppliers doesn’t recognize the different amounts of available waste and, in giving Lean suppliers the same price reduction goals as their inefficient counterparts/competitors, OEMs actually reward those suppliers that have more overall waste! Does this make logical sense? No.
Next, let’s review basic cost accounting. Prices are comprised of material, overhead, labor and margin. For a supplier to reduce their cost-of-goods-sold (COGS), they need to reduce the cost of their material, reduce their overhead, increase productivity, or deliver a combination of the three.

So far, so good. The problem is that over the years the percentage of the COGS that suppliers have control over has gone down significantly. It must also be recognized that the relative contribution that material, overhead and labor make to COGS varies considerably by industry, supplier tier and product specifications. The combination of these two factors is a “double whammy” indictment against a broad-brush price reduction goal strategy.

Why do suppliers have less internal control over their costs? Most industries have, over time, raised the competitive bar by reducing the contribution labor and overhead make to COGS, some more than others. Does it make sense that those that have done a better job at this be penalized by being given the same price reduction percentage targets as those who haven’t? No—because these suppliers have less waste available to reduce. At a minimum, then, if a more focused version of a broad-brush price reduction goal approach is to be used, it would make sense for individual goals to be within specific commodities, not across-the-board. Better yet would be to set general price reduction expectations by commodity and then tailor individual supplier price reduction goals based on their MCT, i.e., longer MCTs imply greater waste.

Delving further into COGS analysis it is well established that purchased material today can represent over 80% of OEM cost. It is also well known that this same ratio applies to many large Tier 1 suppliers to OEMs. Understanding this, does it make sense that OEMs share the same internal cost reduction targets they set for their Tier 1 suppliers? Yes. Does this happen? Usually not.

My experience is that internal OEM goals for cost reduction are set significantly below those applied to Tier 1 suppliers. Does this make sense? No. OEMs setting across-the-board price reduction goals contributes to messaging suppliers, “Do as I say, not as I do,” which, when you get down to it, is a hard argument to sell.

A final point needs to be made relative to the illogic of broad-brush, across-the-board supplier price reduction goals. Over the years, you’d expect the goals being set to be trending downward, right? Why? Because over those same years waste has (at least theoretically) been being squeezed out of supplier operations. In fact, though, analysis shows that even as waste and margins have gone down over the last two decades, OEMs have continued to maintain the same price reduction goal rates on a year-to-year basis. For instance, there are OEMs that set their across-the-board price reductions goals at the same level, year after year. Does this make sense? No.

**The Negative Impact of Across-the-Board Price Reduction Strategies**

What can the ongoing pressure for waste elimination and margin imposed by across-the-board price reduction goals result in? First, understand what is being asked for. For smaller and medium-sized suppliers where the cost of purchased content makes up 50% of the COGS, a 5% price reduction goal actually means a 10% reduction in the costs that the supplier has control over. That type of reduction is not inconsequential, by any means. The only way many suppliers have delivered OEMs the price reductions needed for them to keep their business with them has been by deferring needed investments in their business and reducing positions not seen as imperative to getting the product out the door on a daily basis.

The irony is that this can result in elimination of positions most essential to ongoing continuous improvement. For instance, I’ve known many small and medium-sized suppliers that don’t have an industrial engineering-type person on-staff. In this case this type of broad-brush strategy has resulted in suppliers adopting a tactical, rather than a strategic, focus. Negative impact, indeed!

As I implied at the start of this section, commodity suppliers should be managed differently than engineered product suppliers. Annual broad-brush price reduction goals can be a reasonable strategy for “spot buy” product suppliers. But if you are buying an engineered product there is really no way to reduce price sustainably without either reducing specification and/or reducing processing related costs, i.e., you may get a supplier to reduce their margin a time or two but not perpetually. Yet how many OEMs actively involve suppliers in supply chain integration? Only a relatively small percentage based on what I’ve seen. So when across-the-board goals are applied to engineered products the negative impact can be that suppliers—and buyers, for that matter—get to understand they are playing a game they can’t win unless they make new rules. And those “rules” can negatively impact OEMs, although these negative impacts often are not acknowledged or even measurable.
One impact brought on by annual across-the-board, broad-brush price reduction goals is more savvy suppliers and more savvy procurement personnel. For instance, several years ago I worked with a purchasing director who had come from a large automobile manufacturer. He told me he had learned to pay more than needed in the early years of a supply contract just so he could deliver the annual price reductions his bosses expected. And he said that this was not an isolated practice. That’s certainly a “rule change,” and not in a positive way.

Most of the time, though, the rule changes are more subtle with suppliers understanding that only by padding their initial price quotes can they actually meet customer annual reduction expectations. So unless one of the bidding suppliers is willing to leave this padding out and “buy the business,” it is not unusual for every supplier quote the OEM receives to be padded. Again, current OEM price reduction strategies drive an unmeasurable negative impact.

