

An Introduction to Supply Base Management



This paper provides an overview to the discipline of identifying the appropriate number of suppliers required to support business needs and drivers, referred to as supply base management.



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Reducing an organisation's supplier base is often a key aim of any procurement professional in a new role. It is always assumed, if not always proven, that aggregation is right and less is more when it comes to the long tail of suppliers most large organisations develop.

But in an increasingly complex world, with an ever growing number of exogenous influences on the organisational agenda, we can no longer assume that the standard approach is always the right approach. Performance optimisation is the new mantra. Getting the right solution for your organisation is more important. Aligning the objectives of the procurement strategy with the goals of your organisation is the correct first step. Having these in tune will lead to developing the right strategy for your business.

It is no longer the case that less is automatically more. There are times when a broader supplier base is right for you...for example to spread risk or even for socially responsibility reasons. Although there are surely times when the old way is also still the best way. But sitting down and thinking through what is really needed is always the right first step.

In economics, competition is seen as an important process for achieving the most efficient allocation of scarce resources. In the business and consumer worlds the interaction and competition between buyers and sellers is considered essential in these markets, as a mechanism for the production of new products, services and technologies at affordable prices. So important has this concept become in the modern world, that international bodies such as the World Trade Organisation (WTO) and the International Chamber of Commerce (ICC) in the UK have evolved to negotiate the reduction of trade barriers and to stimulate competition between nations with the objective of achieving the most efficient use of resources; a process often referred to as 'globalisation'.

While there are many observed benefits of competing trade and business between different countries, it must also be acknowledged that extreme competition between countries can lead to negative consequences such as trade wars, protectionism, and even the use of military power to obtain access to resources.

Again world organisations such as the United Nations have been created to try to reduce the consequences of such excessive competition. The antithesis of competition is cooperation, where groups voluntarily agree to work towards a common goal instead of relying on competition and self-organising markets to achieve their objectives.

There are also international and national regulations which attempt to create a level playing field. An example in the area of economics and business would be the Kyoto Agreement, where a significant group of nations have agreed to put in measures in place to reduce greenhouse gas emissions that mainly emanate from economic and business activity.

Just as too much competition can have the negative results as mentioned above, so can too little, perhaps as a result of an over reliance on cooperation, or more often from inertia or support by governments for perceived national interests. Hence, the European Union has produced competition laws that seek to stimulate competition in key economic areas.

Although governments and supra-national bodies produce regulations, in free economies it is the individual businesses and the buyers employed by them, that have to balance competition and cooperation in the best interests of the organisation's stakeholders. At a business level,

competition is often viewed in a very specific way, and there is a tendency to focus on the volume of suppliers providing an organisation its goods and services. A competitive market place is a good thing, it brings with it the opportunities for better quality and improved prices. A professional buyer knows that poor business processes and maverick purchasing can swell the live supply base records making it appear to have many live suppliers and so may try and reduce the volume of suppliers. Organisations typically set targets for reducing the supply base, based on the mistaken notion that this in itself represents best practice; a real example of which is a large local authority which shows 22,000 live vendors, but where there are only 800 truly authorised suppliers. However, the real issue that any organisation needs to address is: -

“What is the appropriate number of suppliers required to support our business needs and drivers?”

The CIPS Position

CIPS guides are designed to provide awareness and a level of understanding to the reader on selected topics. In this case on the use of competition and supply base reduction. They are written for specific use of those interested in business issues as in general, and purchasing and supply management (P&SM) issues in particular. This will include full and part time P&SM professionals as well as individuals interacting with P&SM activities.

The CIPS guide will also include information on the contextual background of the issues, and will give a balanced opinion on those issues that the reader may wish to consider. There will also be references to other sources of information. Most Knowledge Works documents will contain CIPS position statements, that is, CIPS' view(s) on the document's subject matter. The CIPS views are arrived at using extensive consultations with P&SM practitioners and people with expertise relevant to the subject. This includes working knowledge groups and the CIPS Policy Advisory Network (PAN). Following the consultation process the CIPS Council's Key Practice Statements Group finalise the statements.

