

# CREATING STRATEGIC ADVANTAGE THROUGH SUPERIOR SUPPLIER ENGAGEMENT

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A volcanic ash cloud closes European airspace and disrupts availability of a component needed for final assembly of your most profitable, highest volume handheld device. A parasite in Brazil devastates a key ingredient required to manufacture your most important confectionery product. A power outage in Mumbai threatens your global IT network infrastructure. These are just a few of the challenges today's global supply chains face.

Research suggests such disturbances exact a heavy toll on shareholder value. Based on a study of more than 500 supply chain disruption announcements between 1989 and 2000, Kevin Hendricks and Vinod Singhal (2003) reported in the *Journal of Operations Management* that as much as 10% of a company's value (approximately \$251 million on average) could disappear as a result of supply chain glitches.

Risk, however, is not the only consideration. Often, professionals take a wide-ranging approach — of which risk is only one dimension — to managing organizations that supply the goods and services their companies use. Supplier relationship management offers a comprehensive way to assess, streamline, and generally make the processes between an enterprise and its suppliers more effective. While this approach has evolved beyond the conventional supply management maxim that year-over-year cost reduction is the only performance indicator that matters, times and expectations have changed. Assessing and evaluating suppliers reflects only one side of a relationship.

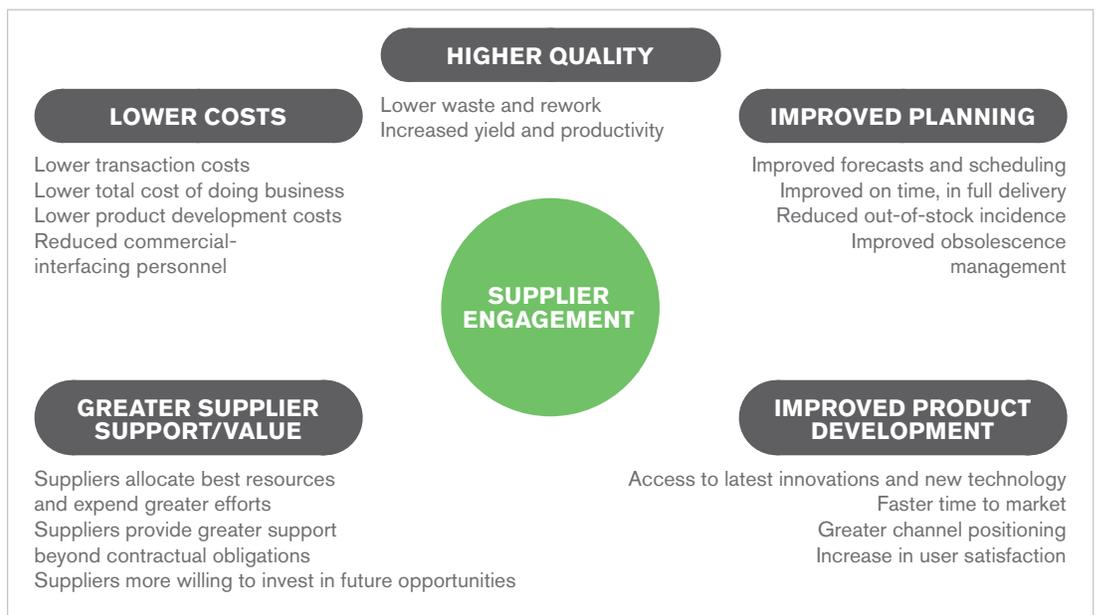
The global financial crisis and ensuing economic downturn created a “new normal” in which supply management must initiate a different set of conversations that lead to the emotional connection of suppliers

with their customers. With an emphasis on new strategic priorities, such as long-term sustainability, supply disruption risk management, and access to cutting-edge processes and technologies, the direct and indirect benefit of being a “customer of choice” is a new opportunity for supply relationships to yield a strategic advantage for companies.

## SUPPLIER ENGAGEMENT APPROACH BENEFITS

The development of a supplier engagement strategy, built on measuring and managing rational and emotional dimensions, will afford companies substantial gains as a customer of choice. The ability to assess these dimensions through a simple, consistent instrument across markets, languages, and product or service categories provides organizations with a highly effective means to measure and manage how they are perceived in the marketplace as a customer of choice. Companies build their reputations through multiple interactions across several touchpoints; those that can effectively measure and manage their reputations will have much to gain.

