

Supplier relationship
management in
today's increasing
economic
environment busine...



Abstract

In today's increasing economic environment, organisations are looking for new techniques to improve their competitive advantage. The focus of my research is in the area of purchasing which has now become a strategic function and a key reason in positioning competitively among all other competitors. The paper discusses that in recent years, the relationships between buyers and suppliers have been continuously receiving a considerable attention for effective operations within organisations. Traditionally, supplier-buyer relationships were regarded as adversarial, arm's length transactions. However, the approach towards managing this relationship is changing and moving towards a more collaborative approach due to the fact that now suppliers are important sources to gain competitive advantage to operate in global markets in terms of their expertise, knowledge and ability of sharing risks. [Research paper - Journal]

The research aims to provide an understanding of supplier relationship management, factors of supplier evaluation and selection process, and the elements that contribute to the establishment of a productive customer/vendor relationships.

Such a study is important for buyers to build and maintain effective relationships with their suppliers for consistent cost reductions while working together to mutually create revenues and other benefits. The paper recommends that this information may work as a reference guideline for buyers when initiating cooperative relationships with their supply sources

resulting in advanced purchasing and strategic supply chain management in their organisation.

The research method adopted in this dissertation is secondary exploring various business journals, business websites, textbooks and articles. Due to continuous new product developments, product innovations and increase in costs, managing supplier relationships will further become crucial in the near future. Due to this reason, therefore, this paper discusses the requirement of supplier relationships and how this shift in organisational strategy towards building relations has and will going to change the employee's role, company's processes and organisational goals.

The findings from this research provides an evidence of how companies have improved their supply chain operations through understanding the importance to develop effective supplier relationships as part of their core business activity for not only to achieve success within procurement department but also to successfully complete other supply chain cycle such as maintaining production flow at all times, planning accurately, inventory handling, logistical issues and achieving financial benefits. Examples included findings from large organisations of Hong Kong, Rolls Royce, GE, and Japanese firm Toyota.

The main conclusion that can be drawn from this research is that every organisation must emphasise the need to actually develop world class suppliers that helps in building long-term relationships, reduction in costs, improved QCDS (quality, cost, delivery and service) criteria, improved

customer service, mutual information sharing, reducing the NPI (new product inspection) costs and becoming world class organisation in the market.

Introduction

Nowadays, the majority of Organisations believe that their company's real assets are embedded in the quality of the relationships shared between the business and their stakeholders such as clients or customers, employees and suppliers. Developing and managing supplier relationship will be the main subject throughout this project.

The objective of this research is to investigate the importance of the need to focus more on building collaborative relationships with their strategic suppliers by large manufacturing companies. With increase in globalisation and restructuring of several organisations, procurement's role has changed focusing more towards costs, quality, flexibility and technology. [Herbig and O'Hara, 1995; Goh and Lau, 1999]

In the previous years (traditionally), purchasing was considered as a secretarial function in which the buyer-supplier relationships were viewed as being adversarial and unsurprisingly results in a win/lose outcome. Before, business operations from manufacturing to assembling the finished goods were prepared in-house but now many organisations have moved towards a more combined approach where manufacturing firms have started concentrating more on their core competencies only and rest outsourcing nationally and internationally to satisfy their customer expectations.

Organisations are going lean i. e. working towards continuous improvement, adopting just-in time and total quality management and eliminating wastes.

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This highlighted the requirement for most of the lean organisations to grow cooperative supplier-buyer relationships to achieve real productivity, improved design and quality that are unattainable unless the supplying partners assist in product innovation. Hence, several manufacturers have recognized their ability to become world class competitors based on establishing high levels of trust and cooperation among their suppliers. [They and Briggs (1994)]

For example, highlighting the case of Rolls Royce, the engine manufacturer, that outsources 70% of their material from external supply chain and that's the reason Rolls Royce try to encourage their suppliers to work openly and jointly contributing to their performance. Rolls Royce belief in building good supplier relationships assures quality and competitiveness to their product offerings and helps to achieve customer standards.

The growing face of domestic and global competition has led to understand the manufacturing companies to practise global sourcing which is a strategy to improve companies competitiveness in the international market through reducing costs, improving quality, increased exposure to universal technology, and improving delivery and reliability.

A 'connection or association' is known as a relationship. Relationships are said to be when individuals, organisations and internal or external groups to an enterprise interact. At recent times, relationship marketing describes long-term marketing strategy that emphasise on building and maintaining long-term relationships with customers rather than just focusing on 'one-time' sale approach. At business level, relationship marketing is applied to

variety of purchasing – supplier relationships in the context of a broader network of interconnected purchasing, supplier and competitor organisations.