CIPS position on Supply Base Management is:

- The discipline of identifying the appropriate number of suppliers required to support our business needs, and drivers should be referred to as Supply Base Management.
- Supply Base Management is an output of strategic procurement activity.
- Supply Base Management is managed by procurement professionals interacting with and seeking guidance from other functions within the organisation.
- It is an element of the purchasing function's role to look at supplier/market development.
- The importance of analysing the supply base must not be underestimated – identifying purchasing requirements and the internal customers' requirements from the supplier(s) is the priority activity.
- Competition in the tender process helps to achieve competitive pricing, but the decision as to how many suppliers to take to contract stage must be given careful consideration bearing in mind the company's strategy for that category.
- Supply base reduction as an end in itself is not a good thing, and buyers should be encouraged to identify the “right” number of suppliers for a given situation.
- The treatment of unsuccessful bidders should be conducted openly, fairly and transparently as this will reap possible future benefits.
- Sustainable procurement considerations including Corporate Social Responsibility (CSR) must not be overlooked.

Definition and Explanations

a) Competition

There will only be competition in a market place if there is sufficient and sustained demand for a product or service to create more than one supplier.

Competition for the buyer could therefore be defined as having many options, choices and alternatives of supply. The supplier base is encouraged to deliver value to the customer when the market is subject to competition, such as better service, faster delivery, improved quality and innovation for a lower cost.

The professional buyer must understand the competitive nature of the market into which he is buying and also his attractiveness as a customer to that market. For example; a buyer with a high level of sustained demand/spend will be more attractive to suppliers. The buyer must remember that there is competition from suppliers who will be competing to supply you as a customer but that you are also competing with other buyers for that supply (you may be in a buyers or sellers market).

It is the buyer's responsibility to increase, or at least not to reduce competition, by using a considered methodology to evaluate and select those suppliers that are right for your organisation.

There is also a wider consideration in that what is right for the organisation may not always be right for the market in the longer term. For example, multi-year framework agreements may force other suppliers to move out of the market over time, or leave you with less choice when you come back to the market later.

b) Supply Base Management

Supply Base Reduction sometimes referred to as Supplier Reduction can simply be thought of as reducing the supply base.

The authors of this paper feel that Supply Base Reduction as an end in itself is not a good thing and buyers should be encouraged to identify the "right" number of suppliers for any given situation. A good tool to use is Peter Kraljics' model which looks at supplier positioning.¹

The model provides a framework for an organisation to assess its vulnerability in the supply chain as well as identifying strategies as to how to prevent them.

The principal tenet in this model is that organisations must first analyse and classify all the purchases in terms of profit impact and supply risk. The supply position is then identified within the model, the strategies and action plans are then devised.

Generally, this model is used to identify the type of relationship an organisation may have with its supplier, and it can also be a valuable model for identifying the structure of the supply base, and thus how many suppliers are needed for each specific product.

¹ Peter Kraljic "Purchasing should be Supply Management" Harvard Business Review 1983

We have adapted this model in order to show clearly what we mean by this. The two dimensions of the model, as shown below, represent both internal and external factors.

The 'y' axis represents the strategic importance of purchasing in terms of the value added by product line and the resources required during the purchasing process i.e. time, and money. The 'x' axis represents the complexity of the supply market such as supply scarcity, pace of technology and/or materials substitution, entry barriers, logistics cost etc.

Too few suppliers can be just as problematic as too many suppliers. For example, an organisation may find that it has to grow its supplier base in say, a monopoly situation.

