The Advantages of PARTNERING

How can companies form the *right* kinds of partnerships with their suppliers and customers? The framework suggested here by one veteran practitioner can help supply chain professionals answer that question. It offers a practical and structured approach for reconfiguring relationships according to their strategic value for both parties—and then executing on that plan.

By Robert A. Rudzki

Over the years, there has been considerable discussion about the working arrangements that are possible between suppliers and their customers. Both suppliers and their customers use the term "partnership" often and casually to describe a wide range of working relationships. But are all relationships truly partnerships? And, more fundamentally, is a true partnership the appropriate form of relationship for every situation?

The short answers are "no" and "no." If I had a dollar for every time a supplier's salesperson came through the door and began talking about "our partnership," I could have retired a long time ago. In the past, I might attend a dozen meetings and hear the term used in a dozen different ways. In many cases, "partnership" is applied to a transaction or a series of transactions—the regular purchase of copier paper, perhaps, or the one-off sale of a suite of software. Marketing impulses have expanded the term beyond reasonable scope, distorting the significance of minor relationships and devaluing the word where it has true strategic importance.

As a result, resources can be misapplied. Supply chain partnerships that, properly managed, could add significant value may be shortchanged on funding, staff, and time.

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With the competitive success of both the supplier and the customer at stake, there is value in stepping beyond casual and traditional approaches to relationships. At best, a traditional method gives you traditional, incremental results. At worst, it can be counterproductive. Companies at either end of the supply chain can sharply differentiate themselves if they apply a disciplined structural approach to their relationships with each other and with other participants in what I call a "value network." In other words, there is great benefit in developing and managing the right kinds of relationships. In some cases, those newly designed and implemented relationships can become the nucleus of an "extended enterprise" involving a network of businesses. That enterprise can offer enormous competitive advantages.

These relationships may require additional measurement processes or new liaisons between senior managers on each side, for example. Conversely, relationships that now or in the future are less critical may be oversubscribed.

Most large corporations are well aware of the differences between true partnerships and more transactional relationships, of course. They have elaborate and proven mechanisms to drive procurement, supplier relations, sales, marketing, and customer relations. And they sometimes have sophisticated operations to drive alliances and other joint ventures.

But business pressures today are so great—and are rising so rapidly—that even the most sophisticated businesses may be failing to realize the full potential of their current relationships and missing opportunities to build new ones. And even if they are maximizing existing arrangements now, they may not be re-evaluating their objectives and achievements with enough rigor to ensure continued optimal performance. For companies that lack the expertise and resources to focus on relationship potential, the dangers are even greater.

A Practitioner's Perspective

Before I go much further, let me explain my personal perspective. I've been deeply involved with procurement and supplier relations for 10 years, and for a long time it has concerned me that businesses essentially leave real money on the table when they do not "partner right." Currently, I'm a senior vice president and chief procurement officer at Bayer Corp., the North American arm of German health care and chemicals giant Bayer AG. In North America, our annual purchasing budget is about $6 billion, covering thousands of supplier relationships in virtually every industry—from chemicals and raw bulk materials to professional services. We are well aware of the value of a disciplined and structured approach to supplier relationships, and we constantly refine our approach to make sure we are getting the best out of each of those relationships.

Earlier in my career, I worked directly on extended customer relationships and on a wide range of linkages with suppliers. My role has also involved negotiations with prospective buyers of businesses being divested and with prospective partners in corporate business development ventures.

Additionally, I helped establish and manage relationships with commercial banks and other financial institutions.

In this article, I want to provide a detailed look at a structural framework that can address the shortcomings in the historical and casual methods of partnering. I will begin by reviewing the external and internal factors driving the need for a new approach to customer/supplier dealings. Then I will lay out a basic framework for defining and developing different types of working relationships between suppliers and customers. As a rule, I will not include purely transactional activities because they do not fit with a rigorous definition of partnerships. So my descriptions will span a range of relationships from what I refer to as "basic partnerships" (which have value and are easier to achieve), through "strategic partnerships" (which have greater value and are more challenging to achieve).

Momentum Behind Partnerships

What's really driving the need for a new approach to dealings between customers and suppliers?

