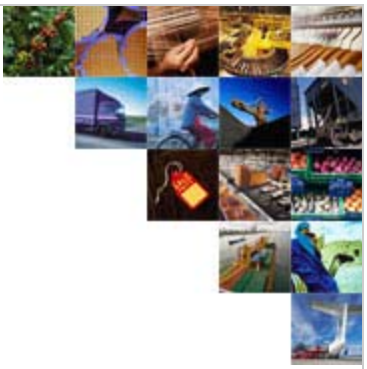

The SRM Series: Next Generation
Best Practices in Managing Suppliers

Part 1: The Outcome Economy

Tapping the Innovation Engine of Your Supply Base

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About ChainLink Research

ChainLink Research, Inc. is a Supply Chain research organization dedicated to helping executives improve business performance and competitiveness through an understanding of real-world implications, obstacles and results for supply-chain practices, processes, and technologies. The ChainLink Inter-Enterprise Model is the basis for our research; a unique, real-world framework that describes the multi-dimensional aspect of links between supply chain partners.

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The SRM Series:

1. *The Outcome Economy*—Tapping the Innovation Engine of Your Supply Base
2. *Lean Machine*—Streamlining SRM Processes, from Initial Negotiation to Managing Ongoing Performance
3. *Inside Job*—Changing the Way Your Enterprise Thinks, Grows, and Relates to Suppliers and Partners
4. *Ascending the Peak*—Advanced Practices for Supply Chain Leaders

This is Part One of a four-part series of reports on the findings from ChainLink research into the next generation of best practices for managing supplier relationships. This research examined hundreds of companies. Among those, ChainLink interviewed the 30 companies achieving the best sourcing results. This series synthesizes the collective next generation of best practices from those top 30 firms.

Who Should Read This Paper

The audience for this paper includes:

- *Sourcing and procurement senior executives and practitioners (for example, commodity manager, buyers)*
- *CEO and C-level executives at firms where supplier relationships are critical to success*
- *IT executives responsible for supporting supplier-facing organizations*
- *Solution providers of SRM (Supplier Relationship Management) and related solutions and services*
- *Executives at the suppliers, in particular customer relationship and customer supply chain services managers at the suppliers. By giving you a better understanding of the customer's perspective, this paper can help you serve your customer and provide ways to bring them up to the next level.*

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Introduction

UNLEASH SUPPLIER CREATIVITY

Are you getting the most from your suppliers? The leading firms recognize that their supply base is a treasure trove of creative energy and innovation. One of the most potent ways to unleash this creativity is to give your suppliers more degrees of freedom in meeting your needs. This requires a change in mentality to reject *Not Invented Here* (NIH) and resist the urge to dictate every detail of the answer; then specifying the outcomes that you want.

Advanced companies have already taken steps to break down their internal silos in the requirements specification and collaborative negotiation by integrating their engineering, manufacturing, service, marketing, and other internal functions into those processes. *Leveraging the expertise of suppliers and partners is the next logical step in the evolution of cross-functional teaming*. By integrating suppliers into the full life cycle of decision-making processes from the very start, the relationship morphs from one of master-subordinate to creative partners.

This report is all about how you can tap into the innovative power of your supply base. Based on dialog with leading practitioners on their most successful strategies and practices, this report describes the findings organized into three sections:

- Outcome Sourcing – specifying and buying outcomes and results, rather than things or services
- Total Cost Sourcing – understanding impact of quality, lead times, and other factors beyond material price.
- Leveraging the Strengths of Your Supply Base – Overcoming the NIH (not invented here) syndrome, to tap into the innovations and unique expertise of your suppliers

XPRESSIVE BIDDING

One promising e-sourcing technology to support outcome sourcing is *expressive bidding*. Reverse auctions technology[1] has evolved to allow evaluation of a broader set of requirements beyond material price, such as total landed cost, quality, lead times, supplier capabilities, and capacity. Expressive bidding takes it further with combinatorial optimization—the ability to analyze thousands of combinations of bids (hundreds of times as many as a human could possibly analyze) across many dimensions (material cost, transportation cost and time, lead times, and so on) to come up with the best combination to meet the objectives of the buyer.