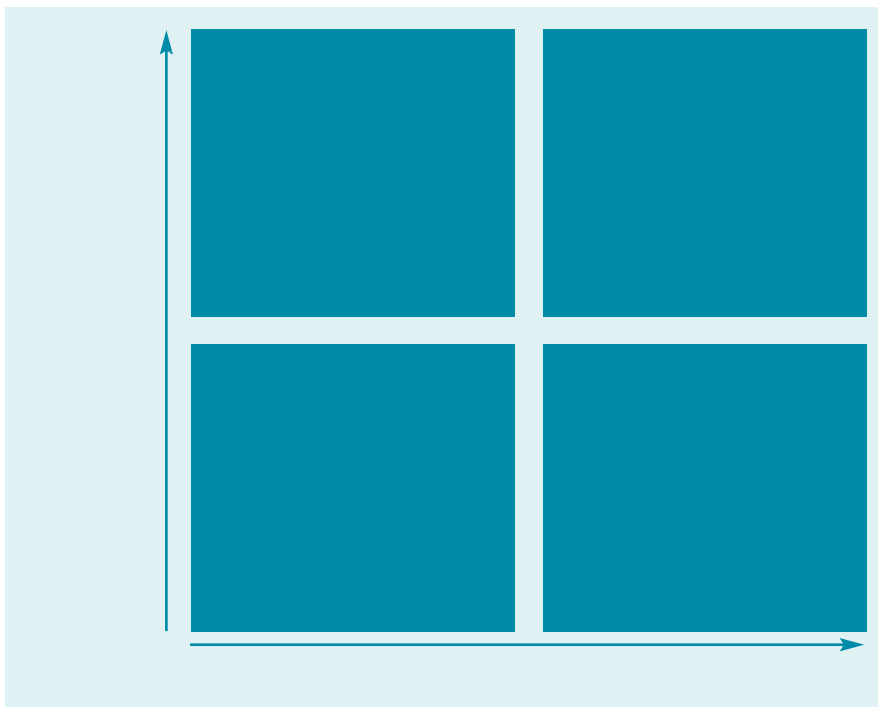


Figure 1: Adapted from Peter Kraljics Model first shown in the Harvard Business Review September/October 1983 article entitled "Purchasing should be supply management" page 111

The buyer should assess each situation and identify the optimum number which would provide the critical mass of suppliers which would best support the business. Indeed each discreet purchasing spend area (category) has its own optimum number of suppliers, depending on the changing circumstances of the both the market and the buyer's organisation.

Spend categories will vary from one organisation to another. Using a simple example, an organisation could source independently for pencils or they could bundle pencils into a stationery contract. The decision to buy pencils independently of paper as against a decision to buy stationery as a single category, will have big implications for the optimum number of suppliers. The stationery decision, for example, may remove all independent manufacturers of pencils and paper and leave the organisation dealing only with distributors. Either of these options of sourcing may be appropriate depending on the circumstances.

Another example may be the building of a new school. The decision you make will have an impact on the amount of suppliers in your supply base.

If you include the provision of fixtures and fittings, mechanical and electrical services, security services etc within the contract, this will restrict the tender to only those suppliers specialising in turnkey or management projects and potentially reduce your supply base.

The argument here is clear in that the external source is better at managing the procurement (aggregation, sourcing, tender process, evaluation etc.) than the buyer is likely to be. If this is not the case, then transferring might leave the number of suppliers in the supply chain exactly the same, meaning that there would be an additional layer in the chain. Potentially, all the costs associated with multiple transactions/ suppliers have been passed to a third party. There has to be a convincing offset for this to make sense. Buyers should not assume that reducing in this way is always an improvement.

Context

In recent years, there has been pressure on organisations to reduce their total number of suppliers as part of cost reduction programmes. This has resulted in large scaled supplier reduction programmes in both the public and private sectors.

Working with a single supplier may yield tremendous efficiency benefits without reducing any sense of external competitive pressure. Consolidating suppliers also reduces the cost of managing suppliers separately, but equally it should be borne in mind that if competition is reduced by buying everything from one supplier then this might result in prices going up in the medium term.

In the past, organisations undertaking a supplier reduction exercise often followed up with a supplier development programme. Key suppliers were encouraged to commence initiatives such as Total Quality Management (TQM), zero defects and cost reduction programmes, including waste reduction in stock holding, movement, manpower etc.. In some cases this resulted in the development and (possible over) reliance on one supplier to supply a good or a service. This shows how important it is to get the strategy right.

It is essential that the professional purchaser keeps themselves up-to-date with market knowledge and trends to ensure that the right decisions are made.

A special case of supply base reduction and single sourcing is supplier tiering. This is a process whereby a reduced number of strategic suppliers, tier 1, are responsible for managing a number of other suppliers, tier 2. This management responsibility passes upstream through the supply chain, in theory making it easier to manage the supply chain.

Some organisations use a model of sourcing called the 'network sourcing model'. In effect every part sourced have 2 suppliers although the supply is usually split to something like a 60/40% or 70/30% split to the preferred supplier. This keeps an element of competition in the process, whilst allowing both suppliers to be considerably developed to meet the organisations requirements. This approach to sourcing has been cited in the automobile sector and in manufacturing mainly as a means of preventing vulnerability in the supply chain.

In general, there is an acknowledgement that competition is one of the main contributors in driving the economy and has resulted in giving purchasers greater choice.

