How Many SUPPLIERS Are TOO MANY?
Cost savings and increased efficiency top the playbook of every supply management organization. A way to achieve both is through supplier consolidation.

The strategy (also called supplier rationalization or supplier optimization) enables an organization to reduce — or optimize — its supplier base to align with business needs, and thus gain value. It’s generally not a one-time event. Markets change, companies change, and mergers cause companies to rethink their supplier base. Thus, supplier consolidation is a measure that organizations must continually engage in to be most strategic.

“A supply management practitioner’s job is to enable the business to be successful,” says Chris Sawchuk, principal and global procurement advisory practice leader at The Hackett Group in Miami. “Part of that is how he or she architects the supply base, not just for supply assurance and savings, but to allow them to meet other business objectives as well such as supplier-enabled innovation and supply risk mitigation.”

LARGE VERSUS SMALL
Procurement organizations manage hundreds, thousands or even tens of thousands of suppliers — plus, due to a changing environment, they have more responsibilities and concerns than ever before. They are constantly challenged to deliver more for less in every aspect of the business.

“Although they’ve squeezed a lot out of certain areas, they must figure out how to become more efficient and effective,” Sawchuk says. “Procurement organizations must make decisions not only regarding what they should be doing, but about what they shouldn’t be doing. They can’t do everything, and must prioritize based on maximizing business value.”

Sawchuk highlights an analogy comparing large, preferred supply bases to having many friends: “It can be quite difficult, if not impossible, to spend quality time with all of your suppliers, so you end up...”
spending a little bit of time with each one. It’s the peanut butter spread model: Every supplier gets a little bit of attention — but not necessarily enough to create differentiating value.”

A smaller supply base, on the other hand, is easier to manage and requires less effort and fewer resources to oversee and monitor, says Juergen Pfeffer, global strategic sourcing director for the gearing division at Altra Industrial Motion, which is headquartered in Braintree, Massachusetts. In addition, he says, it enables practitioners to (1) reduce the number of interfaces to manage and (2) work more closely with fewer contacts.

MANAGING RELATIONSHIPS

A major advantage to having a more manageable supply base is that it facilitates moving from transactional relationships to partnerships, says Amit Rathore, CPSM, a Chennai, India-based principal analyst, laboratory assets and operations at Beroe, a procurement consulting organization. These closer relationships enable both sides to become familiar with each other’s operations and capabilities, thus spurring product development and efficiencies. “When partnerships happen, you’ll realize more innovation and more visibility in the supply chain,” he says. “Having consolidation without partnership is like having half of the relationship.”

Pfeffer says that closer relationships also can lead to:
- Supplier partners lending technical advice during development projects
- The creation of logistical processes tailored to the specific needs of the company’s value streams
- Waste elimination throughout the supply chain
- Opportunities to reduce costs.

Cost savings can range from more common unit price to broader total cost reductions. Sawchuk says that The Hackett Group’s benchmark studies have consistently shown significant correlations that, as the supply base gets smaller, spend cost-reduction savings increase while the cost of procurement decreases.

Having a smaller supply base also sends a positive message to partner suppliers: “It tells them, ‘You’re important; you’re our primary supplier in this area,’” Sawchuk says. When there is a larger base, suppliers are less likely to invest in you as you haven’t invested in them, he adds.

SOLE SUPPLIER DILEMMA

There’s a fine line between having too many suppliers to manage and consolidating so much that there are too few. Excessive consolidation can result in:

Over-dependency on one supplier. What if a single-source supplier for a critical product or service runs into financial trouble? Or a natural disaster, like Hurricane Harvey or Irma, disrupts production or creates logistical issues?

Less visibility. If an organization’s consolidated supply base engages heavily on contract manufacturing, it likely doesn’t know where or how the products are being manufactured, Rathore says: “On one hand, you have the quality of products you want, but there are ethical issues like child labor that you need to address.”

Less competition. “I’m a strong believer in competition, as it fosters creativity,” Pfeffer says. And when there are more suppliers, he says, there is more competition: “Well-managed competition not only keeps costs low but is essential in cases where the internal customers like R&D, value streams, sales and product management search for technological and/or logistical advancements.”

Being taken advantage of. When a supplier knows it is integral to the organization, it may exploit the situation, perhaps charging more than the organization can secure in the marketplace.

