Seeing eye to eye

Reassessing the state of their long-term relationship enabled two firms to improve the way they collaborate and unlock extra business value in the process

by Lynette Ryals and Andrew Humphries

Collaborative relationships between customers and suppliers are the new hot topic in strategic procurement. However, there is a real danger that buyers may not be getting the most out of these relationships because they are still using traditional management and measurement approaches that are not sufficiently systematic or integrated. "Collaboration" really does mean sharing, not only the operational management of the relationship but also the skills and experience that generate valuable learning opportunities. This means that unlocking the value potential in a collaborative relationship requires new ways of measuring relationship quality that go beyond the normal financial and operational key performance indicators. Customers that still treat their key suppliers as "junior partners" in a collaborative relationship, and still measure relationship quality with traditional supplier performance measures, may be missing out on many potential benefits.

It is precisely this problem that is illustrated by our case study, which examines the relationship between Sonatest NDE

ILLUSTRATION: JONATHAN McHUGH

Group, an electronics manufacturer (the customer) and Paragon, a specialist components supplier. The case describes how the two firms used a joint assessment technique, SCCI, to measure relationship quality and value. The assessment exercise revealed that the existing supplier relationship management (SRM) system had not optimised the returns from the relationship. Using these results, the customer made substantial improvements to the bottom line, and both companies learnt, for the first time, how to manage an interfirm relationship more effectively to secure long-term benefits. While the case involves two smaller companies, the lessons are just as relevant for larger organisations.

Setting the scene

Sonatest is based in the English town of Milton Keynes and has 150 employees and forecast revenues of £18 million in 2008. It is an industry leader in the field of non-destructive testing (NDT) equipment and uses high levels of investment in research and design to manufacture and distribute some of the best NDT products from six locations worldwide. Its customer base covers a wide range of industries including oil, rail, manufacturing and aerospace. Sonatest is characterised by an entrepreneurial, innovative, engineering culture.

Paragon is part of a group of companies providing specialist electronics supply chain management and contract electronics manufacturing services. With annual revenues of over £30 million, Paragon employs more than 300 people and is acknowledged as the UK's leading company in its field. Its key strength is supplying producers of low-to-medium volume complex products, with all component kits supplied "assembly ready" and tailored to individual requirements. Its services include purchasing and progressing through inspection, stock control and accounts, thus freeing up customer resources for more strategic activities. The focus is on precision and planning.

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TABLE 1

Mapping the Sonatest-Paragon relationship to best in class

Characteristics of best-in-class collaboration	Sonatest-Paragon
Joint innovation	Yes, but scope for improvement
Customer focus	Yes
High-quality outputs	Yes, but scope for improvement
World-beating practices	Yes, but not integrated
Continuous improvement	Partially, but not integrated
Flexible commercial frameworks	Verbal agreement
Objective performance measurement	Yes, but not integrated
Improved business forecasting	Yes, but scope for improvement
Co-ordinated processes	Yes, but scope for improvement
Honest and open communication	Yes
Two-way information flows	Yes, but not integrated
Clear relationship management	Partially, but not integrated

The 10-year relationship between these two SMEs was seen by both chief executives as successful, but the relationship assessment revealed untapped potential. This case study exemplifies the difference between operationally efficient relationships and value-creating collaboration.

Both firms experienced a watershed in their development thanks to rapid growth in their markets, so both CEOs decided to appoint new managing directors. In addition, as they planned to collaborate on a major new product development, the CEOs decided to benchmark the relationship between their firms. They engaged us to assess the effectiveness of their business collaboration and to make recommendations on how to improve joint performance. Our approach is based on research by Cranfield School of Management and SCCI in the UK and has succeeded with a range of organisations in the public and private sectors, including defence, retail fashion, food, farming, brewing, rail and construction.

The relationship assessment

Under total confidentiality arrangements, knowledgeable staff in both companies completed online questionnaires that allowed a "traffic light" report showing the highs, lows and gaps in performance to be produced. A number of one-hour telephone interviews were then carried out with key personnel in each firm to explore in more depth the issues raised by the survey. Following data analysis, a report was presented to both teams. The report concentrated on the hard issues that, if improved, would make a difference to bottom-line performance.