Organizations adopting a proactive approach to measuring and managing the emotional connections that drive supplier engagement are poised to reap substantial additional economic benefits, including higher quality, improved planning, improved product development, greater supplier support/value, and lower costs.



## NEW STEPS TOWARD BECOMING A CUSTOMER OF CHOICE

Recent studies have examined the value and consequences of the changing quality of commercial relationships, as companies struggle to identify and replicate factors that contribute to the strongest supplier-customer relationships. For some, the threat of risk has been a driving force behind decisions — however imbalanced the decisions may be. Many fear their companies are only as strong as the weakest link in their supply chain. “You might have a perception of risk in your business, but it’s difficult to guarantee your supplier has the same perspective,” says Richard Wilding, Professor of Supply Chain Strategy at Cranfield University School of Management in the United Kingdom. From Professor Wilding’s perspective, it is virtually impossible to coordinate those perceptions of risk without focused and ongoing dialogue between your company and your suppliers.

Exploring supply relationships through the lens of risk provides a focal point for where potential losses are greatest. There is also much to learn from Gallup’s experiences with customer relationship dynamics and organizations’ endeavors to become customers of choice with their suppliers.

Gallup believes that a focus on becoming a customer of choice is an essential transition, and this new emphasis makes sense to many leaders. Such status grants the company unique benefits ranging from access to the supplier’s best people to the resources required to service account relationships, from first access to the latest technological advances to more favorable terms, and from shared risk-taking to the priority allocation of resources or production capacity in times of scarcity. But how does a company achieve such elite status? Like others who have commented on the evolving nature of supplier relationships, Gallup agrees that there are key factors to becoming a customer of choice:

1. *Engage your suppliers.* Seek feedback and listen.
2. *Let your suppliers into the tent.* Willingly share information.
3. *Be easy to do business with.* Strive for clarity, simplicity, and consistency.

Companies must move beyond the transactional dimensions of logistics and supply chain management into a deeper understanding of supplier relationships. Unfortunately, practical tools and guidance in this area are scarce. This is particularly true of mechanisms to ensure constructive dialogue between a company’s buyers and the suppliers with whom they work. The program of research described in this paper seeks to fill this void.

In recent years, organizations have sought greater insights into the nonrational factors that create and cement — or erode and destroy — customer relationships. This focus defies conventional wisdom, which assumes organizations and individuals acting on their behalf would seek to selfishly maximize financial gain at every opportunity. However, the use of such neoclassic economic principles in seeking to win at the expense of others’ losses seems long outdated.

Organizations that want to create strong, sustainable customer engagement understand that loyalty and advocacy are built through the intermeshing of rational and emotional elements. Decision-making, both by sellers and buyers, is not based simply on price, quality, and physical availability. Gallup’s research with business-to-business and business-to-consumer companies’ customers and employees worldwide strongly supports this. Moreover, Gallup’s research reveals that it is the interaction between employees and customers (both statistically and interpersonally) that drives an organization’s operational and financial success. And Gallup believes the same dynamic is true of supplier relationships.

Past attempts to measure the supplier relationship have used complex survey tools to explore every conceivable functional dimension of this relationship. But until now, no simple metric existed to determine the level of supplier engagement in this equation. Nor was there a simple process to ensure ongoing and productive dialogue between suppliers and buyers to highlight opportunities for improving relationships between these important parties.

## ASSESSING SUPPLIER ENGAGEMENT

The challenge was not to justify the value of supplier engagement, but to identify a core set of conditions that captures the extent of a supplier’s engagement level with

a customer, while allowing the customer to meaningfully compare and manage these relationships to obtain the desired outcomes without additional cost. To put it simply, suppliers will go above and beyond for one customer over another, yielding advantages for the customer of choice. Gallup's goal was to develop a mechanism to ascertain how engaged suppliers actually are with the customers they serve, with an eye toward achieving the lofty customer-of-choice status.

