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Chapter 3: Collaborative Partnership – Procurement & Supplier

Objectives

- Analyze the strategic alliance model.
- Examine how a trusting relationship between procurement and supplier is developed.
- Examine what organizational conflicts are and how these can be resolved.

1. Introduction

The previous chapter discussed the selection of suppliers. Implied is the concept of an integrated relationship. This chapter will cover collaborative partnership between a buying entity and the supplier.

Supply chain initiatives fail mainly due to miscommunications and mismatch of expectations.

These usually involve the management of relationships. Supply chain managers assume that relationships will fall into place once the supply chain is activated.

This is far from reality. Relationships at the personal level up to the entity level need to be monitored and managed constantly and consistently. The success of relationships often depends on one element – trust and projecting trustworthiness.

The purpose of this chapter is to focus on the strategic model of developing supplier relationship and strategies to maintain these relationships.

Finally, it will conclude with the actions available when the relationship needs to be terminated.

2. Hierarchical Relationship Between Suppliers and Buyers

As shown in Figure 3-1, there are two forms of relationships:

- Transactional
- Contract
- Strategic

There are advantages and disadvantages of each relationship.

When focusing on the ability to obtain OEM and product components better, cheaper, and faster, a transactional relationship may be preferred.

On the other hand, when focusing on broader business goals such as creating new revenue streams, increasing market share, increasing productivity and improving customer service, a strategic relationship may be preferred.

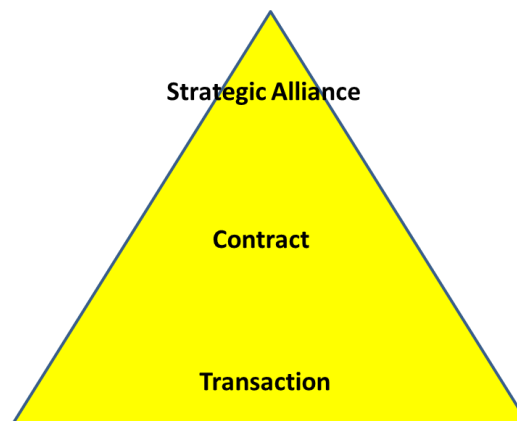


Figure 3-1: Hierarchy of Transactional Relationship

Figure 3-1 also shows an intermediate point between the two extremes – contract logistics. This is the area where customers can define the criteria of services as agreed in a service level agreement or a contract.

Issues	Transactional	Strategic
Fix an immediate problem	Yes	
New revenue		Yes
New competency		Yes
Competitive pricing		Yes

Table 3-1: Different Functions of Strategic & Transactional Relationships

Organizations can work in both transactional and strategic relationships. Immediate problems are solved in transactions. The activity is performed satisfactorily and has no consequence on the medium or long term relationship.

Functions such as new streams of revenue or new competencies need to be developed. These must be handled at the highest level. The implementation will have an impact on the workings of the supply chain entities.

3. Traditional Purchasing and Current Purchasing Practice

Purchasing is the formal process of buying goods and services. The purchasing process can vary from one organization to another, but there are some common key elements.

The process usually starts with a demand or requirements – this could be for a physical part (inventory) or a service.

A requisition is generated, which details the requirements (in some cases providing a requirements specification) which actions the procurement department. A request for proposal (RFP) or request for quotation (RFQ) is then raised.

Suppliers send their quotations in response to the RFQ, and a review is undertaken where the best offer (typically based on price, availability and quality) is given the purchase order (wikipedia date accessed 30 May 2014).

Purchasing can adopt a number of stances towards its suppliers. The two common ones are adversarial and collaborative.

In the adversarial approach, the purchaser would demand the supplier to fulfill every condition with no deviation whatsoever and there will be no sharing of information from the purchaser to the supplier.

It is something like an interview where the purchasing will ask the questions and the supplier will reply. The supplier has to comply with all requirements or lose the bid.

Conversely, the collaborative approach is one whereby the purchasing is willing to work together with the supplier to solve a problem confronting the purchaser.

In summary, the comparison is made for the two approaches.

