PRACTIX
Good Practices in Purchasing & Supply Chain Management

Better Buyer-Supplier Relationships through Supply Base Reduction and Supplier Performance Measurement

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Executive Summary

Supply base reduction and supplier performance measurement can be useful tools in developing closer relationships with suppliers. After successfully reducing its supply base, one company in the transportation industry achieved additional value from its supply base by utilizing a supplier performance measurement system with its remaining suppliers. This best practices report briefly describes the supplier performance measurement system utilized by this company and discusses the increased value that the firm achieved from implementing this tool.

Background

In a previous *PRACTIX*[1] article, Fleet Corporation (not its real name) was shown to have significantly reduced its supply base for truck bodies and chassis. The previous article outlined a seven-step process that Fleet utilized to "purposely choose suppliers." Fleet's main supply management goal was to have a lean, focused, world-class supply base providing a competitive advantage that could be readily accessed by its end users.

Over the past four years, Fleet has reduced the total number of suppliers that it uses from 500,000 to 60,000 (an 88 percent reduction). Prior to supply base reduction efforts, only 23 suppliers sold more than $500,000 to Fleet on an annual basis. In fact, more than half of the suppliers sold less than $1,000 each worth of parts to Fleet each year. Supply base reduction efforts have allowed Fleet to shift more than 50 percent of its nearly $5 billion spend to 105 suppliers.

[1] Ogden, J., "Supply Base Reduction within Supply Base Reduction," *PRACTIX: Good Practices in Pruchasing & Supply Chain Management*, CAPS Research, vol. 6, January 2003, 1-7.

This reduced supply base has given Fleet the ability to partner with select suppliers to ensure low prices, high quality, timely delivery, strong customer support, and constant technological and innovative improvements. According to Fleet's CPO, "Managing relationships takes a lot of time and effort. Consequently, properly measuring and growing relationships with suppliers cannot be done with a large number of suppliers."

Fleet's supply base reduction efforts in the truck bodies and chassis categories yielded a reduction from more than 15,000 suppliers to a preferred supply base of two chassis part suppliers and four truck body parts suppliers. This best practices report focuses on Fleet's ongoing partnership with one of the six body and chassis suppliers that was retained during the supply base reduction process.

Supply Base Relationships Prior to Supply Base Reduction

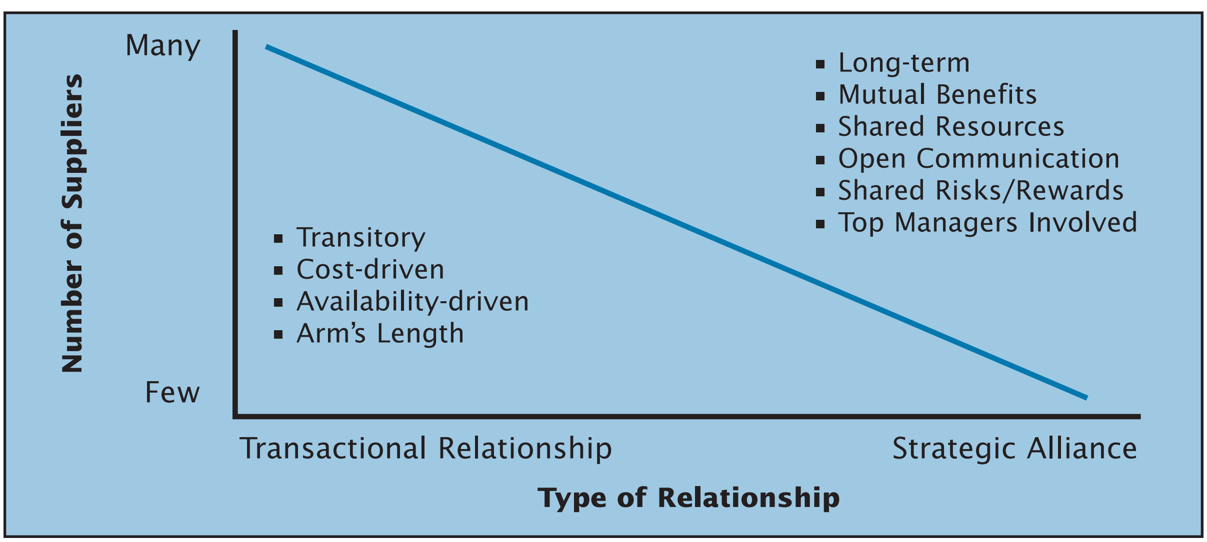
The relationship between Fleet and its suppliers prior to supply base reduction efforts was best classified as being price-oriented, with a small number of what could loosely be termed "alliances." There was very little collaboration between Fleet and its suppliers and very little leverage because of the small volumes that were being purchased from many suppliers. This highly fragmented supply base led to highly variable pricing across suppliers and across locations. Before supply base reduction efforts, there was also limited e-commerce activity between Fleet and its suppliers.