“ Supplier relationship is defined as a systematic approach to supplier evaluation, selection and ongoing relationship management with the goal of cutting the costs of goods and services & boosting profits.”

Supplier relationship management is a proactive approach of an ongoing business links to secure a competitive advantage within the organisation, focusing more on overall relationships between the supplier and the customer (buying organisation) rather than focusing on specific contracts. The idea is to develop trust and understanding of each other’s requirements and interests while providing assistance to each other. For example, Rolls Royce sends their experts to their sub-contract suppliers to improve their technology and performance standards. Such relationships bring profit and provide competitive advantage. [http://www.ogc.gov.uk/process_supplier_performance_and_contract_management_6368.asp]

Today, most of the companies have realised that doing business jointly with their strategic suppliers will enhance their organisational ability to respond quickly to demand changes, focus on core business only and hence, results in implementing best practises.

For example, Rolls Royce believes their supplier make very essential contribution to their business performance as over 70% of their manufacturing costs comes from external supply sources.

focus more on their core competencies such as encouraging suppliers to work with transparency, openly and together to enhance continuous improvements. rather than

Small to Medium size Enterprises and many local businesses use Transactional Purchasing whereas Large Enterprises use Relationship Purchasing to compete strongly in this economic climate.

Transactional Purchasing

Relationship purchasing

Focus on short, discrete purchasing

Focus on supplier retention

Short-term orientation

Long-term orientation

Arm's length

Closeness

Simple buyer-seller relationship

Complicated, including internal relationships

Emphasis on price, quality and delivery in the offered product & No

Innovation

Emphasis on price, quality, delivery & other factors, like innovative design as a collaborative exercise b/w purchaser and supplier

Moderate supplier contacts

High level of supplier contact with each contact being used to gain information & strengthen the relationship

Little sharing of information

Significant sharing of information, including cost information and transparency

Introducing Supply chain management

The project is focused on process for choosing world class suppliers, importance of building supplier relationships, various supplier development approaches and process of negotiation required in purchasing that plays a vital role in today's supply chain management. Explaining what is supply chain management and its various elements that are necessary for the movement of goods and services within the business.

' Supply chain management consists of the intra – and inter-organisational co-ordination of business functions that act as both transformative and support functions'. This emphasises managing supply chain effectively must be a key activity within the businesses. [Mentzer et al. (2001)]

Supply chain combines flow of materials, goods, and information (includes money) that floats within and between organisations linking with a variety of tangible and intangible facilitators, e. g. relationships, processes, activities

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and integrated information systems. Different views of supply chains are implemented in terms of a process when operations are emphasised, a logistical channel when emphasises marketing, a value chain when looking at value added activities, and a demand chain when considering customer satisfaction. [Peck H. (2006)]

Key elements of supply chain

The key elements of supply chain are that links with each other by the movement of products. The following explains that supply chain starts and ends with the customer:

[[http://logistics. about.](http://logistics.about.com/od/supplychainintroduction/a/into_scm.htm)

[com/od/supplychainintroduction/a/into_scm. htm](http://logistics.about.com/od/supplychainintroduction/a/into_scm.htm)]

Customer – This is the customer that starts the value chain by deciding to make a purchase of a particular product for example, in an aviation industry procuring turbine blades or a fan shaft which is offered for sale by an organisation. At this stage, the customer contacts the sales team and places purchase order with a right quantity and delivered on a right date. If in case, this product needs manufacturing then the purchase order includes a requirement that must be fulfilling by the production facility.

Planning – The requirement for planning occurs when customer's purchase order is received and processed with other existing orders. Production plans are created by the planning department to generate products to accomplish the customer's order. If manufacturing requires, then raw materials are purchased to complete the process.

Purchasing – The list of materials e. g. raw materials and services is obtained which is required by the production department to complete the purchase
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order. Then purchasing team issues purchase orders to procure raw material from selected suppliers on their manufacturing site on a requisite date.

Inventory – The raw materials that are received from suppliers are checked for quality and moved into the warehouse. The invoice is received for the parts that are delivered by the supplier and then materials are stored until there is a demand from a production area.

Production – According to the production plan, the raw materials from the inventory are moved into the production area where product manufacturing takes place and creates the finished product. Once the parts are completed, they are again sent back to the warehouse and stored prior to delivery to the ultimate customer.