Purchasing Attributes	Conventional Purchasing	Collaborative Partnership
Supplier/buyer relationship	Adversarial	Partnership
Tenure of relationship	Variable	Long term
Tenure of contract	Short	Long
Order quantity	Large	Small
Communication	PO	Verbal
Number of suppliers	Many	Few
Delivery schedule	Frequent	Very frequent

Table 3-2: Traditional vs Current Purchasing Practices

With the understanding of the two approaches, buying organizations need to establish a collaborative relationship with suppliers to compete in the market place.

The performance of the entire supply chain is the synergy of all the entities in the chain.

A weak link will weaken the performance. It is therefore clear that buyers must work together with suppliers and vice versa. The model below will offer such a possible solution.

4. Collaboration Principles – Market Realities

Collaboration is focused on relationships. In such relationships, there is information sharing. Information sharing may not be of benefit to all supply chain partners, possibly exposing suppliers to their competitors. Supermarket retail and automotive

sales are very competitive. Often, this drives down consumer prices at the supermarket shelves and car dealers' discounts, which in turn causes them to squeeze their suppliers to operate with lower profit margins and tighter delivery schedules while maintaining service quality. As a result, suppliers are forced to behave competitively rather than collaboratively.

Collaboration is dependent on the provision of mutual benefit. In such condition, mutual benefit is difficult to achieve. Trust becomes an issue. See Figure 3-1.

		You	
		Confess	Don't Confess
Your Partner	Confess	5,5	2,10
	Don't Confess	10,2	0,0

Figure 3-2: Nash Equilibrium

Case Study

You and your partner are suspected of committing a crime and arrested. The police interview each of you separately. The police offers you a deal – your sentence will be reduced if you confess.

Here are your options:

- If you confess but your partner doesn't, your partner gets the full 10-year sentence and you get 2 years for collaborating.
- If you don't confess but your partner does, you get 10 years and your partner gets 2 years.
- If both of you confess, each of you get 5 years.
- If neither of you confess, you both are set free.

The question is: Do you trust your partner? What do you think?

5. Collaboration Principles – Best Practice

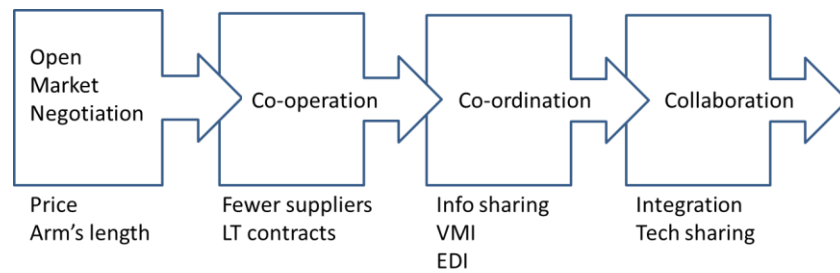


Figure 3-3: Development of Collaborative Model

Collaboration is not developed in a short time. It takes time for trust to be built into relationships. As mentioned earlier, trust is tested all the time before an organization believes the other entity can be called a trusted partner. Figure 3-2 shows the various stages of the development of the collaborative relationship between purchaser and supplier.

6. Strategic Alliance Model

6.1 Overview of Model

The model explains how organizations recruit and develop strategic partnerships with suppliers. It has both vertical and horizontal elements.

The model comprises 3 vertical levels:

- **Strategic Component**
Examines how strategic expectations and evaluations of alliance effectiveness evolve as an alliance progresses in the development stage.
- **Process Component**
Outlines the stages of alliance development – eg formation, implementation and maintenance.
- **Operational Component**
Standard operating procedure for managing an alliance.