Decisions in the public sector are heavily regulated in the area of encouraging competition. This includes private organisations carrying out business on behalf of the public sector ie. third

party service providers. EU guidelines have an implicit view that competition is desirable and this is achieved through a competitive tendering process.

The focus is increasingly on managing the supply base as part of a programme of continuous improvement. This can be achieved through collaborating with key suppliers at a strategic level. Known as strategic supplier management, it is becoming a core business activity bringing greater value for money for the buyer and enhanced profit margins for the supplier. The buyer and supplier co-ordinate a programme of different actions in order to integrate their businesses. This is not sole sourcing or outsourcing, but rather a means to align long term planning which brings about strategic benefits such as market penetration, market growth and product development.

There is a balance to be met in encouraging competition between suppliers and developing preferred suppliers. Consideration should be given to those suppliers which provide a first class service, and cost very little to manage. Why remove them from your supply base for the sake of consolidating supply to one large supplier or distributor? There may be a good reason to do so, but ensure that this decision is made based on your business plan.

Interestingly, after some years when only cooperation was seen as 'good' and any competitive procurement was referred to as adversarial or 'bad', many higher performing procurement operations are now using a better balance of approaches. An analysis of the market and supply position allows a better informed decision to be made as to whether to adopt a multi-source adversarial strategy or a collaborative strategy with long term relationships or any strategy in between.

What are the drivers and benefits of supplier base reduction and increased competition?

Some of the benefits for reducing the supplier base are:

- Reduced overhead costs of maintaining databases and managing supplier performance.
- Supporting the aggregation of spend to fewer suppliers thus increasing leverage and lowering prices.
- Aiding the reduction of multiple competitive tendering and thus assisting the reduction of transaction costs. The fewer suppliers included in the tender process = the fewer tender evaluation and clarification exercises.

The real business benefits to the organisation of reducing the supplier base are:

- More concise reporting.
- More effective supplier relationship management including agreement of contractual terms often ignored where supplier numbers are excessive.
- Greater control of suppliers and buying processes.
- Improved supplier performance as a result of increased time available per supplier to monitor and manage performance.
- Aggregation of spend resulting in greater attractiveness as a customer.
- Increased competition for your custom.
- Lower overhead costs of purchasing.

Of course, reducing the supply base is not a panacea and as already mentioned it may be the right option to increase competition.

The benefits for increasing competition are:

- Reduced prices.
- Improved innovation, quality, lead times and service. The business benefits are:
- Lower overall prices.
- Suppliers working for your business.
- Improvements in supplier performance as each supplier works harder to maintain their share of your business.
- Suppliers come to you with innovative products.

Supplier reduction, rationalisation or optimisation

The terms 'supply base reduction' or 'supplier reduction', tell us immediately what the objectives are, but what does 'rationalisation' or 'optimisation' actually mean?

During your category analysis you may discover that you have far too many suppliers for the level of available spend, and you may wish to simply remove suppliers from your database.

Some simple filters could be used to identify the suppliers you want to remove from your supplier base such as level of spend, numbers of orders etc. This process is a 'rationalisation' rather than simply a 'reducing' of the supply base.

A data cleansing exercise should clean up a database considerably before any active consolidation and reduction takes place. Many suppliers can be eradicated quickly and easily from supplier databases as they may have only ever been used once in the past, or they may have possibly been entered several times within the system as the same supplier. There is a cost associated with the management of each supplier within a system, so this simple task can make a substantial impact on administrative costs.

If this action is taken then it needs to be well communicated to the stakeholders and in particular the business users. Clear instruction must be given to them as to what they must do whilst you are working on a longer term solution and a more comprehensive sector (category) review is completed. Also when the communication process has taken place, the suppliers should be removed from the supplier file and a process should be initiated which highlights any transgressions and outlines the consequences for continued non-compliance.

It is always worth remembering that promoting effective healthy competition in supply chains is usually beneficial. It can lead to positive tension in the supply chain which in turn should promote increased performance and innovation. If you find that you are in a market sector that is constrained, with few suppliers who have dominant positions and are exploiting that dominance, due to issues such as being a technology leader or holder of key intellectual property, one's strategy should then be to promote competition and develop alternative competent suppliers. In this scenario, you should find that you are not reducing, but in fact, growing your supply base.

