Optimizing Supplier Performance:

Essential Factors to Consider When Implementing a Supplier Performance Management System

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CONTENTS

INTRODUCTION

Managing, tracking and evaluating the performance of an organization's suppliers can be a daunting task. Though often time-consuming and tedious, this process can be a critical factor in a company's success and growth. The implementation of a supplier performance management system constitutes an essential first step for any organization interested in improving supplier performance. A supplier performance management system enables organizations to identify and correct problematic areas within their supply chain and unlock potential improvements.

The purpose of this paper is twofold:

1. To discuss the key components to consider when implementing a supplier management system.
2. To provide an overview how each component has the potential to improve supplier performance and, ultimately, an organization's efficiency, quality and profit.

SELECTING KEY SUPPLIERS

Many organizations have trouble determining which suppliers should be included in a supplier performance management system. In an ideal scenario all suppliers should be included, but in light of a number of constraints faced by many large organizations, this can be a difficult challenge.

Evaluating the suppliers who have a large impact on your organization and require a substantial capital commitment is a good place to start. Here are some guidelines to help you determine which suppliers meet these criteria:

COSTLY SUPPLIERS

In many organizations, 80 per cent of the capital spent on suppliers is committed to only 20 per cent of suppliers. As a result, for such organizations it is beneficial to include suppliers who fall in this category in a supplier performance management system.

If your organization does not commit capital to suppliers according to the convention presented above—for example, if capital is committed evenly to all suppliers—then it is important to evaluate which suppliers have the greatest impact on your organization to determine which suppliers should be included in a supplier performance management system.

HIGH-IMPACT SUPPLIERS

To determine the impact suppliers have on your organization, begin by asking the following questions about each of your suppliers:

TIMELINESS

- If the supplier's delivery is late, will it affect or shut down my company's production line?
- If the supplier's delivery is late, will my company be unable to meet its obligations to customers?
- If the supplier's delivery is late, will my company lose revenue in any other way?

QUALITY

- If the supplier provided a product or service that was of unacceptable quality, would it shut down my company's production line?
- If the supplier provided a product or service that was of unacceptable quality, would my company fail to meet the quality standards promised to its customers?

PRICING

- If the supplier raised prices, would my company continue to purchase the same products or services from that supplier?

SERVICE

- If this supplier provided poor service (for example, a failure to promptly respond to an inquiry), would it result in the provision of poor service to my customers?

If you have answered "yes" to any of these questions with respect to a particular supplier, that supplier should be included in your supplier performance management system. However, your business may be affected by specific supplier-related issues that don't commonly affect other industries, so try to create unique questions to determine whether a supplier has a significant impact on your operations.

EVALUATING KEY SUPPLIERS

Evaluating key suppliers on an ongoing basis is another critical component of an effective supplier performance management system. It is essential to get input from a number of different stakeholders across the organization, in all departments. Anyone in your organization who works directly or indirectly with a supplier might have valuable insight on the performance of your suppliers.

KEY PERFORMANCE INDICATORS

Another critical element of an effective supplier performance management system is determined by the group of Key Performance Indicators (KPI) that your company selects to measure the performance of its suppliers. Performance measures differ from organization to organization but usually fall into one of four categories:

COST PERFORMANCE

Cost performance measures relate to the direct financial impact of a supplier's performance on your business and can include price, payment terms, shipping charges, savings from process improvements and more.

DELIVERY PERFORMANCE

Delivery performance measures relate to a supplier's ability to support your scheduling requirements and can include the timely delivery of goods, the timely completion of services, stock availability, or any factor related to the cycle time between order and receipt.

SERVICE PERFORMANCE

Service performance measures relate to the interaction (electronic or otherwise) between the buyer and seller and are determined by responsiveness, the resolution of problems, the technology used to provide customer service, and other factors.

QUALITY PERFORMANCE

Quality Performance measures relate to the conformance of a product or service to specified standards and can include rejection rates, warranty claims, the technology used to improve products and services, and other metrics related to the durability, reliability, and consistency of a product or service.

Each performance measure that you select should be specific and measurable.

METHODS OF RATING

Be advised that the performance measures you choose and your method of acquiring information are interrelated. The performance measures you choose may drive how you go about acquiring information. Also, limitations to acquiring information may require that you "tweak" the performance measures that you have selected. Ideally your company should retain the means of acquiring the information you need to support your selection of the best performance measures for your company.