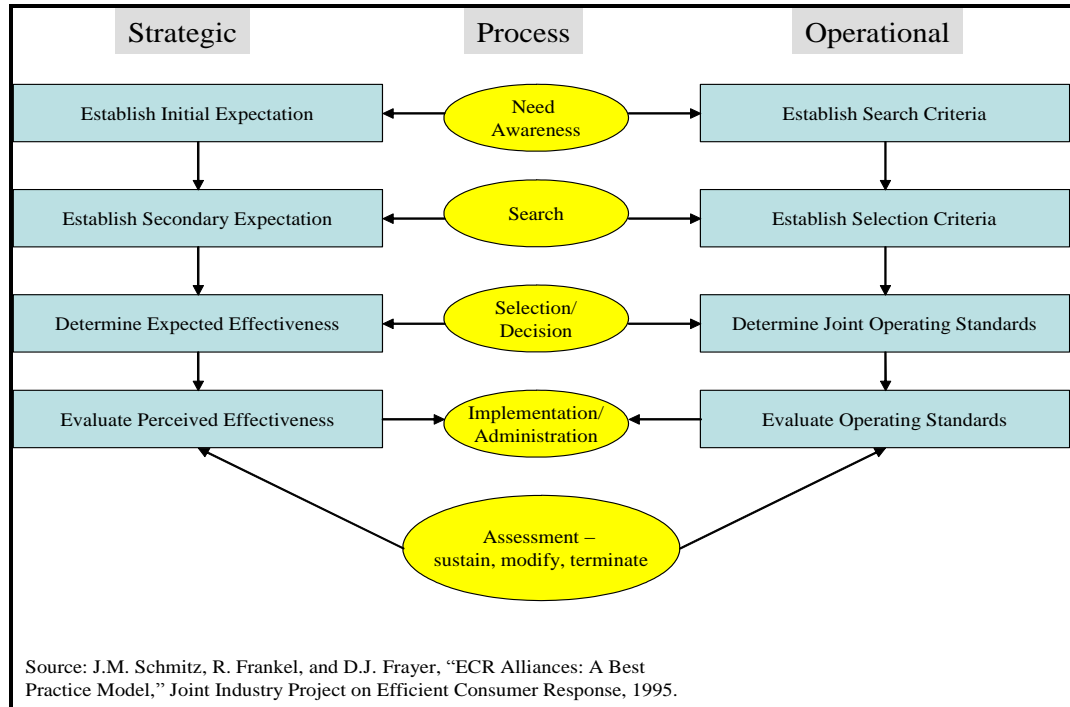


Figure 3-3: Strategic Alliance Model

6.2 Level 1 – Alliance Conceptualization

The organization determines that it needs a collaborative arrangement and a potential possible relationship. Its direction is set jointly at the top management level and the shape of the new alliance should look like.

The need for partnership often begins with a need for a product or service. Such a need is met either through in-house or through outsourcing. There are two possible areas on the development of the need. It could be a one-time requirement or it could be perpetual. In the case of the latter, firms will seek a more permanent solution.

At this level, all the attributes of the potential ideal partner are listed. These are the characteristics that the searcher wishes its partner to possess. The lists should be categorized into good-to-have and must-have. The must-have list will ensure that the values and practices of the firm will not be diluted by the forging of the partnership. The partnership is to strengthen the two entities and adding more value and a single entity could achieve on its own. It is to help the firms achieve their strategic goals.

6.3 Level 2 – Alliance Pursuance

At this level, the decision is to proceed to seek for possible potential partners. Strategic and operational considerations are established to select partners.

From the earlier Level 1, initiating firms will now clarify and define their new strategies with the potential partner. The aim is to seriously pursue a strategic partnership. More and detailed information regarding the potential partner will be sought.

The initial strategic goals could be further refined since potential firms can request for goals to be modified in the interest of creating a new relationship. We must remember that firms do have existing norms and rules which cannot be ignored. Each party have different set of strategic goals but it does not mean that there is a winner and there is a loser. The alliance must be perceived to produce a win-win case for both firms.

Manufacturer Perspective	Supplier Perspective
Improve inbound	Increase sales volume
Reduce costs	Increase customer loyalty
Reduce inventory	Provide value-added services
Improve quality	Reduce costs

Table 3-3: Manufacturer's vs Supplier's Perspective

The searching firm will endeavour to find both formal and informal information about the other firm is to tighten the selection criteria to a more manageable list, improve the quality of the search and increase the success of finding a suitable partner.

Selection criteria should revolve around processes, materials, finished products and services.

It is important for both parties to perceive that there are benefits by forming an alliance. From a cost benefit analysis, both must be able to perceive that the benefits are greater than the costs of the partnership.

This stage is critical because it will determine whether the relationship will be successful or not.

Data collected include profile, financial position, capability, TQM philosophy, HSE compliance, production system, IT system capability, sourcing strategies and so on. In other words, due diligence on the firm must be carried out.

6.4 Level 3 – Alliance Confirmation

The process focuses on the selection of the partners and to determine the strategic and operational expectations of the relationship. The consequence is the creation of partnership.