Supplier reduction is a means to an end; it can create greater efficiency and effectiveness. Questions such as "what is the right level of supply base for your business?" should be driven by objective analysis

The Risks

The following is a list of some of the likely problems which may result from trying to reduce your supply base:

- Focusing on supplier base reduction as a KPI could overly reduce your supply base.
- If not managed properly by a professional purchaser, single sourcing can lead to supplier complacency and in turn to reduced performance.
- Beware of collusion between suppliers if you reduce your supply base to two or three.
- Concentrating too greatly on supply base reduction might restrict time that can be better spent on supplier development.

- Could result in monopolies and anti-competitiveness
- Reluctance to write off shared investment in resources between buyer and supplier.
- Buyer inertia to resource a product or service.
- A risk of non-compliance in the public sector with anti- competitive regulations.
- May focus too much on the process of reduction rather than the strategic priorities.

The following are general risks relating to the supply base:

- Suppliers may avoid competition by creating cartels or colluding in other ways.
- Lack of understanding of the market and ability to refresh knowledge.
- Reciprocal trading restricts competition.
- Conflicting policies eg, corporate social responsibility (CSR) , diversity etc, may restrict ability to act.
- Branded specifications will reduce competition. Problems which may result from focusing too much on increasing competition.
- Missed opportunities to aggregate spend by increasing demand and attractiveness to the supply base.

Hints and Tips

- Knowing the needs of the internal customer is an essential part of ensuring supplier usage. There are plenty of examples where the procurement team finds a supplier which the internal customer found unsuitable. Often this unsuitability is not specifically explained, but is demonstrated through lack of supplier usage. Make sure you understand your customer.
- The buyer should implicitly 'regulate' the marketplace ensuring that not too much work is placed with one particular supplier.
- Ensure that the tendering process follows any agreed strategic position. For example, if tendering is based on a sole supplier arrangement which is linked to volume, then diluting the volume by having say, two suppliers instead of one can create lack of trust by the supplier from the outset. It also means that the supplier's price may be incorrect.
- Giving a full debrief to unsuccessful bidders may help them in future to provide a better bid. This also increases the viable competition for your organisation.
- Look for opportunities to benefit from consortium arrangements. Ensure compliance with the relevant legislation and regulations eg. EU rules, internal regulations.
- Purchasing departments have the ability to change the characteristics of the market place by their buying power. Irrevocable changes can occur through lack of total understanding of the wider picture. It is an imperative for the purchasing department to engage with the entire supply chain to discuss such changes thereby ensuring that an organisation's dominant position in the relevant buying market does not become an abuse of that position. This would lead to the risk of disappointed suppliers reporting the company to the Office of Fair Trading, and consequent fines.
- Be careful that you are not over protective of suppliers because they are local, but also recognise that there are sometimes advantages in terms of value for money and sustainability in doing business with smaller and less local / more diverse suppliers.
- Ensure that you meet all the requirement of EU rules and regulations.
- It is important to use a suite of completely objective criteria in the selection of the supplier. The name and size of the organisation should, in a sense, be irrelevant, provided the capacity criteria are met. An assessment of quality of service should form part of the assessment process. Relationships and procurement strategy should ideally be based on a combination of factors reflecting the nature of each purchasing area, including: risk, complexity, value, the general market and basic matters of supply and demand.
- Carefully weigh the length of the contract and the potential benefits of a long-term relationship with the ability of the buyer to exit from the relationship.

Summary

Both too few and too many suppliers can be problematic for an organisation. The purchasing function has a role in developing an appropriate approach to supply base management

depending on the category of purchase i.e. high value/ low value or high risk/ low risk. The 'right approach' decision requires a close working relationship with other stakeholders, and in particular the identification of internal customer's needs.

It is important that any approach adopted is in accordance with your organisations procurement rules; these could include EU rules and financial authority levels. It is important that a fair and transparent process of procurement is employed and competition is encouraged wherever appropriate.

The key to choosing the right approach is having a good understanding of the business environment, both inside and outside the organisation, then the purchasing professional can make the right decision as to the appropriate number of suppliers required to support their organisation's business needs and drivers.

Further reading and references

Purchasing and Supply Chain Management - Seventh Edition

Kenneth Lyons and Brian Farrington

ISBN 0-273-69438-3 - Chapter 11, Sourcing and the Management of Suppliers.

Purchasing Principles and Management - Ninth Edition

Peter Baily, David Farmer, David Jessop and David Jones

ISBN 0-273-64689-3 Chapter 8 Source Decision Making.

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