Prior to supply base reduction efforts, there were no long-term contracts between Fleet and its truck body parts suppliers. User locations frequently switched between suppliers due to price and service differences because there were relatively low costs associated with switching suppliers in the parts market. Although these switching costs were relatively low for each individual location, their cumulative effect was significant on Fleet's overall total cost of ownership efforts. In the past, Fleet's locations were the ones that considered when to re-source truck body parts from different suppliers. Such switching was often done when difficulties were encountered with one supplier and an alternative supplier was needed.

Supply Base Relationships After Supply Base Reduction

The relationships between Fleet and its suppliers *immediately* following the supply base reduction efforts were initially focused on price and delivery. Since the supply base reduction efforts, Fleet has shifted from a price-based focus to an approach of total cost of ownership. Reducing the number of suppliers has allowed Fleet to shift away from short-term, transactional relationships and move toward long-term, integrative partnerships and strategic alliances with its key suppliers (see Figure 1). One of the tools that Fleet has utilized in this shift has been its supplier performance measurement system.

Figure 1: Relationship between the Number of Suppliers and the Type of Buyer-Supplier Relationship



Supplier Performance Measurement System

Since its supply base reduction efforts, Fleet has used its supplier performance measurement process as the primary mechanism for effective supplier relationship management with its field locations. "It serves the company's best interests to develop long-term, mutually beneficial supplier relationships, and supplier performance measurement is the roadmap to that destination," said Fleet's CPO.

The supplier evaluation process captures and communicates field requirements and expectations to suppliers along five key areas:

- Product and technology leadership
- Service and support leadership
- Quality
- Delivery and leadtime performance
- Total cost performance

Fleet conducts a semi-annual survey to evaluate a supplier's performance against expectations in these five areas. Both employees and managers at Fleet's 1,200 locations evaluate the suppliers along these five dimensions. They rate supplier performance on a scale of 1 to 10 on specific items within each major area and then assign a single corresponding letter grade of A, B, C, or D to each major area. The long-term expectation is for suppliers to perform at a B level (7 to 8.9) or higher.

All key suppliers are rated during the supplier performance process. Each supplier is then provided its individual score and the scores of the other suppliers in the same commodity category, but not by name. If any performance gaps are detected, the supplier provides an improvement action plan to correct problems and prevent recurrences. As suppliers improve, the other suppliers feel motivated to improve.

To facilitate supplier improvement, Fleet gives awards to suppliers that demonstrate quality performance and service in the five areas of supplier performance. Supplier A has won awards for being the "best-in-class" supplier for the past two years. Fleet also uses its supplier performance measurement system to reward outstanding suppliers with more business. This type of reward system keeps suppliers actively involved in improving their performance and keeps suppliers from becoming complacent with their position in the supply chain.

Although short-term business levels are fairly stable across the supply base, dramatic shifts can occur over the long term. Because of its performance over the past few years, Supplier A, which had 40 to 50 percent of Fleet's truck body spend immediately after the supply base reduction process, now (three years later) receives 80 to 90 percent of that same spend. The following sections discuss the increased value that Fleet has realized through the close working relationship with this key supplier.