No one debates the fact that businesses everywhere are facing increasing competitive pressures. Capital moves immediately and massively around the world. Product cycles get shorter every year. Average product development time today—16 months from concept to launch—is 12 percent less than in 2000, according to a recent survey by consultancy Deloitte. Businesses are innovating faster than ever. The Deloitte research finds that by 2006, 35 percent of manufacturers' revenues will come from products introduced during the three preceding years, up from 21 percent in 1998.

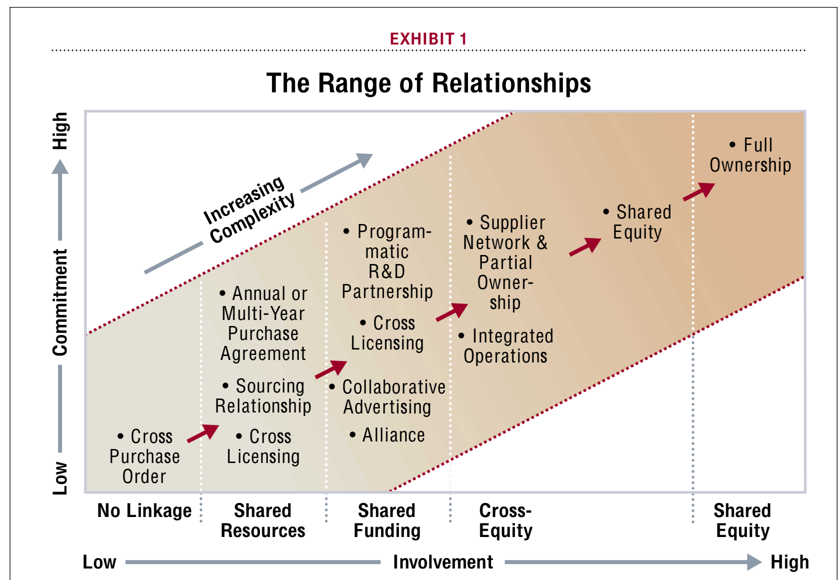
Increasingly, markets, sources of supply, and sources of competition are global in span. Another Deloitte study finds that more than 30 percent of European manufacturers say they'll locate or expand factories in China over the next three years. Additionally many U.S. and European manufacturers are locating product engineering far afield. Communications are denser and faster all the time. Sales grow more complex as customer expectations rise around the world.

Companies should not overlook the role that suppliers and supply chain partners can play in helping to respond to these market pressures. We are a long way from the vertical industry business models that prevailed in Henry Ford's day—when Ford Motor actually owned the rubber plantations that supplied the raw materials for the tires that its own factories made. For many businesses, the biggest component of their cost structure is purchased goods and services. In the steel, oil, and chemicals industries, as much of 70 percent of revenues goes to the cost of goods and services. In automobile manufacturing, it can reach 60 percent; in retail, it's at least 30 percent.

Many organizations learned long ago about the transaction and coordination costs of managing long lists of suppliers. Many companies have worked hard to rationalize their supplier rosters so they can focus limited internal resources on fewer suppliers. At the same time, the last few decades has seen much more attention to other forms of relationships: joint research and development projects or co-branding initiatives; partial equity investments; and long-term strategic alliances, such as the code-sharing initiatives run by many airlines. Sometimes a deeper relationship has served as a pilot run for, or a precursor to, an outright merger or acquisition. (Exhibit 1 shows the many forms that partnership structures can take.)

EXHIBIT 1

The Range of Relationships



Spurring on the extension of relationships is a factor unknown to business until the 1990s: the Internet. Although telecommunications and computer networks have progressively extended and accelerated collaborative activity, the Internet has led to an explosion of commercial interactions of every type worldwide—and will continue to do so.

Partnership Pitfalls

All is not perfect when it comes to partnering. I have seen failures and disappointments with business relationships that I believed had great value, and no doubt you have too. Information from a mid-1990s report by The Conference Board points out that as many as 40 percent of partnerships have failed or not realized their true potential. Failures are often attributed to factors related to "partner selection" and "partnership implementation."

In almost all situations, difficulties are rooted in very human factors: fear, mistrust, culture, and power. Suppliers typically cite the following concerns:

- Fear of overdependence on the customer.
- Different company cultures.

- Inequitable power in the relationship.
- Fear that the customer's emphasis will be on price and margins.

Similarly, customers often have sufficient reason to hesitate. They cite lack of trust in suppliers, concern that there will be more risk than benefit (or inadequate grounds for sharing benefits and risks), and fears that forming a relationship will mean relinquishing control.