Broad-brush price reduction goals, then, are short-term strategies that may not reduce supply chain waste. And when waste exists, OEMs will eventually pay for the lower prices they get in terms of lower quality, reduced order fulfillment support, etc. Broad-brush, across-the-board price reduction goals are, in my mind, a strategy of someone looking for a silver bullet that doesn’t really exist, unless you are actually buying a true commodity.

An Effective Price Reduction Strategy

An alternative approach, especially for engineered products, is to understand your supplier’s cost structure and help them reduce waste in a collaborative manner either through supply chain integration, supplier development or by eliminating unneeded and cost driving specifications. Knowledge of supplier MCTs play an integral role in this. This type of strategy takes more effort and requires more time to deliver results, but the results delivered are sustainable and, over the course of working together to reduce a supplier’s wastes, both sides can end up as winners.

Conclusion: Everyone’s Got to Eat

The goal of every OEM’s procurement function should be Lean, not anorexic, supply chain performance.

I took my first purchasing job in 1988 as a procurement engineer (translation: technical buyer) of hydraulic components. One of the responsibilities of that job was to negotiate pricing with newly designed and/or revised parts and components. Having a mechanical engineering degree and experience in design, reliability and quality I was ill-equipped to do this, so my employer sent me to one of those “two-day wonder” negotiating seminars. You know the type, the ones that tout things like “you don’t get what you deserve—you get what you negotiate.”

Anyway, after attending the training I felt I was “ready-to-rock.” Luckily for me one of my first negotiations was with the owner of a cylinder company who apparently had been around-the-block more than a few times with “young bucks” like me. When we had finally arrived at what looked to be a fair agreement I pulled the ask for one more thing strategy by saying, “We are going to need something more to close this deal.”

He sighed, looked me straight in the eyes, and said, “Paul, you know everyone’s got to eat.”

Well, my negotiation training hadn’t prepared me for such a fundamental truth and, after a moment of contemplation, I replied, “You’re right” and shook his hand. After that experience I came to understand that even after—perhaps especially after—my two days of negotiating training I was still ill-equipped to successfully conduct meaningful negotiations. That capability, by the way, came to me only after years of further learning and experience.

The reason I’ve related this personal experience is that it both relates directly to the difference between Next Generation Supply Management and traditional Purchasing. If the supplier you are negotiating with is strategic to your business, you need to let them eat.

Along these lines I want to share some feedback I received from a supplier firm living under the sort of “broad brush” OEM mandates discussed in this Guide’s previous section. I show that letter below in its entirety:
continually being handed 4% annual supplier cost reduction goals (as cited in the reader feedback), I would ask the following two questions;

1. What is the basis of these price-reduction targets?
   Are they based on supplier operational data showing available waste? Are they required for the ongoing survival of the company? Or (most likely) are they pulled from the air by some chief financial officer who knows nothing about supplier operations who wants to increase stock price so he can look good? If so, they should be challenged.

2. Is the 4% price down goal being set for suppliers the same as the internal cost-down goals?
   In other words does your company “walk the walk” or just “talk the talk?” After all, in extended enterprise supply management all operations—be they internal (OEM) or external (supplier)—are just another link in the order fulfillment chain. What should be good for one should be good for all, right? So, if your internal operations are not being given that same 4% goal, year-after-year, you should ask why not and demand an explanation.

If Supply Management isn’t allowed to pose these types of questions within your organization I think you understand that the function is considered tactical by your executives. As I elaborated on earlier in this Guide, this is unfortunate because it will prevent your company from attaining status as a world-class manufacturer. Why? Because your Supply Management organization is not positioned to deliver Lean Supply Chain Performance, i.e., the non-piece price financial benefits that are available from such a supply chain.

My answer to the second question is that while I agree that over the last couple of decades “broad-brush” across-the-board price-reduction expectations have been a kind of “gravy train” for many OEMs, my gut feeling is this easy ride is just about over. You might ask, “How can you know this?” Here’s how I answer that question.

I am an executive level Supply Management consultant and in that role I have exposure to many suppliers. What I’ve seen is that many have reached the same point of frustration as expressed in the supplier’s feedback letter that I shared. They have done about all that they can do to cut costs—even cutting things that are necessary for their longer term viability—and there isn’t anything more to cut. Many have reached the point where they are “mad as hell and are not going to take it anymore,” to quote the line from the movie “Network.”
And suppliers understand they have been working with their OEM customers like “the condemned man digging his own grave” (as the supplier wrote), “hoping to buy time.” But all they bought was more of the same. Realizing this, I see suppliers positioning themselves to push back. How? In many ways.

First, as the supplier response cited, suppliers are less likely to take on additional cost to support un-forecast customer demand. This is something the OEMs have come to expect at “no charge.” Some of my OEM clients tell me this type of support has already started going away.

Second, other support “freebies” are now resulting in charges, such as design engineering support. Previously suppliers had tried to eat these costs in their pricing overhead. Now, due to the annual OEM price downs, services like this will now likely need to be charged for. Again, some of my OEM clients are wondering why their suppliers are starting to “nickel-and-dime” them. Go figure!