Transportation – Logistics department then finds the most efficient shipping method in order to achieve on-time delivery at the right date mentioned by the customer. After goods are received by the customer, an invoice is sent by the organisation (supplier) for delivered products.

Outlining Case study: GE-Aviation

In this project, there will be discussion on relationship purchasing within aviation industry considering GE Aviation as a case study. Suggesting methods of procurement and ways of maintaining GE's existing and new relationships with suppliers.

On-line procurement is one of the major processes that I will be focusing in my project which GE adopts within their business that not only reduces the cost and saves time but also provides the right amount of communication

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with its suppliers at the right time. For example, GE-Aviation has its own department for RB211 jumbo jet engine where there are teams responsible for engineering, operations, purchasing and billing. The engine gets repaired and maintained on site. For RB211 engine type, GE's biggest supplier is Rolls Royce who is the OEM's and can provide material many times.

Using SAP software within the whole organisation saves a huge amount of time for purchasing transactions and also makes easy for GE purchasing team to analyse demand raised and provide forecasting to their suppliers for each product by just looking into the system and working through its historical past. GE uses Relationship Purchasing in which they believe to maximise their revenue it is very important to have good supplier relationships. Some of the key approaches/strategies required before working towards building relationships are as follows:

Selecting a world class supplier

Companies that outsources internationally their materials opens the opportunity to identify potential suppliers, evaluate and reasonably short list them that result with the best supplier. This is considered as one of the most important process to perform by the procurement team that aims to choose the best supplier that ensures reliable supplies with low risk involved and maximises the overall value to the buyer.

The following are the seven key steps involved in supplier evaluation and selection process: (Fig 7. 5 Supplier evaluation and selection process [pg 163])

Recognise the need for supplier selection

The first step is to recognise the actual need for selection of supplier.

Purchasing team must work with new product development department in order to recognise future buying behaviours. Purchasing groups proactively select suppliers and anticipate demands rather than wait until a demand rises. The process to start this evaluation arises due to the following scenarios:

Through new product development

Poor performance received from existing internal and external suppliers

Closure of the contract

Procuring new tools and equipments

Thinking to expand business into new markets or products

Due to inadequate capacity of existing suppliers

Throughout outsourcing and re-engineering analyses

Deciding to reduce the size of the supply base

Identifying the main sourcing requirements

All the way through evaluation process, procurement team must keep an eye on what they are intended to do. Acquiring materials is not just important but also focus to meet specific requirements set by the other internal customer and indirectly by other supply chain members. For example, an aviation company like GE that makes engines has to buy all the machinery

and spare parts along with buyers taking care to ensure a perfect quality products are delivered on time.

Establishing sourcing strategy

Developing purchasing strategies results in long term alliances that buyers look each time to compete in today's growing competition. Several vital strategic decisions that affect the selection of suppliers are:

Picking single or multiple suppliers

Creating short-term or long-term contracts

Supplier's wish to develop working partnerships rather than arm's length relations

Working with suppliers that can provide support with product designs rather than those who cannot modify designs

Having choice of local, domestic, foreign or global suppliers

Therefore, sourcing strategies and policies must be carefully re-evaluated during supplier selection as requirements changes frequently in shorter times because of changing market conditions, changing consumer preferences and accustomed corporate goals.

Identifying potential suppliers

This stage identifies a list of suppliers that can actually have the capability to deliver of what is required by the customer. Buyers can use various numbers of sources to develop the preliminary list of supply sources by a quick search

of company websites as well as long and detailed search for companies that can support with design and make specialised products. A rule of thumb must take place to determine the effort to be used into supplier selection by comparing the existing supplier's efficiency and strategic importance of an item because too much effort and expensive resources are wasted; too little effort and potential suppliers might be missed in this initial search criteria. Following are the sources of information widely-used to identify potential suppliers:

Current suppliers - Using existing suppliers who are already on the preferred list which are consistently meeting buyer's requirements that reduces the purchasers time and effort in evaluation of supplier capabilities. But at the same time, existing supplier may not always provide the world class long term results and that is the reason why organisations scan information continuously to recognize potential new sources.

Sales representatives and agents - Marketing information received from these individuals can become a valuable source of information for new product offerings. Buyers keep this information in their file for future reference even if there is no urgent requirement for a supplier service.