Other internal factors play out too. Poor leadership often gets the blame for failed partnership implementations. External factors, such as changing business climates, also are cited as reasons for failures attributed to partner selection.

This means that those eager to establish and nourish the right supplier/customer relationships must attend to an array of soft issues. Put another way, it is crucial for each side to occupy the other's shoes for the duration of a partnership.

A Foundation Framework

With this understanding, let's turn now to a framework for thinking about, designing, and implementing relationships. As I've noted, relationship structures can take many forms; the challenge is to select and develop the appropriate structure. What you see in Exhibit 1 are the dimensions of commitment level and involvement and a spectrum of supplier/company arrangements—from a simple purchase order to the highest level of commitment and involvement (full ownership of the supplier).

In fact, you can classify relationship structures into four major categories, with the level of commitment increasing from 1 to 4:

1. Transactional relationship: Noncritical; low value. Focuses on the efficiency of the transaction

2. Basic partnership: Noncritical but high value. Involves areas that are not a core capability.

3. Strategic partnership: Important; high value. Involves an exchange of technology or other core capability, for example. Valuable when acquisition is not possible or desirable — such as in cross-border situations or when there are financial limitations.

4. Acquisition/Equity stake: Critical; very high value.

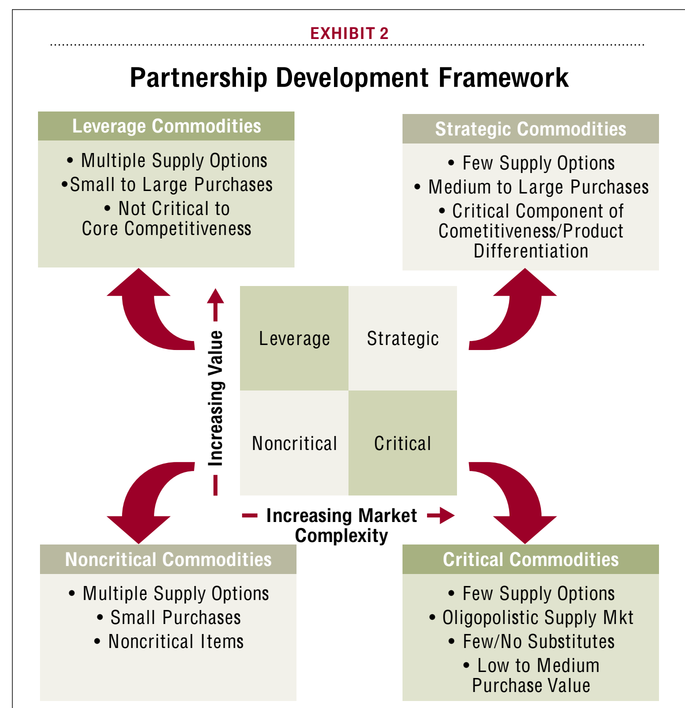
As you might expect, the level of complexity—both *negotiation* complexity and *implementation* complexity—increases the more strategic the relationship. Negotiations in a straightforward transactional relationship typically revolve around price, terms, delivery, and order-processing issues. But in a strategic partnership, they will extend to include factors such as levels of risk and reward sharing, managerial structure and team make-up, levels of contribution, ways to balance cultural differences, and methods of conflict resolution.

It's much the same with implementation complexity. Whereas a simple transactional relationship may have a single point of contact—the traditional buyer/salesperson interface—a strategic partnership will involve many more disciplines and points of contact, at all levels. At the highest levels, it will sometimes bring in the chief executive. You might think this seems intuitive, but it's often not how relationships play out in practice. I've certainly seen transactional relationships where a whole team from the supplier will show up. On the other end with more strategic relationships, I've far too often seen situations where a single representative from the supplier—a mid-level manager, or at worst, a sales representative—attempts to carry the ball for the whole organization. It just doesn't work.

What is needed is an objective, value-driven framework. The framework can help identify the right relationship structure for the required objectives and the applicable constraints. Conventionally, purchases might have been analyzed along simple Pareto lines, focusing on the 20 percent of transactions that comprise 80 percent of spending. But newer methods of thinking are focused on a spending "portfolio" to be arrayed in a matrix that has value (or spending) on one axis and market complexity on the other. (Exhibit 2 depicts that matrix.)

