The New Customer of Choice Imperative: Ensuring Supply Availability, Productivity Gains, and Supplier Innovation

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Abstract. Rising commodity prices, tightening labor markets, an increasing reliance on suppliers for cost savings and product innovation ideas—all of these contribute to a shift in the balance of power toward suppliers in a sellers' market. This shift is causing progressive supply professionals to rethink the way they structure and manage relationships with suppliers, in order to ensure their company can secure disproportionate access to scarce supplier resources (materials, services, or ideas) at the times they're needed the most. This paper and the presentation will outline the criteria suppliers use to make decisions about so-called "key account" treatment and customer prioritization. It will also explore elements of effective tactics to build and maintain customer of choice status, based on demonstrated best practices from leading supply organizations.

Introduction. An upward trend in commodity and services prices alike over the past three years, compounded by recent challenges in securing supply availability, all signal a shift in market power toward suppliers. This shift is happening at a time when in many ways, companies are more tied to suppliers than ever before – as indicated by the rise of contract design and manufacturing, the spread of complex EDI systems that span nodes in the supply chain, and the dramatic increase in the average company's spend accounted for by outsourced services. One consequence of this change in power dynamics is that in spite of recent successes, corporate savings rates are decreasing; in one recent survey, over 50% of large global companies say they have experienced a decrease in year-over-year cost savings rates from 2004 to 2005.

In addition to diminishing savings rates, more and more supply organizations are reporting negative outcomes of other kinds as a result of the shift toward the sellers' market, including missed innovation; paying higher prices than peer companies (or competitors) for core products or services; or disruption of operations. This phenomenon is happening across industries and around the globe, to large and well-known companies as well as small players. The negative results range from higher costs to lost revenue, leading to, at its worst, a loss of competitive advantage in the marketplace.

Definition of "Customer of Choice." But even in this tough environment, there are companies who are getting <u>what</u> they need from suppliers, <u>when</u> they need it. A customer of choice is defined as a company that consistently receives competitive preference for scarce resources from a critical mass of suppliers. How do you know if you're a customer of choice? Litmus tests include:

1. <u>Consistency</u> – The supplier consistently addresses your organization's needs ahead of those of other companies (perhaps including competitors);

2. Scarcity – The resources in question – whether materials, services, new ideas, or supplier staff – are limited in availability;
3. Critical mass – Your company receives this type of preferential treatment from more than just the small handful of "strategic" suppliers, and thus is able to secure support for a wide range of business needs.

Sizing the Opportunity. A 2005 survey of senior sales executives reveals that suppliers overwhelmingly allocate valuable resources to their most-preferred customers ahead of others. Specifically:

- 75% of suppliers say they regularly put most-preferred customers at the top of allocation lists for materials or services in short supply on a regular basis;
- 82% say that these customers consistently get first access to new product or service ideas and technologies;
- and a resounding 87% of suppliers offer unique cost reduction opportunities to their most-preferred customers first.

Research from the Procurement Strategy Council (PSC) indicates that the benefits from "customer of choice" status can potentially be worth hundreds of millions of dollars. The value can come from successful programs to leverage supplier cost improvements, avoided losses from supply disruption; and/or breakthrough product or service innovations fueled by supplier collaboration. Taken together, these benefits have the potential to deliver value equivalent to an additional 2 to 4% of savings off of the company's total spend base.

It's no wonder that leading supply organizations are taking steps to sustain customer of choice status where they need it most, in order to block potential moves by other companies competing for their suppliers' scarce resources. They are also actively seeking to build customer of choice positions where they do not yet have it.

View From Across the Table: Understanding Supplier Decision Criteria. The first step in securing customer of choice status is to understand how your suppliers are allocating resources and benefits among their customers – and how they are choosing between customers. A recent survey of over 800 sales account managers and one-on-one interviews with senior sales executives reveal a number of surprising findings, which also point to opportunities for sourcing and supply management organizations. These findings undermine some perhaps common myths about the relationship between suppliers and customers:

- Myth #1: If a supplier considers my company a "key account," we automatically get better performance and resources. *Reality: Most so-called "key accounts" are denied preferential treatment at one time or another.*
- Myth #2: There is little we can do to become a customer of choice; it's based on company characteristics like size, brand, market position and so on. *Reality: Willingness to truly collaborate with suppliers can secure customer of choice status over time.*
- Myth #3: Most procurement organizations are well-positioned to collaborate with suppliers. *Reality: Suppliers continue to suspect ulterior motives behind procurement's collaborative overtures, indicating different approaches may be needed.*

- Myth #4: Procurement's need to generate cost savings precludes the possibility of gaining preferred access to supplier resources. *Reality: Procurement can exercise multiple levers that are greatly valued by suppliers – beyond spend volume.*

A look at the scorecards suppliers use to evaluate their customers clearly shows the importance to suppliers' decisions of criteria beyond just price and volume. These scorecards place high weight on additional factors, including strategic "fit," cost to serve the customer (i.e., delivery cost, servicing requirements, customization), and predictable decision processes – all things that supply organizations have an opportunity to influence, or to communicate to internal business partners even if they cannot control them directly. In other words, supply management professionals can significantly influence how suppliers view them as customers – and, consequently, the amount and type of scarce resources those suppliers provide.

Elements of Effective Practice. A handful of leading companies have developed systematic approaches to building customer of choice positions that go beyond the traditional definition of "supplier relationship management," and which have resulted in demonstrable benefits. Their experiences and lessons learned point to three imperatives for supply organizations:

<u>1. Start by looking at yourself as suppliers do</u>. Most supply management staff don't know where they stand with suppliers relative to peer companies or competitors. Category managers and supply professionals should incorporate a self-diagnosis of their company's attractiveness as a customer into supplier and category analysis.

<u>2. Use interactions with suppliers as an opportunity to uncover "hidden" decision criteria </u>:
One company provided its buyer team with an easy-to-use reference guide to help them uncover important information about supplier organization dynamics, power structures, reward systems, and more (in some cases, as simple as a reminder to look for clues in supplier staff office size, parking spaces, or KPIs) – and then use that information in supplier action plans. In one instance, the sourcing organization helped to uncover a personnel issue at a major supplier that proved critical to the success of a multimillion-dollar project, and was able to act to avert a crisis.

<u>3. Being a customer of choice is as much about selling as it is about buying</u>:
The information gained from understanding hidden supplier decision criteria can enable supply management organizations to go beyond just negotiating for the best deal or contract terms, to make a compelling offer for partnership that is aligned with suppliers' business objectives. One sourcing group was able to initiate customer of choice relationships with suppliers which had no history of doing business with their company, and where their share of spend was relatively small, in just this way. They systematically mapped their own assets (such as co-branding opportunities, internal staff expertise) to the target supplier's business need, and factored the value of these capabilities into an ROI calculation for the desired partnership.

4. Low cost-to-serve customers are as attractive to suppliers as low-cost suppliers are to buyers:
Companies on both sides of the negotiating table are faced with pressures to reduce costs in the face of increasing input prices and labor rates. Increasingly, suppliers are analyzing the cost to serve their key accounts – and de-prioritizing, or even de-selecting, high cost-to-serve customers. Removing unnecessary cost-to-serve burdens on suppliers improves end-to-end supply chain economics for all concerned, and helps to secure customer of choice status.

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