The finalist will still have to go through a few more tests to check that the strategic goals of both firms are really aligned in thought and in practice. This is done to increase the chances of success of potential alliance.

The partners must now establish the process of managing the relationships such as the parameters and mechanism for the working relationship. The most important being the KPI used to measure the success of the joint agreement and the mechanism to resolve conflicts.

While there may not be detailed answers to many of these questions, managers must understand the spirit of the alliance in the context of strategic goal achievement.

6.5 Level 4 – Alliance Implementation & Continuity

The final level involves the operational mechanism of making the partnership work and establishing a system to monitor it.

The outcome of the monitoring system is either to sustain, modify or terminate the partnership. At this stage, mechanisms are in place to manage conflicts.

At this final Level 4, both parties have now committed to the partnership either verbally or in written form. Both are binding though verbal agreement may face legal challenges.

When the partnership takes off, we should be able to monitor the performance of the relationship.

When the performance is met or exceeded, minutes are taken and sent to the top executives and everyone is happy.

Things can turn nasty when performance falls below par. The test of any partnership is really dependent not on how successful it is but rather how partners handle the problems as partners and not blame each other.

When relationships are tested, trust between partners will thin down. Hence, organizations must be prepared to build up trust. How can they do it?

7. Developing Relationship

Best practice for supply chain demands organizations should look to form closer and longer term relationships. Such trusting relationships help to reduce total supply chain spend. World class organizations recognize the importance of developing and maintaining an efficient chain that gives them a competitive advantage. Strong relationships help drive collaboration

7.1 Reliability

This attribute describes the consistency of performance. If a company is said to possess reliability, it means that it can be trusted to be able to perform its role consistently at least most of the times.

Reliability is also demonstrated to its predictability. Eg if a company delivers and deliver according to promises, then it is considered a reliable deliverer. There is an alignment between words and actions.

Failure to match words to actions will eventually lead to lack of trust in the relationship.

7.2 Competence

In order for the supply chain to work efficiently, every individual in the chain must be competent. Competence is a sum of attitudes, skills and knowledge. It is a demonstration of a person's ability to perform a task.

In supply chains, competence is the initiating firm's perception of the other organization's ability to meet commitment. Incompetent organizations simply cannot meet its commitment to its clients. It cannot keep its promises made.

Trust is absent when companies keep breaking its promises due to its incompetency.

7.3 Loyalty

Loyalty develops when both parties experience a period of reliable performance and a degree of faith is developed between the parties. Both parties will trust each other to perform under extraordinary circumstances eg unplanned rush orders.

Expecting suppliers to perform consistently under pressure is a bit too much for suppliers to handle.

7.4 Win/win Solutions

Work towards a collaborative relationship driven by shared benefits. Naturally the client will look for cost-effective services and will want compensation when things go wrong.

Adversarial relationships are not well suited to the complexity of IT outsourcing deals that have to adapt to changing requirements over several years.

In every situation, identify ways for both organizations to benefit.

7.5 Co-operation (Not Domination)

In the initial stages the client will feel very much in control, defining requirements and choosing between suppliers. During negotiations the two sides may feel more like adversaries, protecting their own interests.

Once the contract is signed, the power should not shift towards the supplier. Try to establish a co-operative approach.

7.6 Foster Good Communications

Set up processes for sharing information at all levels.

Be as open as possible about strategy and plans. Encourage everyone to share good news and bad. Do not just communicate when you have something to complain about.

7.7 Aim for Mutual Understanding

The client should help the supplier learn about the organization, business objectives and plans, market positioning and competitive strengths.

The client should take an interest in the supplier's fortunes and how this deal fits into the wider picture. Look beyond the individuals you know to find out how the organization works and where it hopes to develop.

7.8 Criticize the Facts

When things go wrong, stand back and take an objective look. Is it entirely the supplier's fault? Look at the issues from different perspectives.

When you have identified problems, discuss them openly and honestly. Tackle problems immediately, do not let them fester and grow.

7.9 Know When to Compromise

The client needs to strike a balance between ensuring proper control and knowing when to give a little.

Both organizations need to feel that the deal is worthwhile. The client wants value for money but the supplier must be able to make a profit. Everyone will need to compromise from time to time.

7.10 Resolve Personality Conflicts

Individuals make relationships work. Sometimes key individuals find it difficult to work together. Personality clashes need to be recognized and resolved. Try to prevent confrontations and avoid a blame culture.