EXHIBIT 2

Partnership Development Framework



Commodities (a term I use very broadly) located in the top right quadrant are characterized by few supply options and thus a more complex market from the procurement perspective. They involve significant spending and are often critical to your company's competitiveness. From the buyer's point of view only, commodities in this quadrant should be managed using joint ventures, strategic alliances, and value-added arrangements.

At the other end of the matrix, the "noncritical" quadrant represents those types of spending characterized by multiple supply options and relatively small spending, such as office supplies. In this quadrant, the buyer's goal is to simplify and

automate as many of these functions as possible. Procurement cards (or P-cards) can be an ideal solution for buys in this quadrant.

In the upper left, the "leverage" block, as the name implies, represents relatively sizable types of spending and fairly uncomplicated markets. We're talking about a buyer's market. Here, the buyer believes it's best to expand the use of minimum specifications for opportunity purchases, to increase concentration with the right suppliers (sourced globally), and to make only short-term commitments.

"Critical" are relatively low-spend items that can often become bottlenecks. Examples might include motors, bearings, and power transmission units. (For many customers, each of these item might fit the concept of a critical commodity—assemblies of comparable performance and quality that can be sourced from a few suppliers.) One way to deal with that market complexity is to rely on distributors, which can provide value-added services—matching motors and transmissions, for example—and broader buying efficiencies. Buyers also might manage critical commodities using tactics such as buying consortia, longer-term agreements, hedging, and lumping purchases together for leverage.

Fitting Viewpoints to the Framework

To properly assess the right form of relationship between a customer and a supplier, it is necessary to evaluate *both* perspectives. Within each quadrant, the buyer and the supplier has its own unique viewpoints, which become the drivers—or in some cases—the constraints in developing the partnerships. (Exhibit 3 summarizes the two viewpoints.)

In Exhibit 3, I've layered in the supplier's considerations when viewing the relationship with the customer. The supplier would look at market competition on the X-axis, and the value of the customer's business along the Y-axis. The data or insights to populate the chart could come from multiple internal meetings at the supplier organization. A designated team leader would be responsible for gathering and portraying the data after all parties agree on definitions of terms (that is, strategic, leverage, noncritical, and critical).

Properly used, the grid can quickly expose significant similarities or differences in the viewpoints of the prospective partners. Let's look at one example (rail transportation) where there's plenty of room for differences of opinion.

In Exhibit 4, the buying organization, denoted by "B," may view rail transportation as a commodity of relatively high market complexity. Accordingly, its view would be reflected on the far right on the matrix. But the supplier (the railroad)—denoted by "S"—may well see this as a low-competition situation, especially if it is the only rail supplier serving that customer. Thus, the supplier view would show up on the far left. Similar exercises with other customer/supplier pairings can highlight convergence of viewpoints. The chart clearly pinpoints the closeness or distance between the viewpoints of the prospective partners and thus is valuable to help determine the type of relationship that will work best.

