

Supplier Development: More Than a Good Idea

"Think outside the box." Since 1993, when Michael Hammer and John Champy's book *Re-engineering the Corporation* became a business best-seller, we have been trained to seek dramatic improvement of business processes and results. However, this "reengineering" mindset presupposes that we exercise some control over our business environment, which is not always the case. For example, having a sole or a single supplier can severely limit control if not managed properly.

Having no or little choice of suppliers can be constraining or even threatening. In cases where there are only two or three suppliers it often feels like being in a chess game in each decision is strategic. In addition, sometimes organizations choose to "single source" even though multiple sources are available. Single sourcing can yield strategic benefits (such as lower costs and more innovation), but it needs to be "checked" by external reference points.

Monopolies are usually regulated to protect shippers. US regulators (until the 1970s) and overseers (in more recent years) have often employed a "cost-plus" approach to monitoring railroads by

capping their ratio of revenue to variable cost, and they have applied a similar approach to coastal maritime trade lanes where cabotage was immune from competition. Many countries similarly regulate electric, gas, and water utilities.

However, duopolies are more common and are not always tightly controlled. Railroads often have no competition or compete solely against truck traffic. The split-up of Conrail in the US left many "two-to-one" locations in which locations had been served by the two acquiring railroads (CSX and Norfolk Southern) were henceforth served by only one of them. Duopolies often exist in air traffic as well, with some lanes served by one primary carrier and one competing alternative - usually a smaller company that offers a lower price.

If you face an involuntary captive (monopoly) situation, use these five possible strategies, or levers, to improve your position:

1. Use a competing mode. For example, if you are shipping cargo use truck instead of rail.

2. Develop an alternative source for raw materials, manufacturing, or transportation, whichever is the most costly link in

the value chain.

3. Consider acquiring strategic suppliers and setting fair transfer prices.

4. Litigate. Use the court system to police monopolistic rates or force the entry of more competitive suppliers.

5. Regulate. Lobby for change in the rules of oversight, governance, or rate/price setting.

If you have voluntarily decided to single source, take these seven steps to maximize the benefits of doing so, and simultaneously minimize the risk of becoming dependent upon or captive to that supplier:

1. Keep your switching costs manageable. If supplier-specific information systems or infrastructure are required, ask the supplier to make or share the investment. Don't make all the investment yourself.

2. Structure long-term agreements that lower the cost of renegotiating contracts and prices, and that benefit from lower unit costs on higher committed volumes.


3. Implement some form of gain-sharing or outcomes-based agreement (for example, compensation based on fill rates, sales, or volume handled) to ensure alignment of goals.

4. Collaborate on future demand in order to synchronize capacity, thereby ensuring superior service levels and reducing inventory or excess capacity.

5. Establish a simple and easy-to-administer indexation of prices for commodity inputs such as fuel and labor.

6. Stay abreast of alternative sources and their current prices through ongoing market intelligence.

7. Work with a preferred alternative source to ensure an acceptable alternative service or product, and let the single source know that you have this alternative handy.

Being in control is not only a good idea - it's an obligation to customers and shareholders. Think ahead and prevent loss of control by structuring market intelligence, bids, and contracts to build supplier relationships that assure competitive advantage. 

David Jacoby is the President of Boston Strategies International Inc, a consulting firm that provides consulting, cost and price analytics, and market research to manufacturers and their supply chain partners worldwide. To contact Mr. Jacoby or the firm, please call (1) (781) 250-8150 or e-mail info@bostonstrategies.com.