While there are many ways of acquiring information and converting that information into supplier KPIs, we will focus on three of the most common:

1. Supplier Surveys.
2. System Metrics.
3. Supply Chain Event Management.

SUPPLIER SURVEYS

Supplier surveys are a common starting point for organizations seeking a method of rating suppliers. These surveys allow stakeholders to evaluate suppliers and provide results in detailed scorecards outlining a supplier's proficiency on the basis of a number of selected performance measures. The scores for each performance measure are usually based on a scale where low scores indicate poor performance and high scores indicate high-quality performance. The performance measures are typically weighted, since not all questions are considered of equal importance. The weighted scores for individual performance measures are added to produce a total score which can be used to determine the value of your organization's individual suppliers.

PERFORMANCE MEASURES

The following is a list of some sample performance measures that could be used in a supplier survey to rate the performance of a supplier:

- Provides competitive pricing.
- Consistently delivers on time.
- Responds promptly to emergency situations.
- Consistently provides products that meet specifications.

Supplier scorecards are a useful component of a supplier rating program. However, there are disadvantages to this approach that should be considered. Supplier scorecards are subjective by nature and the scoring process is often based on opinion rather than provable fact. As a result the integrity of a supplier rating program can be compromised. Also, while the supplier scorecard approach may seem inexpensive to implement, it can be a labor-intensive process.

SYSTEM METRICS

The metrics generated by your procurement system have the potential to eliminate some of the subjectivity from the supplier survey process. A typical metric gathered from procurement systems will relate to the timeliness of deliveries. A procurement system is capable of correlating due dates for an order with a specific supplier and determining which orders have receipts on or before the due dates, and which orders have receipts after the due dates.

System metrics are most commonly used in production environments where receipts, inspections, and warranty data are recorded. To determine whether using system metrics as the basis for your supplier rating program is the right approach for your company, first assess whether you have the systems and procedures in place to capture the necessary data.

For example, if your business is service-based, you may not require a formal "receipt" for incoming deliveries in your procurement system. If your company does have a procedure whereby receipt transactions are required, consider the degree of accuracy that can be expected from the receiver (usually a shipping and receiving department or an actual end user). Determine whether you can rely on the individuals responsible to promptly enter receipts into the system. If not, your supplier ratings may be distorted.

THE ROLE OF SOFTWARE IN OPTIMIZING SUPPLIER PERFORMANCE

While a supplier management system can be implemented without software, the benefits of establishing a software-based system are numerous and significant. Depending on how comprehensive the solution is, a software-based system is capable of providing real-time metrics that can be accessed instantly with the click of a button, thus rendering an entire supply chain transparent. Some critical features of a comprehensive software-based supplier management system include:

SUPPLIER MANAGEMENT AND EVALUATION

The system should be able to register and categorize suppliers by company name, supplier number and performance rating as well as other details in a centralized portal. The system should use this information to schedule, notify, and archive all supplier evaluation activities and results and develop a consistent supplier rating program with customizable surveys.

RISK MANAGEMENT AND CONTINUAL IMPROVEMENT

To avoid quality issues and ensure all elements of the supply chain run at peak performance, the supplier management system should be capable of:

- Tracking supplier non-conformances and all details associated with those non-conformances.
- Specifying target investigation dates or target response dates and manage all investigation related data.
- Implementing corrective actions and measure their effectives over time.
- Reporting on and analyzing root causes.

STREAMLINING WORKFLOW

To take the time and energy out of micromanaging data and issuing notifications, the system should be capable of streamlining supplier management workflow by tracking all supplier and vendor data in a central portal that's accessible across the organization. A proactive system should also be capable of sending automated email notifications on pending and overdue supplier tasks to employees and their supervisors.

REAL-TIME VISIBILITY AND REPORTING

An ideal system should be capable of monitoring, reporting on and storing data on each stage of the process, including initial vendor registration and setup, ongoing supplier performance assessments, the implementation of corrective and preventive actions and evaluations on the success of those actions. Employees with access to the system should be able to instantly update information and generate ad hoc, boardroom-quality supplier management reports on root causes, corrective actions, and authorize claim amounts based on real-time data.

KEY REQUIREMENTS

An internet- or intranet-based supplier management system should be:

- Accessible from multiple locations around the world under stringent security protocols.
- User-friendly and intuitive, thereby increasing user adoption and reducing training and support costs.
- Easily configurable to address company-specific requirements and metrics (initial and ongoing).
- A scalable solution, allowing an organization to roll out the system to key suppliers.