The relationship assessment was not expected to expose significant issues. However, the analysis revealed that although it was an above average business-to-business relationship – a good example of 1+1=2 – it was still falling short of the integration necessary to deliver the benefits of a truly collaborative relationship. There was significant unrealised potential from the combination of these two highly innovative companies.

Collaboration between suppliers and buyers over a period of time can generate additional revenues and competitive advantage for both parties that neither could achieve on their own (1+1=3 or more). In truly collaborative relationships, value is created through investments in people, infrastructure and systems, and by fostering a climate in which innovation and the free flow of ideas flourish. The result is the creation of reliable business systems and high-quality goods and services. In effect, a virtuous cycle is created that is capable of securing long-term profitability and market share. Therefore, these relationships are valuable – core assets that good corporate governance demands must be managed effectively. However, this is not so easy to accomplish because a complex mixture of hard and soft issues need to be measured and understood to ensure optimisation of the benefits of collaboration.

Using a series of benchmarks based on the characteristics of best-in-class collaborative relationships, the analysis of this functional relationship revealed a number of areas for quality improvement (*see table 1*). As the table illustrates, the Sonatest-Paragon relationship completely mapped to best in class in only two areas: customer focus and honest and open communication.

In other areas, such as joint innovation, the quality of outputs, forecasting and co-ordinated processes there was room for improvement. Individually, the partners had some world-beating practices, performance measures, relationship management and formal communication, but these were not sufficiently integrated. Information flows within Sonatest, and between it and Paragon, tended to be unco-ordinated and haphazard. This had, on occasion, resulted in inappropriate ordering of components and quantities, unreliable planning, forecasting and decision-making, inadequate information feedback and dissemination, compartmentalisation of important information, and insufficient knowledge about the partners' capabilities and limitations. As one of the Paragon respondents commented: "They have a bit of a gap between the engineers and other departments such as purchasing, R&D and commercial. Sometimes we, their supplier, have to bridge this gap for them."

Another area in which value was not being maximised was clear, joint performance targets. For example, shared performance targets could have been set for component availability, test yields, customer returns and ongoing cost reductions. Their dearth tended to drive up inventory holdings, rework costs and delays and potentially affected end-customer satisfaction and business profitability. Another Paragon interviewee noted: "They have placed orders without delivery dates or defined requirements. Better forecasts would mean everyone could be leaner."

A traditional emphasis on time, cost and quality – often called supplier or project management – may devote insufficient attention to the underlying causes of difficulty

In addition to integrated shared targets, the third significant issue related to process management. It was apparent that, over time, joint operational processes had become ill-defined, indicating that there was no central point of responsibility for maintaining coherence. As a consequence, individuals had developed their own practices, which created gaps and overlaps that in turn increased costs and risks. The analysis revealed the potential for greater overall integration to increase the value generated by the relationship.

From a strategic procurement perspective, integration between supplier and customer firms is probably one of the most difficult things to implement, although it does have substantial value-generating potential. Shared targets are slightly easier, although they do require the procurement manager to have a strategic vision and also to trust the supplier. The process management issues are well-known to procurement managers, and providing (and enforcing) a centralised contract and set of processes is an important function.

The Sonatest-Paragon relationship provides an important example of the opportunities for value creation over and above operational improvements.

From operational improvement to collaborative value creation

The senior managers in both companies were surprised by the report because it revealed a number of important operating issues of which they were not aware. Although there was a clear understanding between the companies at senior level, this was not apparent at lower levels. Despite these issues, the collaboration brought both companies considerable business benefits and there was a strong commitment by all staff in both firms to the relationship and its future success. In the words of one Sonatest respondent: "Of all our partners, this relationship still has magic. We probably wouldn't go anywhere else. We have a lot invested in the relationship and get a good return from it."

The analysis not only revealed some areas where the relationship could work better at a strategic level, but it also became clear that the supplier had a lot more to offer than the customer recognised. An opportunity for value creation had been missed through underutilisation of Paragon's resources and skills.

This illustrates the danger of supplier relationship management systems, if they exist. They tend to measure historic performance rather than future potential and concentrate on a lower level of detail that fails to tap the health of the relationship as a whole. The second problem is that the perception of the relationship is diffused throughout the two organisations and there is often no central, joint focus for managing it.