In collaboration with the European commercial team of Mars, Inc., Gallup interviewed a large sample of suppliers representing direct and indirect supplies and across segments with high and low value and exposure (where "exposure" means that a supply chain failure would leave the enterprise highly exposed and vulnerable). Nearly 1,000 supplier representatives (including decision-makers, influencers, and transactors from the selected suppliers) participated in the interviews, representing more than 670 companies. Initially, Gallup interviewed numerous internal stakeholders and senior representatives of supplier organizations. These interviews allowed Gallup to determine the breadth and depth of the kind of issues that could potentially form the core of its supplier engagement construct. Building on prior research experiences, it was important that this approach would address certain key requirements:

- **Be brief.** Pare down the measurement tool to a vital few questions.
- **Be discussion-based.** The tool should open the door to further discussion between buyers and suppliers.
- **Include emotion-based metrics.** The tool should allow buyers to not only know how suppliers *think* about them, but also how they *feel* about the relationship.
- **Show links to performance** based on perceptions of performance, momentum, commercial importance, and best-in-class comparisons.
- **Be engaging enough** for suppliers to complete the survey to ensure optimal participation. In return for completion, suppliers would receive feedback as part of ongoing dialogue.

Based on their statistical relationship to a range of important outcome measures — including willingness to take risks for the client, willingness to go "above and beyond" for the client (giving them priority and access to scarce resources), buyer-evaluated quality of the current relationship, relationship momentum (improving or declining), and "best-in-class" comparisons — Gallup selected 10 items to include in the final metric. The 10 items allow for measurement and action at a local buyer, supplier, subcategory, or category level.

Gallup sees the nature of the customer-supplier relationship through a lens that allows for measurement *and* action at a granular level. Gallup's experience in this area draws from its ongoing work helping organizations develop strong, mutually dependent partnerships and the most recent discoveries in behavioral economics and psychology to capture the essential elements of creating and nurturing emotional attachment. This is not simply based on the relationship between the procurement function and the supplier organization; the strength of the relationship encompasses all touchpoints, of which procurement — although important — is only one.

Five core dimensions, each composed of two separate items, capture the strength or weakness of supplier relationships:

- **Clarity** — reflects the clarity of expectations and the quality of communication pathways to ensure these are clear to all
- **Simplicity** — reflects ways of working and, in particular, the ability to deliver excellence
- **Integrity** — reflects the notions of trust and the ability to overcome problems to reach a mutual agreement
- **Reciprocity** — reflects the value both parties place on the relationship
- **Connectivity** — reflects the interdependence in the relationship and the recognition of shared outcomes

Although not specifically arranged in a hierarchy, there is an anticipated progression through these dimensions that

will allow relationships to develop. A foundation of clarity, simplicity, and integrity appear to be prerequisites on which reciprocity and, ultimately, connectivity can be built.

<b>SE<sup>10</sup>: SUPPLIER ENGAGEMENT DIMENSIONS</b>	
<b>CLARITY</b>	<p>My company knows exactly what (Company) expects from us.</p> <p>My company has regular open and honest discussions with (Company) about their needs and expectations.</p>
<b>SIMPLICITY</b>	<p>(Company) is always easy to do business with.</p> <p>(Company)'s processes and procedures make it easy for my company to deliver excellence.</p>
<b>INTEGRITY</b>	<p>My company and (Company) can always count on each other to do what we say we will do.</p> <p>When problems occur, (Company) works with my company to resolve them in a way that is fair to both of us.</p>
<b>RECIPROCITY</b>	<p>When we share our best practices or new developments with (Company), they are eager to hear our ideas.</p> <p>We both need each other in order to be successful.</p>
<b>CONNECTIVITY</b>	<p>We can't imagine our business without (Company).</p> <p>(Company) takes risks to help my business succeed.</p>

Understanding the full range of responses to these items (and the respective dimensions of the model) at multiple levels within the supply chain — from the individual supplier representatives, the supplier in total, and in each product or service category — provides a company with a comprehensive perspective on the strength and quality of its supplier relationships.

### **PRIORITIZING THE SUPPLIER ENGAGEMENT STRATEGY**

Gallup recognizes that not all supplier relationships are equally important to an organization from a strategic priority standpoint. Most companies will benefit from evaluating and nurturing the full range of supplier relationships. In others, however, not all supplier relationships may be equally valuable or equally consequential to the enterprise's health. As a result,

strategic priorities may dictate that relationships with some less important suppliers focus only on the foundational dimensions of the model: clarity, simplicity, and integrity. In these cases, a clear supplier segmentation strategy is essential to identify suppliers that are mission critical and those that are not.