Rathore explains this risk with an example of a health-care company that was the sole customer of single-source supplier: Despite a 30-year relationship, the supplier offered only a 6 percent discount to the company. The company analyzed the matter by (1) reviewing the supplier’s financial data, including materials cost; machine time; and labor, depreciation and other expenses, (2) extrapolating the respective operational costs, (3) determining the supplier’s costs and overhead and (4) conducting a should-cost analysis. The two sides then renegotiated, and the company and supplier settled on a 22 percent discount on the existing price.

WHERE TO START

Determining where to pare the supply base can be daunting: With so many suppliers, it’s hard to know where to
focus. However, the type of spend can provide a clue. The Hackett Group studies have consistently found that supply bases tend to be more optimized for direct spend categories than indirect spend.

There are two primary reasons. The first is that supply management capabilities in direct spend have traditionally been more mature, although that gap has been closing. The second is that supply bases in direct spend tend to be more global overall; however, in some indirect categories, that’s also changing due to such industry consolidation strategies as M&A, Sawchuk says.

Tail spend — the large portion of total spend that is made up of small purchases from myriad suppliers — also can provide consolidation opportunities. “Organizations shouldn’t allow a big tail — it’s lost money,” Rathore says.

Pfeffer recommends focusing on the material-supplier combinations that represent a low supply risk and a low spend volume. “Typically, consolidation in these areas is smoother, and progress can be achieved without adding substantial supply risk,” he says.

One of Altra’s companies conducted a Pareto analysis of its suppliers over a two-year period. It showed that 12 percent of the company’s suppliers accounted for 80 percent of spend, Pfeffer says, while more than 70 percent of the supply base accounted for the bottom 5 percent of spend. The company then embarked on a supplier reduction program to optimize the tail-spend supply base.

“In a first step, with rather limited efforts, we’ve been able to delete a remarkable number of these supplier numbers, as they’ve been redundant or just used for a one-time demand,” he says. The program is ongoing, he adds.

There are many strategies companies can employ to determine where and how to consolidate their supply bases. Rathore recommends looking at the total cost of consolidation, not just the cost of products or services. By conducting a total-cost analysis, organizations can examine such factors as:

- Change in resources needed to manage the supply base
- Logistics costs (for example, a reduction in shipping costs)
- Regulatory and compliance costs
- Supplier risk.

Supply managers must continuously review their supply base for consolidation and improvement opportunities, especially in more dynamic industry markets, and ask themselves whether their current supply base provides them with the optimal value that their business needs to be successful, Sawchuk says.

### SUPPLY BASE OPTIMIZATION

Striking the right balance and number of suppliers often provides greater total benefits than the advantages of supplier consolidation alone. That’s why the term “supply base optimization” is often preferred to supply base consolidation, Sawchuk says.

What is the optimum size of a supply base? That differs depending on the organization, market, industry, type of spend and situation. An organization must understand the characteristics of its supply base and supply market to determine the optimal number of suppliers within each category of spend, Sawchuk says. For example, an organization might have a good reason for having 10 suppliers for a product category, he says.

However, changes in the marketplace — such as expansion into new areas — may cause an organization to rethink its number of suppliers, he says. “This becomes part of your category strategies,” he adds. “And those strategies have to be aligned to what you’re trying to enable in the business.”

Another consideration is the industry: Some industries — such as pharmaceuticals — face inherent supply base dilemmas, making it difficult to reduce the supply base in their direct spend. Sawchuk says that the reasons include:

1. Each product component is provided by a different supplier,
2. There may be only one supplier that can provide a component and
3. Meeting regulatory approvals could take considerable time.

Also, organizations need to weigh the risks of consolidation versus the benefits, Sawchuk says: “This entails asking such questions as, ‘Do I need two suppliers because I’m not comfortable with having one supplier attached to 60 percent of my revenue? Do I need a second supplier — or can I have my current supplier manufacture my supplies from more than one site?’”

### WORTH THE EFFORT

Transitioning to a consolidated supply base can take time and can disrupt an organization. “Supplier transition is a big issue,” Rathore says. “I’ve known a few companies that have taken almost three years to complete the transition from one supplier to another supplier at a global level.”

Also, changing the makeup of the current supply base can, Pfeffer says, “trigger the reflex that consolidation won’t work or may even harm the supply, a typical reaction with all change management activities.”

Nevertheless, he says, supplier consolidation is worth the effort. A consolidated supply base can provide organizations with value that goes beyond cost savings. It can lead to partnerships, collaboration, visibility and efficiencies — particularly, Sawchuk says, when supply management organizations understand their objectives and architect the supply base accordingly.

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