Internet searches - Nowadays suppliers launch customer websites as part of their marketing approach and help the buyers with detailed information from a simple search of possible suppliers. Various other websites can also help in discovering and assessing important information like reviews, comparisons, comments, analyses and case studies of potential suppliers.

Experience – Experienced individuals working within purchasing team generally carries a wide knowledge about various capable suppliers as experienced buyers have already worked in a particular industry for many years and familiar with the main suppliers and their features.

Internal sources – Operating different business units within large organisations, each may have their own procurement department. Therefore, other units in the same organisation becomes a valuable source of information exchange to buyers through informal meetings, formal team sessions, an internal database, purchasing newsletters, etc.

Limit suppliers in the selection pool

At this stage, the procurement team must consolidate and analyse the information gathered on potential supply sources that helps them to make informed decisions. Getting a long list of suppliers is just the initial task but buyers then have to eliminate the weakest suppliers until they attain the strong shortlist. Therefore, the final supplier is then selected from this list. The following are the entry qualifiers features that influence buyer's final decision [Howard (1998)]:

Financial strength

Appropriate business strategy

Strong supportive management

Proven manufacturing capability

Design capability

There are also many reasons that influence buyer's decision to procure material on the following basis:

Buying directly from the original manufacturer or distributor - Original equipment manufacturers mostly offer lower prices that avoid the costs of wholesalers and retailers along with profit margins. The final choice must be considered on the basis of four factors including the size of the purchase, the manufacturer's policies of direct sales, availability of storage at buyer's facility, and the required additional services.

Local, national, international and global suppliers - Choosing international suppliers are more favourable as they usually offers the best price along with technical support but these have to be balanced by higher shipping costs, stocks, communication problems and common risks involved. Also, choosing local suppliers are considered more responsive to fluctuating demands, small deliveries and regular changes in purchase orders using Just-in-time method that not only supports local suppliers and allows the buyer's to enhance local economy but also helps in building community goodwill.

Large or small suppliers - Usually buyers focus on supplier's capability to do the work rather than selecting on the basis of its size. But a buyer must keep in mind the unexpected increase in demands that can only be dealt by larger firms providing extra capacity to overcome these fluctuations. At the same time, in order to create a diversified supply base, buyers intentionally deal with smaller suppliers.

Multiple or single sourcing - When there are numerous different suppliers available then it becomes very difficult to make a decision of how many to

use? Most of the organisations have chosen a trend to reduce the supply base that will benefit them accordingly.

Determining method to select supplier

This is the last stage where buyers are left with four to five suppliers in their shortlist and decide to evaluate these remaining organisations by looking at the alternatives in more detail for example, using supplier-provided information, supplier/customer visits, preferred list of suppliers and third-party information.

Supplier-provided information – Detailed information can be acquired through requesting price quotations. Information received from quotations are then used to understand the product description and supply which is then followed by another requests of a detailed cost breakdown of the price quoted by suppliers initially that must include the costs of labour, materials, overheads and profit as buyers also require operational details to finally evaluate them.

Supplier visits – One of the most efficient ways of getting an overall view of supplier's capabilities and performance is to visit supplier's facilities by a cross-functional team. Generally, these visits are expensive and time consuming so a buyer must balance their desire to gather as much information as possible confidentially. The following table shows important information points that a buyer must collect during its visit:

Management capability

Quality management

Technology levels

Planning and scheduling effectiveness

Financial strength

Personnel relations

E-business capabilities

Sophistication and efficiency of operations

ISO certifications

Skills, knowledge and experience of workforce

Evidence of good management and housekeeping

Types of inventory

Nature of the goods inwards, stores and outwards areas

Environmental practices

Employee employment contracts

Any significant changes planned or expected

Contact details of key decision makers

Use of preferred suppliers - This is a list of suppliers created by the purchasers to reward their best suppliers that consistently meets their strict

performance criteria. The list can also be used as an incentive to improve the existing supplier's performance and assessed accordingly.

External or third-party information – This consists of all the other information available about a potential supplier. For example, Total quality management is a system that insists suppliers to meet the quality standards as similar to buyers and generates a flow of related information throughout the supply chain.

Selecting supplier and signing agreement

This is the final step to choose the supplier followed by signing a contract.

This includes different purchasing orders required for routine and major items, i. e. using standard purchase orders for routine items whereas, detailed negotiation is required to agree on specific details for major items that increases the complexity in the purchase order.

Supplier evaluation criteria

After considering various steps in selecting suppliers, the buying organisation must analyse the following questions with the supply organisation in order to progress outside their traditional purchasing relationships and possibilities for long term relationships with them:

[Spekman (1988)]

Has the supplier signified a dedication or willingness for a longer term relationship?