PROPERLY UTILIZING SUPPLIER PERFORMANCE INFORMATION

If your company has determined who your critical suppliers are and the method by which they are rated, you can use this information to motivate suppliers to perform at the highest possible level. A supplier that performs well can help an organization:

- Become more efficient.
- Produce higher quality products or services.
- Reduce costs.

Alternatively, a supplier that performs poorly may:

- Disrupt operations.
- Damage a company's relationship with its customers.
- Increase costs and curb profit.

Clearly, suppliers that perform at the highest possible level will enable a company to perform its best for their customers.

RESPONDING TO PERFORMANCE METRICS

There are two sides of performance improvement motivation: rewarding suppliers who perform well so they will aspire to continue performing well; and applying corrective action to suppliers who underperform.

REWARDING GOOD PERFORMANCE

Rewarding suppliers is not a difficult task, yet few companies formally recognize and reward high-quality supplier performance. A supplier awards program designed to motivate your suppliers to improve their performance requires little time, money and effort, yet the rewards can be substantial.

There are a number of different ways of rewarding suppliers for consistent, high-quality performance, including the following:

- Issue a press release acknowledging a supplier's performance excellence.
- Begin a "Top Ten Suppliers" program.
- Hold a supplier awards reception and acknowledge Gold, Silver and Bronze suppliers.
- Provide a plaque or statue top suppliers can display in their reception area.

Suppliers want prospective clients to know they consistently meet and exceed expectations and are appreciated by existing customers. If you help their business by communicating their strengths to others, your suppliers will reward you with enhanced performance.

CORRECTING POOR PERFORMANCE

The opposite of rewarding high-quality supplier performance is correcting poor supplier performance. When it becomes apparent through your rating methodology that a supplier is not performing optimally, arrange a meeting with the supplier in question with the intent of improving performance. Some things to consider when initiating corrective actions include:

- **Timeliness:** Schedule a meeting with a supplier immediately after it has become apparent that the supplier is underperforming to minimize any damage that may be occurring as a result of your supplier's performance.
- **Collaboration:** Avoid creating an atmosphere of hostility during your meeting with your supplier. Convey to the supplier that you are there to collaborate with them so your companies can mutually benefit.
- **Explanation:** Prior to the meeting, indicate to the supplier that you will be seeking a reason for the incidence of poor performance. If the supplier does not begin thinking about finding the root cause behind the problem until after

the meeting, then the corrective action will be delayed. If the supplier knows that an explanation will be required to account for a specific problem during your meeting, the problem can be assessed and corrected as soon as possible.

- **Planning:** Before the meeting ends, ensure that your company and your supplier have agreed on the following action items:
  1. The development of an action plan to resolve the performance problem.
  2. The timeline in which the problem will be solved.
  3. A mutually agreed means of measuring how effective the resolution is.

  An example of these three points being formalized in the resolution of a quality problem is as follows:

  1. The supplier will have its production machinery recalibrated.
  2. The supplier will achieve this by the Monday of the following week.
  3. The supplier will test the first 10 components produced for you prior to shipping to ensure that they function in accordance with contractual tolerances.

If your efforts to correct performance problems through collaboration fail, then the outcome is obvious: your company should seek to replace the poorly performing supplier with another supplier that can meet and exceed expectations.

However, it is never safe to assume that switching suppliers eliminates problems. Since your company may find equal or more severe problems after switching suppliers, it is essential to perform due diligence and invite prospective replacements to provide evidence supporting the claim that their company represents a superior choice.

CONCLUSION

By rating suppliers, your company will ensure its most important suppliers are adequately contributing to your company's success. To implement a supplier ratings program, determine the suppliers you will rate (that is, the suppliers that have a high impact on your organization), the individuals who will rate those suppliers, and the performance measures you will use to determine how your suppliers are performing.

Following this, choose a methodology to determine how you will obtain information related to your suppliers' performance. Three common ways of collecting information on supplier performance are supplier scorecards, system metrics, and SCEM software.

Finally, recognize and reward supplier performance excellence and immediately collaborate with underperforming suppliers to correct performance deficiencies. The direct result of a supplier rating program will be improved supplier performance, which will guarantee your organization greater efficiency, superior products or services, reduced costs and increased profits.

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