Increased Value from Relationship with Supplier A

The characteristics of strategic alliances that are listed in Figure 1 form the framework for the discussion of the relationship between Fleet and Supplier A. These include:

- Long-term commitment
- Mutual benefits
- Shared resources
- Open communication
- Shared risk/rewards
- Top managers involved

Long-Term Commitment

Prior to the reduction in the number of suppliers, long-term commitments did not exist in Fleet's supply base. Locations would order from the supplier with the lowest quoted price or the fastest delivery time. It was not uncommon for these locations to only use a particular supplier for one out of every 10 to 20 orders for a given product or service.

To facilitate better relationships with its suppliers, Fleet chose to establish three-year contracts with the suppliers that were selected during the supply base reduction process. Supplier A was one of these suppliers. At the end of the three-year contract, Fleet had Supplier A bid on some additional items that were not on the initial RFP used in the supply base reduction process. It then established a five-year contract with the supplier, which Fleet plans to extend for several more years as the expiration date nears.

Mutual Benefits

There have been a variety of mutual benefits that have been achieved by Fleet and Supplier A through their partnership.

Technology and Innovation

Supplier A's large account with Fleet has led it to continually innovate and improve its product offerings. Supplier A currently works with Fleet on special projects and exclusive designs and innovations. Because of the close relationship and larger percentage of spend, Supplier A currently devotes a much larger portion of its budget to Fleet-related R&D than it did prior to Fleet's supply base reduction efforts.

When Fleet discovers a problem or issue with a truck body, it works closely with Supplier A to develop a solution by providing detailed maintenance records and by testing prototypes in the field for Supplier A. Supplier A is then able to incorporate these design changes and improvements into vehicles that it sells to Fleet's competitors and other customers, but does so at a competitive advantage to these companies. Fleet is able to get customized vehicles that exactly fill its needs, rather than having to buy standard truck bodies and make them work in Fleet's specialized environment. Fleet is also made aware of and approves other changes to the truck bodies that may be generated from other sources.

One of the innovations that Fleet has benefited from is the development of "plug-and-play" connections for the truck bodies. Historically, each different type of truck body had a unique wiring harness and air line design. Because of these unique designs, it took quite a long time to install the truck bodies on the various trucks. The new innovation has standardized the connections for the wiring harnesses and air lines, which has significantly reduced assembly time. Rather than having to run individual wires from the truck chassis to the lights and appliances on the truck body, the truck body is simply placed on the chassis and plugged into it via the standardized connections.

Availability and Capacity

The close-knit relationship with Supplier A allows Fleet's orders to get preferential treatment in production schedules. Fleet also gets preferential treatment during times of shortages or price increases.

Inventory

Fleet has reduced its truck body and chassis inventory by more than 66 percent as a direct result of its supply base reduction efforts. Reducing the number of suppliers has allowed Fleet to standardize the various types of truck bodies and chassis and to better communicate with its suppliers about maintenance inventory requirements.

Rather than having order cycle times of six to eight weeks, the long-term nature of the relationship between Fleet and Supplier A allows Supplier A to build ahead of actual orders and keep a stock of Fleet trucks ready for immediate deployment. Fleet and Supplier A share the costs of this safety stock; half of the costs of this safety stock inventory show up on Fleet's balance sheet and the other half shows up on Supplier A's balance sheet.

Uncertainty/Risk

Uncertainty is minimized because of the close relationship. Supplier A shares its concerns with Fleet and keeps Fleet informed about scenarios that may impact its operations. To further minimize risks, Supplier A has developed contingency plans that relate to the production and delivery of Fleet's truck bodies. Although these contingency plans do not reduce the risk factors that Fleet faces, they help to mitigate the impact or damage should certain events occur.

Unit Costs

Because of the close relationship that Fleet has with Supplier A, Fleet's truck body unit costs provide a competitive advantage over competitors.