Procurement managers who are working in the strategic area need to view themselves as relationship managers, and understand that the latter face a number of difficulties in doing their job. Despite the presence of good contracts, operational failures and poor teamwork will often lead organisations to focus on the "small print" and self-centred, opportunistic behaviours rather than building long-term value for the customer. However, no matter how close the relationship in its strategic intent, underperformance will not be tolerated.

A traditional emphasis on the management of time, cost and quality – often called supplier or project management – usually ignores the effects of organisational interaction and pays insufficient attention to the underlying causes of difficulty, which often occur insidiously. Relationship managers are likely to see the warning signs and might know what is happening, but they don't know why. Examples include:

- Complacency (accepting average performance and normalising problems).
- Distrust (failures to perform cause self-centred behaviours).
- Opportunism (seeking gain at the expense of the partnership).
- Quality failures (unresolved, joint process problems).
- Poor communication ("fuzzy" channels).
- Cost overruns (internal optimisation resulting in increased joint costs).
- Late deliveries (process hiccups multiply at organisation interfaces).

As a result, relationship managers spend most of their time fire-fighting symptoms and sometimes, in frustration, invoking penalty clauses with the inevitable dangers of diminishing joint performance and causing relationship fracture.

Regaining the competitive edge

From what we have said so far, it is clear that collaborative relationships are complex situations in which a clear picture that enables decisive management is difficult to capture. It is essential that relationship managers have an objective means of measuring relationship performance that covers the full extent of the collaboration and encompasses both soft and hard aspects.

This ought to make sense of messy situations by exposing the good areas, the poor areas, the inefficiencies and the wastage within both partner organisations. It must offer practical recommendations for improvement and enable cost-effective, continuous improvement programmes to be implemented.

It will need to transform perceptions by promoting understanding of the way that the partners view each other and strengthen the relationship. Lastly, it has to provide a benchmark against which future progress can be planned and measured.

Recent academic research in both the public and private sectors has strongly indicated that there are specific key performance drivers in business relationships that can be accessed and measured. An example template of practical KPIs is shown in *table 2*.

TABLE 2

Practical performance measures of relationship value

KEY PERFORMANCE DRIVERS	INDIVIDUAL MEASURES
Creativity – promoting quality, innovation and a long-term approach encouraging high performance; the "spark" that generates the enthusiasm to go the extra mile	The relationship encourages the achievement of high performance by both parties (eg, consistent product quality, on-time delivery, reasonable forecasts)
	The relationship encourages us to be innovative and flexible in the way we do business
	When an unexpected problem arises, we would rather work out a solution than hold our partner to the original contract terms
Stability – synchronising objectives and investing in people, processes and infrastructure; the confidence-building foundations of a successful relationship	The relationship with our partner provides a dynamic business environment within which both parties can seek increasing rewards
	I have complete confidence in their intentions
Communication – frequent, open dialogue and high-quality information sharing	We would welcome a shared data environment where market, planning, technical and pricing information are made freely available
	Exchange of information takes place frequently and informally, not just according to specified agreement
Reliability – concentrating on service and product delivery, lowering joint costs and risks, building up trust	The quality of service (eg, billing, prompt payment, administration and delivery) is entirely satisfactory
	Our relationship is characterised by continuous improvement
	We trust that our partners act in our best interests
Value – creating a win-win relationship to which each side is equally committed through positive participation	The gains from our relationship are equally shared between us
	We are willing to invest more (money, time, information, effort) in the relationship

Within these five key performance drivers of creativity, stability, communication, reliability and value (and in addition to the analysis of the individual measures), values are assigned to intrinsic relationship characteristics such as long-term orientation, trust, personal relationships, commitment, adaptability and teamwork. Richer, more descriptive results are obtained by linking the statistics to anonymous quotations from the interviews.

The assessment process should be simple, sponsored by senior management and co-ordinated by the relationship managers. Guaranteed anonymity will ensure that full and frank views are expressed and the report should allow managers from both companies to develop and improve the relationship. Regular assessment should be part of the contract management process.