7.11 Foster Realistic Expectations

A combination of hard sell from suppliers and an enthusiastic in-house team can give business managers unrealistic expectations.

They may assume that higher-quality, cheaper services will be provided from day one. When this does not happen dissatisfaction begins to grow.

Everyone concerned needs an accurate picture of what should happen when. This in turn will form part of a communications program.

8. Conflict Resolution

In spite of the good intentions of partnership, conflicts do arise due to mismatch of expectations, misalignment of performance requirements, difference in opinions on how processes should be implemented and so forth.

There are a number of alternatives which can be adopted by parties in dispute. These include:

- Doing nothing
- Less formal method of conflict resolution eg face-to-face arbitration
- Allow parties to resolve the conflict themselves
- Allow conflict to escalate
- Engage dispute using legal and non-legal means eg mediation

The constant monitoring of performance against agreed standards will ensure that the two parties are fully aware of deviations. This will allow parties to work together to correct discrepancies rather than waiting for things to get out of hand.

Often, under such circumstances, firms may start to blame each other. Should such a stage be reached, then the simplest method of conflict resolution involves face-to-face negotiation.

Firms need to deal with the issues and not allow themselves to point fingers at each other.

An example is the interpretation of delivery of goods. Buyers usually asked for delivery based on date of PO.

However, buyers can be late in down payment and sellers may use the date of down payment as the initiating point to commence production.

8.1 Arbitration

In the process, a third party is involved in dispute settlement. Both parties are of the agreement that their emotions can get in the way of a settlement.

The choice of a fair and rational person who oversees the process will ensure that both parties are given a fair hearing and a fair judgement is made by the arbitrator.

Arbitration is handled properly is a less expensive and less time consuming process and a reasonable solutions to both parties. In this process, both parties must agree that the settlement reached is accepted.

Arbitration is binding.

8.2 Mediation

Unlike arbitration, mediation is not binding to both parties. A mediator is appointed to reconcile, settle or compromise. He has to listen to all the facts, examine all documents, verbal statements and render judgement.

The acceptance of the mediation result will depend on the parties.

8.3 Litigation

This is used as a final stage of the dispute resolution process. Litigation should only be used when both parties cannot come to terms in arbitration or mediation.

Litigation is usually lengthy and expensive and create acrimony when the legal process ends.

9. Issues with Relationship

Let us now return to buyer-supplier relationship. Certainly, due to the need to work closely with each other, issues will rise due to differences in opinions and perceptions and approaches and methods of resolving work-related problems.

- Employment of advanced technology which is expensive.
- Essential to development trust as discussed above.
- Supplier often has more responsibility resulting is more manpower to manage relationship.
- Expenses increase for supplier due to increased managerial responsibility.

10. Characteristics of Collaborative Relationship

Types	Decision Maker	Inventory Ownership	Skills of Vendor
JIT	Production		
QR	Retailer	Retailer	Forecasting
CR	Contract terms	Either retailer or vendor	Forecasting Inventory mgt
VMI	Vendor	Either retailer or vendor	Managing retail

Table 3-4: Characteristics of Collaborative Relationship

A huge advantage of collaborative relationship is the knowledge the supplier has about order quantities. This means bullwhip can be controlled.

As shown in Table 3-1, there are different types of characteristics of partnerships.

In JIT, the buying organization will have the demand or forecasting information available. The buying organization makes ordering quantities to supplier whose task is to fulfil the quantities. Internally, the production floor will pull the actual quantities from suppliers on a periodic basis.

In QR, customer demand information allows vendors to reduce lead time.

In CR, depending how the retailer works with the supplier, retailer supplies demand information and make the order quantities or hand the demand information to supplier and the supplier will in turn make ordering quantities.

In VMI, retailers provide demand information and suppliers make ordering quantities.

11. Conclusion

We have studied the framework for alliance between procurement and supplier and how trusting relationships can be developed. In every relationship, supply chain members need to prepare for conflict resolution. Every entity should strive to reach a settlement amicably without resorting to litigation.

References

1. Schmitzm J.M., Frankel, R. and Frayer, D.J (1995) ECR Alliances: A Best Practice Model, Joint Industry Project on Efficient Consumer Response.