Third, and perhaps more ominously, suppliers are starting to identify those OEM customers that don’t care whether or not they Get-To-Eat or not, and starting to position themselves so they can walk, if need be. You may say, “So what? There is always someone else who will take on their business.”

I’d ask you to consider two things in this regard. First, many suppliers have learned how to play the OEM pricing game and second, the old “buying the business” pricing approach will only likely be used by suppliers in desperate straits, i.e., ones you really don’t want to be working with. In other words, the classes of suppliers you really need to be working with are less likely to quote low-ball prices to get their foot-in-the-door with customers who ask them to “dig their own graves.” Remember, the cost of changing suppliers is not trivial, at least for non-commodity parts, and the threat of shutting down a supplier’s business is often a hollow one.

And the final reason I think the “gravy train” might be leaving the station is that among my steady clients are two Standard & Poor’s Top 100 companies with which I have had extensive engagement. They don’t listen to everything I have to say, nor do they initiate every strategy I recommend, but they are starting to make changes from the traditional Supply Management strategies that have carried them over the last couple of decades.

What are my clients picking up on? They see that the “zero sum game” that is represented by strategies such as OEM “broad-brush” across-the-board annual price reductions is not the way forward. They understand that at least for some supplier categories the only way to get sustainable cost/price reduction is to “increase the size of the pie” so that both sides see the relationship as beneficial. But probably more importantly they see that these traditional strategies have not produced lean supply chain performance that they need to differentiate themselves from their competitors.

Going back to the reader’s feedback, ten years of working under their OEM customer’s program has not led them to leanness; instead, it has left them anorexic. The goal of every OEM’s procurement function should be Lean, not anorexic, supply chain performance. I think some of us have forgotten that.

I started out by telling a story about an owner of one of my suppliers telling me that “Everybody’s Got to Eat.” To my credit, I listened to and learned from him. I hope many of you are also listening. Suppliers are less likely than they have been in the past to “dig their own graves,” which I’m afraid may be a shock to many OEMs.

**Next Steps: Activities for Moving Forward**

I’m a big believer in individual empowerment. In other words, I believe that people who want to make things happen can make things happen. Of course, individuals will have varying levels of effectiveness promoting Next Generation Supply Management based on their position in the Supply Management hierarchy. If—after reading through this Guide—you are convinced that there are at least parts of what you read that you would like to pursue, there are activities available to all tiers of job classification for taking “first steps.” Some of these are fundamental and must be put in place as a prerequisite to other actions and I’d like to use a couple of them as examples of how one might proceed in moving your procurement practices up to the next generation.

**Supplier Categorization**

Understanding who are and who are not strategic suppliers is fundamental to Next Generation Supply Management. Why? Because relationships with Strategic suppliers are critical and need to be managed differently. In fact, under Next Generation Supply Management the management of non-Strategic Suppliers aligns closely with traditional
procurement practice. Conversely, it’s with strategic suppliers that the “rubber really meets the road.”

Regardless of your role within an organization, you can adjust your thinking to reflect this strategic vs. non-strategic position of your incumbent suppliers per the definition presented in this Guide;

Resourcing business from a strategic supplier exposes a purchaser to excessive cost or order fulfillment risk.

And remember, the primary difference in how they are managed is (as was previously presented in this Guide):

OEMs providing strategic suppliers the same level of manufacturing improvement support they would receive if they were internal factory departments.

Once you differentiate your suppliers using this very straightforward criteria—and thinking about the differences in managing them based on whether they are strategic or not—it shouldn’t take long to see the additional benefits you can expect once you implement this Next Generation Supply Management practices.

Manufacturing Critical-path Time (MCT) Mapping

As outlined in this Guide, knowledge of supplier MCTs provides a tremendous level of insight into how they attain their performance. MCTs, then, can provide the basis of understanding of true supplier competitiveness above and beyond what can be gotten through the quoting process. MCTs also provide both justification for and help prioritize supplier support/supplier development efforts. I recommend conducting a “proof-of-concept” pilot within your scope of “command and control.”

MCT Critical-path Maps are used to define MCTs. The data for these is both easy and non-burdensome to gather and the maps themselves can be created very simply either by hand or through available tools. My company—Factory Concepts LLC—has such a tool which is described on our website: www.mymanufacturing.org. Feel free to take a look.

Supplier categorization and MCT Critical-path Mapping can be done with very little training. If you are a buyer, select a product category and start out applying your concepts locally. If you are a manager, you may want to have a couple of your buyers conduct their own “pilots.” Then sit down with a couple of your strategic suppliers and target collection and creation of a few of the high impact part numbers they supply. I suspect that both you and your supplier will be surprised in what they reveal.

Of course, categorizing suppliers per the Next Generation Supply Management criteria and developing MCT Critical-path Maps represent just the “tip of the iceberg” of changes in practice you’ll want to investigate. Once you get started there are a multitude of activities and opportunities that will present themselves to you and your organization.

Feel free to contact me through my company email: contact@mymanufacturing.org.

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