Case study outcomes

The SCCI assessment allowed the companies to take an objective view of their relationship, instead of one fraught with individual opinion and fear of upsetting the status quo. A Sonatest respondent noted: "We have not resolved all our problems, but we now have a relationship that allows us to raise them and discuss a way forward without conflict."

A quick win out of the review was a £40,000 annual saving on in-house testing within Sonatest, because it realised that boards supplied by Paragon were already fully tested and certified.

The assessment recommended that a more robust joint business framework that better supported the complexity of the relationship should be put in place. The companies jointly agreed to formalise processes and to hold regular planning meetings that would also review performance, work-in-progress and sales against orders. In order to improve communications, they decided that Paragon technical representatives would spend more time in the Sonatest factory.

As a result of the closer collaboration between the companies, a joint team working on the design of the new versions of Sonatest's leading products transformed the development process. As part of this Paragon proposed a number of additional services, including design-for-manufacture and design-for-test. These measures resulted in improved first-time manufacturing yield from around 50 per cent to over 95 per cent; the use of cheaper, more reliable components with greater functionality; and a cut in the delivery time to end customers from four to two weeks.

Furthermore, pushing manufacturing even further back into Paragon was under active consideration so that Sonatest could concentrate on its core strengths of designing new products, marketing, distribution and customer service. As one Paragon participant put it: "Together we have a new way of working that allows us to focus even more clearly on the customers."

Enhanced interaction made the partners realise that the use of ageing technology and uncertain consumption information required excessive and costly stockholdings. A review resulted in more relevant holdings and the disposal of redundant items. In addition, improved forecasting from regular reviews of forward order book and supply chain requirements resulted in significantly better availability at lower cost.

Lastly, Sonatest realised that its IT systems were fragmented and not providing adequate management information. The review diagnostics enabled it to accurately define the requirements for a new IT package to be used to integrate production, stock ordering and customer relationship management.

CHECKLIST

How to extract more value from collaboration

- Centralise the management of your key supplier relationships in a single, professional team.
- Recognise that relationship managers are experienced, knowledgeable, high-integrity people; recruit, train and reward them accordingly.
- Keep relationship managers in post for reasonable periods – don't rotate them on to another project just as they are building the trust-based supplier links that are vital if full value is to be captured.
- Task relationship managers with aligning the parent company functions that service its relationships.
- Encourage collaborative planning and forecasting with key suppliers.
- Engage in "adult-to-adult" conversations with suppliers; recognise that they are experts in what they do and may be able to solve your problems for you.
- Introduce appropriate metrics to measure and monitor relationship performance.
- Reward problem-solving and creative behaviours among your staff.
- Involve other supply chain partners in regular planning meetings.

General lessons

We have described the importance of positively managing business relationships from a joint perspective to replace the self-centred key account management and supplier relationship management approaches. Relationship managers face difficulties gaining objective information to control and continuously improve performance.

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Within a confused situation laden with emotive and process complexity, what gets measured gets managed. We have outlined an innovative assessment technique that provided measurements and diagnostics enabling our case study companies to enhance their relationship. It created clearer joint understanding, trust and commitment, which freed them to focus on quality, innovation, cost reduction and on-time delivery. However, we have also come to the conclusion that companies need to consolidate their relationship management activities into a single focus with the status to maximise value creation from collaboration.

Major companies such as Hewlett-Packard, Xerox and Coca-Cola have put in place a dedicated alliance management function charged with institutionalising processes and systems and spreading know-how throughout the company. It also co-ordinates relationship activity across departments and ensures the necessary resources are provided to support the alliances.

Importantly, the initiative has stimulated the creation and use of alliance metrics that allow relationship managers to systematically evaluate performance. As a result, companies like these have a 25 per cent higher alliance success rate and generate almost four times the market wealth compared to others, according to research[1].

The relationship focus should not be a secondary commercial or sales one, nor should it be diffused across departments. Without objective performance measurement providing the right knowledge to monitor, steer and improve activities, the relationship value will be below its potential. ■

FURTHER READING

[1]Jeffrey Dyer, Prashant Kale and Harbir Singh, "How to make strategic alliances work", *MIT Sloan Management Review*, Summer 2001, volume 42, number 4, pp37-43