EXHIBIT 3

The Supplier and Buyer Viewpoints

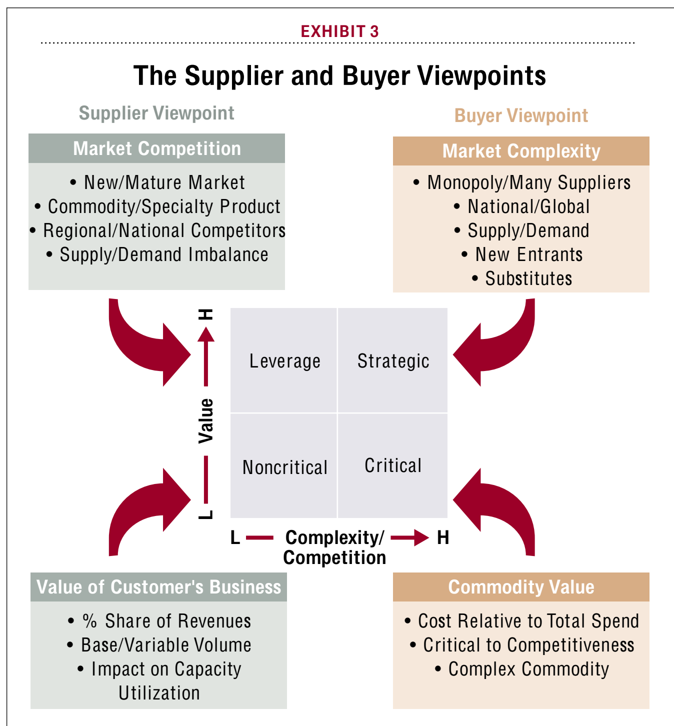
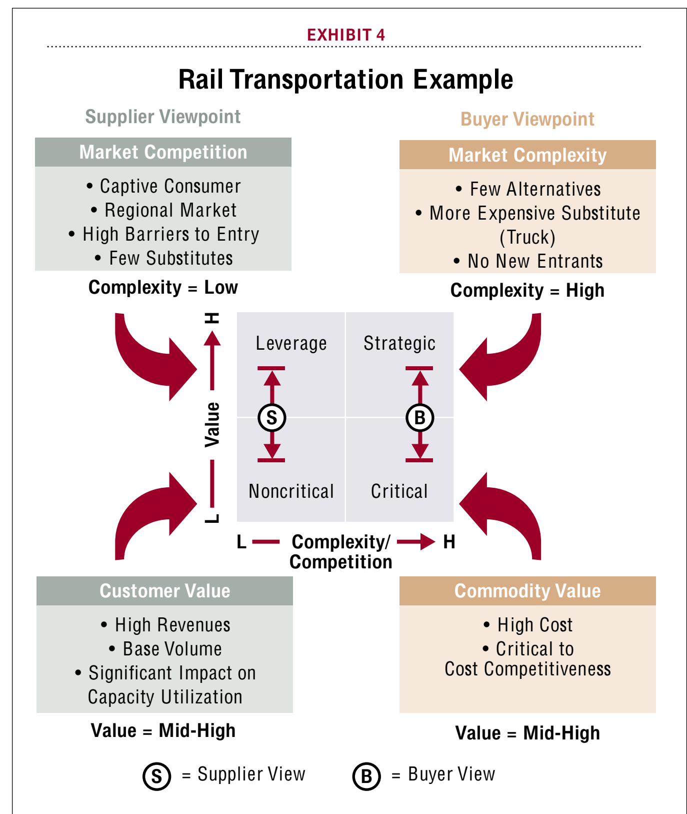


EXHIBIT 4

Rail Transportation Example

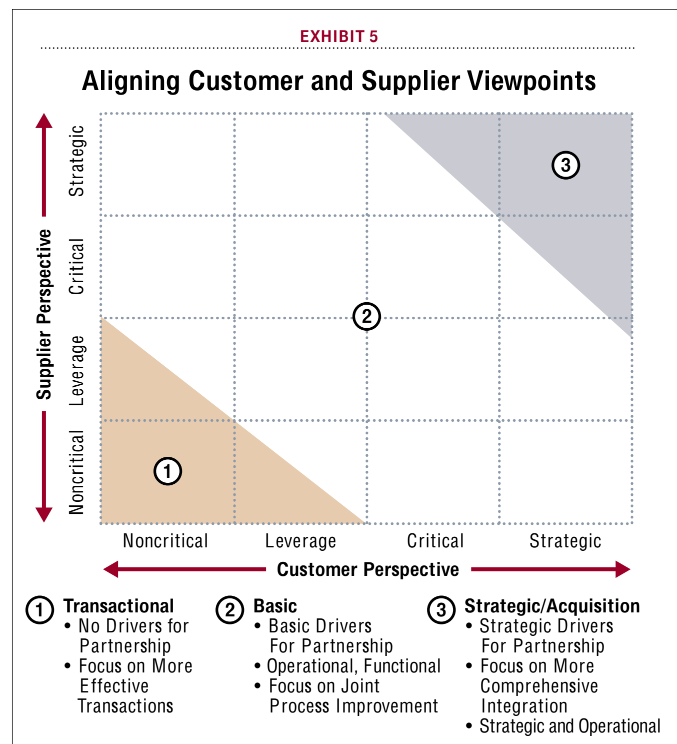


A word on how it works. It would be ideal if both sides could, in an orderly fashion, meet to work out chart placements like this. In practice, it is of enormous value if even one side—it does not matter which—goes through the exercise. The resulting framework then becomes an ideal discussion document. It

can accelerate a productive discussion about definitions of terms, generate clarity about the future plans and expectations of each side, and quickly pin down key areas of agreement and disagreement. In my experience at Bethlehem Steel and now at Bayer, the exercise, and the framework it produces, saves a great deal of time, debate, and downright aggravation. Frankly, it would be wonderful if more of the salespeople who visit us had gone through a version of the exercise before arriving on our doorstep.