Partnerships

Another benefit that Fleet has seen from its partnership with Supplier A is greater respect among its supply base. Fleet's other suppliers, both past and present, have seen the relationship that Fleet has with Supplier A, and they are eager to form similar relationships with Fleet. Even suppliers that were eliminated during the supply base reduction process are striving to regain Fleet's business and form close relationships with the firm. This increased desire to form partnerships is helping to change Fleet's industry.

Shared Resources

Rather than sending sales employees to Fleet on a regular basis to try and gain its business, Supplier A currently has one of its full-time employees located at Fleet's corporate purchasing office because of the close partnership that has been formed. The nature of the long-term relationship between Fleet and Supplier A has made account representatives unnecessary. This has led to huge sales- and marketing-related cost savings for Supplier A and has helped improve service levels for Fleet. Supplier A's representative facilitates the order placement, order fulfillment, early supplier involvement in new product development, supplier performance measurement feedback, and supplier development activities.

Supplier A has also shared its leverage capabilities with some of Fleet's other (non-competing) suppliers. These suppliers have been able to work with Supplier A to get better pricing on commodities such as steel.

Open Communication

The co-location of employees and the establishment of electronic communication networks have facilitated the open communication of strategies, schedules, inventory levels, demand patterns, cost structures, design changes, and many other types of information between Fleet and Supplier A.

Shared Risks/Rewards

Some of the risks that Fleet and Supplier A share are design change risks and mutual dependency risks. Both Fleet and Supplier A spend a great deal of time and resources designing and redesigning products. Since both companies contribute to this process, they both share the risk that the new designs won't work out.

Fleet accounts for a large portion of Supplier A's business. Likewise, Supplier A is responsible for a large percentage of Fleet's truck body spend. There are risks associated with such arrangements, but working together, the two companies can help minimize these risks. Each needs the other to be successful in order to be successful itself. Some of the rewards that the companies share are cost reductions and product improvements.

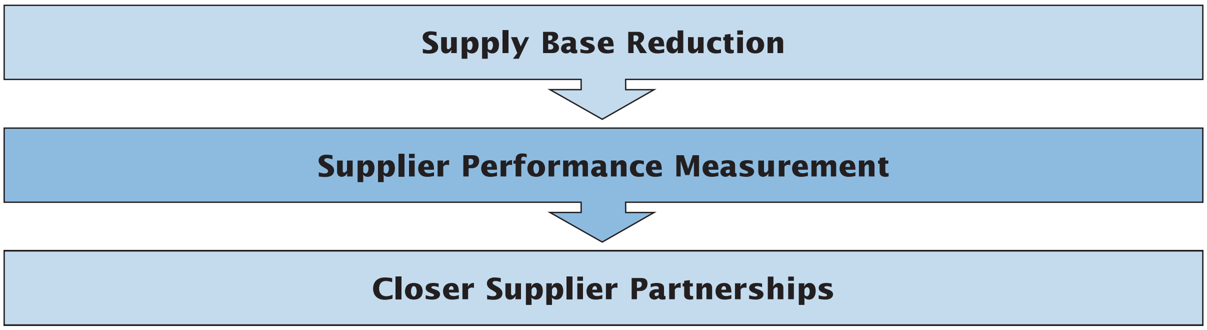
Top Managers Involved

Supplier performance reviews are conducted quarterly between top management at Fleet and Supplier A. These reviews usually take between four and six hours. The location of these reviews alternates between the headquarters of the two companies. These reviews keep management on both sides focused on long-term goals and working on ways to meet short-term needs.

Conclusion

Supply base reduction efforts and the utilization of a supplier performance measurement system have allowed Fleet Corporation to develop, maintain, and strengthen relationships with its suppliers (see Figure 2). These closer partnerships would have been impossible to establish at Fleet prior to the reduction in the number of suppliers. These stronger relationships have yielded many benefits for all parties. Other organizations should be able to achieve similar results through a combination of supply base reduction, supplier evaluation, and strategic alliances.

Figure 2: Supplier Relationship Process



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