A 5-step framework for managing supplier performance

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Despite fluctuations in our global economy, globalization and outsourcing trends have continually accelerated. In a globalized and outsourced environment, managing the performance of suppliers has taken a new sense of urgency, particularly in the executive suite.

In many cases, half of every dollar in revenue can be spent on goods and services purchased from external suppliers.
As companies focus on their core competencies and outsource their non-core operations, this percentage has increased, leading to an increased dependency on suppliers. In certain industries such as technology and automotive, purchases from external suppliers can be over half of the total cost of new products. Increased dependency on suppliers not only significantly increases an organization's supply and pricing risk, but it also increases exposure to adverse scenarios such as a safety issues or lack of regulatory compliance. To continually improve operation performance, manage costs and reduce regulatory risks, a company must be able to not only select the appropriate suppliers, but also to monitor and manage performance of these partners over time.

Companies that implement successful supplier performance management programs tend to be able to identify problems earlier and implement corrective actions more quickly, before the problem snowballs, affecting both reputation and earnings. Nevertheless, recent analyst reports have shown that often less than half of enterprises have formal procedures or systems in place for consistently measuring supplier performance.

The benefits of a sustainable supplier performance management program

Supplier Performance Management is the process of measuring, analyzing, and managing supplier performance for the purposes of reducing costs, mitigating risk, and driving continuous improvements in value and operations.

Many companies that have implemented supplier performance management programs have been able to significantly improve the efficiency and effectiveness of their supply chain.
Key benefits these companies have realized include:

- **Identify and address weak links**, as well as reward strong performers in the supply chain using the Key Performance Indicators (KPIs) to help ensure a well functioning and competitive supply chain.
- **Reduce supply risk** by gaining visibility into metrics that serve as an early warning system for potential supply interruption, quality issues, or price fluctuations.
- **Develop a scorecard** on how well a supplier is doing against its contract terms and, as a result, get a mechanism to implement contract compliance.
- **Increase organization-wide alignment** on key operational objectives, because, in the process by setting KPS for measuring a supplier they are able to identify the business objective that is most important when evaluating that supplier among such things as – a) reducing component costs, b) improving component quality, c) increasing component delivery flexibility, d) accelerating volume ramp-ups, etc.
- **Build a strong foundation** for implementing continuous improvement programs to identify future cost savings, improve quality, increase flexibility, improve delivery metrics, etc. For example, our customers use KPI's to benchmark a supplier against its peers to compare their cost, on-time delivery, quality, support and responsiveness to issues, and then use the information to set future process improvement goals for the supplier.
- **Gain a mechanism to evaluate** the capabilities of a supplier, which can serve as an input into future sourcing decisions. For example, if a company is looking to expand their supply base in anticipation of higher demand, they can use this information to select a supplier that has the best record for both delivery flexibility, as well as an ability to scale rapidly.

Framework for successful supplier performance management initiative

IBM has worked with more than 200 hundred Fortune 1000 companies, over the past few years, in helping them develop and improve their supply management and supplier performance management programs. In working with those companies, it has become clear that there is a framework for success. Below are 5 key steps common among successful supplier performance management programs:

Step 1: Identify metrics, thresholds and targets:
The first step is to capture key performance metrics in the supplier's contracts. This validates key terms and measures to help ensure contract compliance are visible. Secondly, gather input from key relationship managers to understand their supplier performance objectives and use the information to establish metrics and validate that they are aligned with overall strategy. These metrics and targets should be shared with suppliers and mutually agreed to, so both the company and suppliers can create the right performance management program.

Step 2: Collect data through various mechanisms:
On a consistent and frequent basis, the company should collect information to calculate current values on an agreed upon set of metrics, thresholds and targets. Various methods that can be used to gather this data include supplier assessment surveys, information from Enterprise Resource Planning (ERP) systems, homegrown operational systems, instant supplier feedback, etc.

Step 3: View and analyze aggregated information:
Once data is collected, it should be aggregated to report on performance versus plan. While spreadsheets and other tools can be used for analysis, supplier performance management systems significantly improve the ability to analyze the information. For example KPI's allow companies to monitor the progress of their suppliers helping ensure they get early warnings if suppliers are under-performing. KPI scores can be compared with contract terms to help ensure contract compliance. Scorecards further aggregate this information and provide companies the ability to view supplier performance at a moment in time or monitor trends over a certain period. They allow the purchasing organization to compare the performance of a supplier to those of their peers. Alerts let companies know when their suppliers are operating outside pre-established tolerances. Color-coded status buttons quickly flag potential areas for the company to focus on.

Step 4: Identify gaps, prioritize and communicate:
Scorecards, trend reports and alerts help identify gaps between target and actual performance for virtually every supplier. The purchasing organization should use this information to review the impact of performance gaps on their business in order to prioritize them and then communicate the priorities of the gaps that need to be addressed with the supplier and ask for a remediation plan. The use of collaborative supplier portals that provides this information to suppliers, along with the ability to set priorities helps ensure that nothing falls between the cracks and both parties are on the same page with respect to what is working well and what needs improvement.

Step 5: Implement continuous tracking:
Supplier performance management is not a one time process. Performance should be tracked on an ongoing basis - both to help ensure that previously identified gaps were remediated and also to keep the focus on continuous benchmarking and improvement.

A supplier performance management initiative needs to be sustainable since it provides a core foundation for measuring, analyzing and improving supplier performance. Hence it must be implemented using a technology platform, so it is repeatable and consistent, scalable to support growth, and transportable to other geographic regions in which the company operates. History teaches us that an organization will generally only enjoy limited benefits from such an initiative if it is implemented using spreadsheets and manual methods and not using enabling technology.

A supplier performance management initiative provides a critical foundation for improving operational performance, reducing supplier risk, reducing component costs and improving supply chain efficiency. It is not about completing a one-time review with suppliers. To be successful, it must be sustained on an ongoing basis using enabling technology – and ideally implemented globally. With these elements in place, a company's supplier performance management initiative can significantly improve operational performance and competitive advantage.

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