Agreement over the degree of overall alignment of the supplier and buyer viewpoints can help select the right relationship framework. It is not enough to look at the relationship in your own terms; when you examine *both* viewpoints, you can more ably assess the likely value of partnering and at what level. Indeed, the very act of sitting down with the other party to work through the framework bolsters the relationship.

Until now, I've been showing you a 2 x 2 matrix to match suppliers' and customers' viewpoints. That's useful as far as it goes because it can help with the more obvious choices of relationship. However, it falls short of helping you figure out the next best alternative in the many cases where the relationship is less clear-cut. So it is helpful to develop a more detailed breakdown, by creating a 16-element grid that plots supplier perspective against customer perspective and then groups the 16 elements into three broad relationship zones (See Exhibit 5). (For simplicity, it makes sense to group acquisitions in with other strategic relationships.)



Here's a glimpse of how this grid can be applied in interactions with the other side:

Zone 1: If market forces are driving the relationship toward being transactional, it makes sense to acknowledge there is little incentive for a partnership and to focus instead on more effective and efficient transactions. The zoned

The Importance of Measuring Performance

You're familiar with the saying: "You get what you measure." The corollary is: "Measure what you want to achieve." Unless you and your supply chain partners apply detailed and sustained performance monitoring and measurement, you will have no way of knowing for sure if your partnerships are effective. You may not even know if they're a net positive or negative on your resources. If you don't have a scoreboard, you certainly won't have a way of tracking trends.

Three interdependent dimensions determine success in supplier partnerships. There is an operational dimension common to all forms of partnership; a cultural dimension that is also pervasive; and a strategic dimension that applies to deeper enduring relationships of high value to both parties.

In terms of operations, you want to find ways to gauge the flow of information and the compatibility of the partners' processes. Typically, you'll have checklists to identify and eliminate duplicate activities and to improve transparency of information. You'll assemble joint teams for implementing improvement programs and resolving problems, and you'll have mechanisms for periodic joint performance reviews. Ideally, one team member will be designated to lead the measurement effort and to devise effective ways of not only continually gathering the right data but also conveying it to supply chain decision makers.

On the strategic level, the metrics will focus on the degree of business integration necessary for a continued strategic fit and on the characteristics vital for a long-term partnership. Key dimensions to monitor include: linked business goals with specific targets, jointly defined performance standards, pay that relates to performance, and cost transparency.

However, I've found that the area most likely to contribute to the success or failure of partnerships is cultural. That's the area that's most difficult to change. If the supplier and customer start far apart culturally, you have to question whether partner selection was done properly. To test for cultural affinity, the "dashboard" has to indicate commitment, compatibility, and cooperation toward continuous improvement and growth. For example, one gauge may measure mutual assistance in problem resolution while another tracks continuous improvement processes. Still another might weigh compatibility of management styles. This last measure is especially important when there are significant management changes at one partner, or if one comes under new ownership.

It is crucial to get a sense of the cultural fit as soon as possible. Ideally, it should be fully assessed before there is any mutual commitment in the first place. If the ratings are low, the success of the partnership is in serious doubt.

approach instantly clarifies things for those supplier sales representatives whose offering is low value and noncritical to us. It helps to make their sales process much more efficient, enabling the sales representatives to spend their time more productively with us. It certainly helps crystallize discussions quickly without damaging relationships.