Early Use in Transportation

The early use of expressive bidding was in transportation optimization. Traditional reverse auctions ask a carrier to bid on a handful of lanes. With expressive bidding, *all* the carriers bid on *all* the lanes and are invited to give as many different proposals, on as many different combinations and permutations, as they want. The bid analysis software then crunches through all of these different possible combinations to find the optimum set. *Optimum* of course depends on the outcome that you are trying to achieve (for example, low cost, on-time delivery, supplier diversity, and so on). Therefore, these tools give you a number of optimization parameters to play with and let you compare multiple scenarios (combinations of bids) and evaluate the tradeoffs.

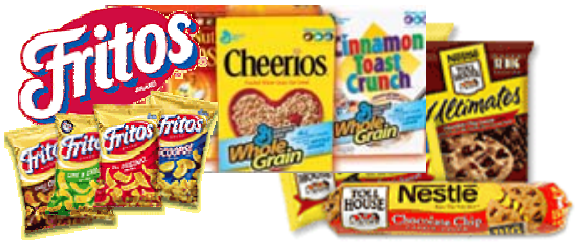
Another way to view expressive bidding is as an auction where suppliers do the lotting and can bid as many times as they want. This enables buyers to solve very complicated problems by giving the suppliers many more degrees of freedom in responding. It uncovers hidden opportunities: for example, lanes with empty backhaul, which would never be discovered in normal lane-by-lane bidding.

Use in Dynamic and Complex Spend Categories

Companies have discovered that they can apply the expressive bidding approach in many other areas. For example, P&G uses expressive bidding for chemicals, packaging, contract manufacturing, and display production. These are dynamic and complicated situations. P&G has gotten good results, not just on price but also on rapid delivery/response. They likened it to “getting the early e-auction results without the suppliers being mad”. Suppliers can be as creative as they want and the buyer discovers the suppliers’ cost structure and opportunities.

[1] Instead of buyers bidding up a price, sellers bid down the price they are willing to offer for supplying something.

about leveraging suppliers' expertise and, as a
some successes. Frito-Lay has flavors that suppliers with development groups dedicated just to Frito-Lay. The suppliers agreed to set up a firewall between that dedicated group and the other developers who create flavors for other customers. Ideas generated out of the Frito-Lay–dedicated group form a pipeline of products that can't be easily duplicated by their competitors. Frito-Lay pays a premium for flavors that are assured to be unique.



General Mills and Nestles also focus on value engineering, innovation, and strategic supplier relationships. They establish joint programs with core suppliers. Design and manufacturing teams work with suppliers on everything from forecasts, requirements, and materials, to layout, JIT (Just-in-Time) delivery, and timing coordination. The teams can't be too big or they become unwieldy, but must have the right representation across the firm and chain. The teams work together in how to become more productive. Suppliers are free to question why things are being done in a certain way and offer better approaches.

Increasingly, competition for CPG brands is coming from their own customers—the retailer's own store brands. A common thread among the more successful CPG firms in this battle is better leveraging of innovation from their supply base.

Procurement Involvement in the Design Phase

P&G took a novel approach to leveraging innovation with suppliers: they created buying organizations devoted solely to R&D. These buyers report to the purchasing department, but they co-locate with R&D and have dotted-line reporting to R&D. The buyers work jointly with R&D early on, as partners in selecting and working with suppliers. This enables better partnership with suppliers during the design phase. This includes things such as deciding what level of non-disclosure is needed to protect IP (Intellectual Property) so that patent, research, and commercial pieces are blended together as they approach suppliers. From there, these buyers take it all the way through final contract and initial commercialization (production ramp). When it is a *going material,* they pass it over to the *going materials group*. Both procurement groups report to the same leadership, so it's not a blind hand-off—the going materials group knows what is coming in the pipeline.

As a result, P&G's R&D engineers bring their dedicated buyers into the design process early. The engineers might have discovered a molecule they think they could do something useful with, and they see three or four possible synthesis routes (different ways to make it).

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