For example, a supplier in a direct segment with few competitors where exposure and value are high represents a critical partner and a relationship that the company must nurture. With such suppliers, being a customer of choice is essential, and building on the full range of supplier engagement dimensions — from clarity through connectivity — is required. In contrast, being a customer of choice for a supplier in an indirect segment with many competitors where exposure and value are low may be less important and less consequential. Nonetheless, even with these indirect suppliers, building strong relationships based on the dimensions of clarity, simplicity, and integrity is important. Each company must make informed choices about prioritizing its supplier relationships, focusing efforts on those high-priority relationships that have the greatest potential to achieve a customer-of-choice status.

### **USING THE APPROACH**

Depending on the size and nature of each supplier relationship (multiyear, multiple touchpoints, etc.), different interventions are possible. Gallup's recommended supplier engagement approach will typically include five key phases of activity per cycle:

- 1. Situation Analysis** involves evaluating the current strategic procurement framework, including:
  - analysis of the financial and nonfinancial investment profile for the given market(s)
  - stakeholder interviews with function heads, plus commercial vice presidents and heads of function and/or budget holders for key line items and investment areas
  - heads of department/strategy — to identify potential suppliers for inclusion as part of the core group of strategic/target accounts

**2. Program Design** involves developing specific items, sample frames, and reporting structures:

- inclusion of language options to increase response rates and capture top-of-mind responses; demonstrating final structures before launch

**3. Data Gathering** involves using either telephone or Web-based methodologies (single methodology):

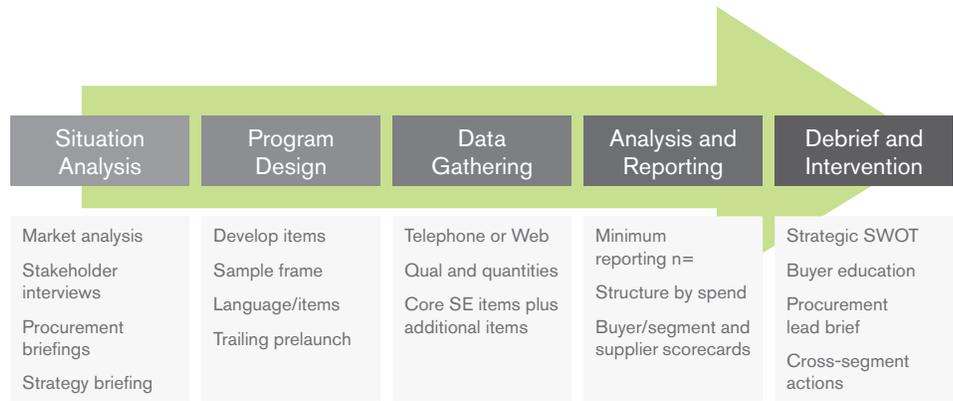
- inclusion of qualitative and quantitative (open-ended) questions
- use of core supplier engagement items plus additional themes determined in phases one and two

**4. Analysis and Reporting** involves focusing on providing granular reports to support local ownership and action:

- minimum reporting thresholds to allow for per-account/per-buyer profiles

**5. Debrief and Intervention** involves the vital element of the program, including the debrief and working session(s):

- provision of insights into the key areas of strength and opportunity across all accounts to strategic procurement heads
- configuration of sample to allow for specific working sessions with buyers/account leads to establish working plans based on engagement hierarchy, communication flows, gap analysis, and/or competitive-set analysis to prioritize areas for focus



**CLOSING THOUGHTS**

The new normal of the economic landscape has fundamentally reshaped the nature of supplier-customer relationships. Rather than defining “great” suppliers as those who can simply provide the best cost savings, today’s procurement professionals must broaden their definition to include a combination of rational and emotional drivers that yield additional benefits to the firm. These benefits run the gamut from access to the latest innovations and new technologies to preferential treatment when commodities become scarce, and many others, including reputation and enhanced risk management. To gain access to these kinds of benefits, supplier relationships must become a two-way dialogue if suppliers are to be fully engaged with the companies they supply. By focusing on and building the critical dimensions of supplier engagement — clarity, simplicity, integrity, reciprocity, and connectivity — all organizations, whether service or product providers, will be well-positioned to thrive in the new normal.

Gallup recommends that the company review each account on a periodic basis to ensure that progress is being made and that actions across the entire account are supporting the desired partnership state.

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