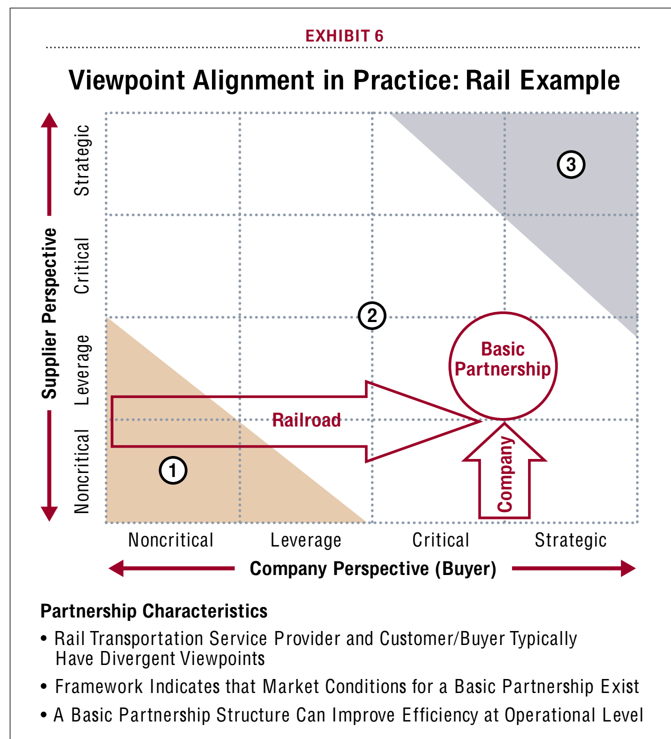
Zone 2: Where a basic partnership is suggested, the focus should be on joint process improvement. (See section that follows: "Bayer's Experience.")

Zone 3: Where a strategic partnership is warranted, the focus is on a much more comprehensive integration. Agreement on definitions and positions in the zones makes for faster and more certain resolution of the details of a strategic partnership. Plus, it makes it much easier to reconcile divergent viewpoints because it quickly unearths reasons for divergence.

If you relate this framework to the earlier illustration on rail, you will see that conditions exist only for a basic partnership, not a strategic linkage. This suggests that efforts would be best focused on joint efforts at process improvements. (See Exhibit 6.)

EXHIBIT 6

Viewpoint Alignment in Practice: Rail Example



Partnership Characteristics

- Rail Transportation Service Provider and Customer/Buyer Typically Have Divergent Viewpoints
- Framework Indicates that Market Conditions for a Basic Partnership Exist
- A Basic Partnership Structure Can Improve Efficiency at Operational Level

Bayer's Experience

So how does this all work in practice? I'll draw on our experiences at Bayer to say what works and what doesn't.

First, a quick backgrounder. Bayer Corp. today comprises four groups: Bayer CropScience for a range of agricultural products; Bayer HealthCare for consumer medicines, diagnostics equipment, and biological materials; Bayer Chemicals, for a wide range of chemical products; and Bayer MaterialScience (formerly Bayer Polymers) for polymers. We have more than 30 production facilities in North America. Of the roughly $6 billion in procurement spend, about half goes to raw materials (such as ethylenes, benzene, and toluene) and energy (such as natural gas, coal, and electricity). The remainder buys capital equipment, professional and logistics services, and indirect purchases, including IT products and services and maintenance, repair, and operations (MRO) products and services.

We can point to successes in each spend category. But first we need to be clear about our terminology. To us, not every buying relationship is considered a partnership; it may simply be a transaction, or a series of transactions, or even a transactional relationship. Not long ago, Bayer, like many organizations, could have fielded a range of definitions for the term "partnership." So our procurement council held a meeting to nail down what we meant. It was not a long and elaborate exercise, but it was a vital one that led us to develop a discipline for framing relationships with our suppliers. Today, our procurement council reserves the term "partnership" for those special relationships where (1) the supplier maintains a leadership position in technology, service, and cost, and Bayer is receptive to the supplier's ideas; and (2) there is an appropriate consideration for the amount of business Bayer directs to the supplier.

Bayer's *basic* partnerships are long-term, mutually responsible business relationships that are the result of tangible effort and attention to activities such as these:

- Jointly committing to information exchange, planning, continuous improvement, and cost reduction.
- Encouraging a more interactive and trusting environment.
- Agreeing on measures of key performance factors.
- Sharing of risk to achieve mutual benefits.
- Working to prevent problems from initially occurring, solving problems as they occur, and preventing their reoccurrence.

Using the series of frameworks, we have successfully implemented several basic partnerships with significant results including reductions in total cost of ownership and inventory savings to bring about more effective use of working capital. Some of these basic partnerships are in the MRO arena, where we use single-source suppliers for a wide range of products and services. The supplier provides, among other things, professional and technical expertise, inventory management, and continuous improvement. The benefits from these arrangements have been significant over the years—literally in the millions of dollars in some cases.