Is the supplier enthusiastic to perform resources to develop this relationship?

Is the supplier willing or able to participate at the early stage or throughout the stage of product design?

Has supplier brought any unique service to the business?

Is the supplier showed their interests or commitment towards customer's problems and effectively solving them together?

Is the supplier is interested in improvements and innovations in the operations?

Is there any openness of sharing and exchanging information between both companies?

How much knowledgeable is the supplier about the customer's industry and business?

Is the need for confidentially exchanged information taken seriously?

Supplier management and development

In today's time, the need to improve supplier performance is open in large or small organisations and for this reason; the purchasing teams must introduce a supplier relationship management (SRM) approach to achieve their organisational goals and success in global purchases of technology. Therefore, this calls for managing resources efficiently throughout supply chain collaborations, dedication required from supply managers, creating standardised best practices effectively and tools required for tracking and evaluating the results. The process must begin with effective supplier performance measures required to undertake strategic supply or

procurement decisions for the organisation. [Minahan T. And Vigorose M. (2002)]

Effective supplier performance measurements

What to measure – The factors important to assess the performance includes:

Delivery performance – The purchase orders that are sent to suppliers involves all the appropriate information on deliveries, with quantities, lead times and due dates. Therefore, it is buyer's responsibility to check regularly that how well a supplier actually meets their expected conditions.

Cost performance – There are many ways that can measure cost performances for example, monitoring real price delivered by the supplier after adjusting increase in the prices (inflation).

Quality performance – In order to measure quality, the best criteria for buyers is to check that products are delivered in 100% perfect condition with no defects. This also includes comparing previous performances, latest performance with mutually agreed standards and various other figures.

Other qualitative factors in supplier performance

Factor

Explanation

Problem solving

Supplier's attention to provide solutions to the problem

Technical skills

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Comparing supplier's manufacturing capacity with other business suppliers

Reporting progress

Supplier's incomplete reporting of existing problems and identifying and communicating other potential problems

Corrective action

Supplier's timely response to requests for corrective actions and requests for changes

Cost-reduction plans

Supplier's enthusiasm to find techniques that helps to reduce the total purchase cost

New-product development support

Supplier's capability to reduce time and cost required for new product development

Buyer/seller compatibility

Rating subjectively how well a purchasing firm and a supplier work together

Therefore, the above are various other factors that help the buyers to measure the supplier's technical ability and closeness of both parties' relationships.

Reporting frequency – This includes preparing reports to provide a clear feedback to supplier on their performance. Purchasing management must communicate with their buyers to send these reports by reviewing them weekly, monthly, quarterly or annually which is then followed with more face-to-face team meeting that reviews their actual performance, discussion on targets, identify potential improvements, examine changes, and so on. Any problems (for example, supplier fails to meet the required standard) occurred during crucial time must be addressed with special reports and meetings to avoid any financial and operational problems.

Use of measurement data – Procurement staff can make use of data collected from its measurement systems in many ways including:

Identifying suppliers which are not meeting the performance goals and highlighting areas that calls for improvements, followed by corrective actions taken to raise the performance to acceptable levels or else finding new suppliers.

It helps in discovering excellent performances achieved from supplier which then helps identify preferred suppliers that qualify for long term alliances.

It also recognises the worst performing suppliers that are continuously not improving and needs to be removed from supply base whereas offering more work to superior suppliers.

Supplier measurement techniques – There are three techniques discussed for evaluating performance of suppliers, each differs in their use, level of subjectivity, resources required and implementing cost.

Categorical techniques - These techniques considers a particular aspect of performance, for example lead time and classifies a set of categories for performance rating as excellent, good, fair or poor and therefore, helps buyers in deciding which supplier is good or bad. This is an easiest system of measurement, easy to use, comparatively inexpensive and also the most subjective.

There are some drawbacks of using this technique as they do not provide a clear analysis of performance, slower than automated systems and regarded as the lowest of the three techniques in terms of reliability.

Scoring model - This method overcomes the subjectivity of categorical technique by calculating a weighted score for different performance categories. This is more reliable and requires reasonable implementation cost providing flexibility for buyers to change the categories included as well as weights allocated to each.

Cost-based techniques -This technique is the most comprehensive that can help the buying organisation to look for the total cost required for doing business with a particular supplier by identifying the lowest purchase price is no