In another recent negotiation, our approach allowed us to streamline dramatically the development of a basic partnership with a major logistics supplier. The supplier's president recently headed a delegation comprising chiefs of strategy, sales, marketing, and others. We laid out a strawman framework for an alliance backed by our definition of "partnership," and the delegation quickly gave us a high-level authorization for the structure of a basic partnership.

Later, the supplier's chairman stopped by for what was supposed to be only a few minutes to see exactly how the partnership could work. The framework, however, led him to stay for several hours to solidify his company's commitment to the deal. Without our frameworks, the discussions could easily have favored emotion over rational results. It certainly would have taken many more cycles to arrive at the same outcome—perhaps with less certainty of what we were doing.

We also have implemented a few relationships that truly meet the tough definition I've offered for "strategic partnerships." These relationships meet all of the standards applied to basic partnerships while also being characterized by long-term supply/purchase commitments—as much as 10 years — and by significant sharing of risks and benefits.

Our strategic alliances typically feature innovative pricing/cost approaches, such as gainsharing, or mutual cost-reduction programs. For example, we are collaborating with distributors on the indirect-purchase side to cut total costs over a multi-year period. The cuts can come from product substitutions, vendor cost savings, or from gains in transaction efficiencies. These strategic partnerships oblige the distributor to devise new ways to trim costs while requiring that we be receptive to those ideas.

Strategic partnerships often are steered by joint operational integration teams and are subject to rigorous ongoing performance measurement. It goes without saying that they have been screened for a close cultural/philosophical fit. In some cases, Bayer has actually taken an equity position in the arrangement.

One of those strategic relationships—involving a key raw material used in Bayer plants that supply chemicals and polymers—meant that the supplier did more than simply monitor our inventory and truck or pipe in fresh supplies according to our demand signals. The company set up a production facility at one of our plants. The partnership evolved during almost 12 months of discussions and negotiations. We explored strategic, cultural, and operational aspects. (See sidebar on "The Importance of Measuring Performance.") We thrashed out relative competencies, risk sharing, and shared investment. And of course, we wrestled over prices and delivery. This was no quick series of meetings. In fact, it can often take a year or more to put a strategic partnership into practice.

Because strong supplier relationships are critical to Bayer's long-term competitiveness, we are always willing to invest in designing and implementing frameworks that make those relationships as effective as possible. That policy goes right to the top office. In 2003, the host of the two-day event to recognize our premier suppliers was Attila Molnar, Bayer Corp.'s chief executive.

Stakes Are High

Businesses can no longer afford *not* to partner where it makes sense, and they cannot afford to partner poorly. At best, the companies that put only minimal effort into their customer and supplier relationships will miss opportunities that their more committed competitors will seize. At worst, partnership laggards will find it harder and harder to turn in satisfactory financial performance.

The stakes are already too high for substandard partnering initiatives, and they are getting higher as cost pressures intensify and innovation cycles accelerate. We are entering an interconnected era in which the global corporation will be eclipsed by the more massive and complex "global enterprise"—an ever-changing mesh of business entities and the relationships between them. The global enterprise will be a natural evolution from today's network of strategic linkages.

Businesses can no longer afford *not* to partner where it makes sense, and they cannot afford to partner poorly.

Consequently, supply chain leaders will need to take into account not only their own companies' core competencies but also those of current and potential supply chain partners. They must be able to look well beyond investments in their own facilities, infrastructure, and resources to include those of their key partners. This calls for a much broader vision of what constitutes as supply chain value. Supply chain managers must rapidly move from a transactional orientation to a strategic orientation to help develop the company's competitive value-added supplier networks.

This article has laid out a case for more thoughtful relationship evaluation and design and has presented a practical and disciplined framework for reconfiguring relationships according to their strategic value to both parties. I do not pretend that the framework is a fix for more fundamental supply chain challenges. Nor is it planned or implemented overnight. But if properly done, it should help companies respond better to current and future partnership opportunities and challenges.

A structured analysis can help select the appropriate partnership framework and minimize the potential for failures. But the analysis and the framework are only the earliest steps. Supply chain managers must use those tools—tailoring them to their own needs—to wholeheartedly rethink their approach to supply chain value. As such, they must rework business processes, performance tracking and measurement systems, and incentives.

It will not be easy, but it will be well worth it.