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**FRIENDS OR FOES?: DILEMMAS IN  
SUPPLIER RELATIONSHIPS**

*Applying principles and rules of  
lean to the customer-supplier  
relationship can drive out waste  
without taking short cuts on the all-  
important product.*

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There seems to be a great deal of confusion about how firms should be working with, or against, their suppliers. There is a great deal of conversation on the topic, but only one consistent theme seems to emerge: no one is satisfied with the current state of affairs.

The first question we should ask ourselves is why there is any difference between supplier relations and customer relations. If you surveyed most companies they would tell you that they try to partner with their customers, understand their needs, integrate with their processes, and constantly share information. If we believe that approach is good for our customers, why would it not be good for us if we allowed our suppliers to approach us in the same way? That contradicts most of the conversation today about supplier relations which begins with “arms-length relationship” and ends up somewhere around “those slimy suppliers.”

Most efforts today in supplier relations fall under the category of “those slimy suppliers” such as mandatory price cuts or on-line auctions. Mandatory price cuts have become a club to which everyone wants a membership pass. Companies such as DaimlerChrysler, Ford and Caterpillar have demanded price cuts from their suppliers. Those who don’t comply are asked to sell their components somewhere else.

The second cousin, the high-tech cousin, of mandatory price cuts is on-line auctions. The promise of on-line auctions has been broad, but the delivery has been limited to just a digital version on mandatory price cuts. Promised were things like new suppliers entering the mix or new motivation to drive cost improvement. While bringing new suppliers into the competitive fold is a noble goal, it is hard to believe that companies out there just didn’t know how to get in touch with potential customers, as if it were hard to find the address for General Motors.

The idea that forcing pricing down through whatever mechanism creates motivation to reduce costs should be tested as well. The question here becomes: why wouldn't suppliers, whether privately or publicly held, be focused on controlling or reducing their costs on their own? Isn't that critical to profitability? So why would they only react to a price cut? Motivation is not the problem. The overall price cut mentality needs to be challenged by looking at both long-term and short-term concerns. Short-term, buyers benefit from price cuts because their overall "buy" is reduced. Long-term, however, is in question. Price can only come down in a sustained way if cost also comes down. Without costs coming down, which depends on capability and not just motivation, the supplier quickly gets into financial trouble. Here is where most buyers miss the boat entirely.

If we were to add up all of the long-term costs of these price cuts we might be surprised. Costs include managing "at-risk" suppliers such as extra inspection or redundant suppliers, transfer of knowledge or tooling transfers to new suppliers, effort to find new suppliers and the cost of daily management of delivery and quality. These costs never ever show up in the piece price and very few of our cost-management systems capture any of these costs, but if we were to have more accurate costing systems, such as those supplied through activity-based costing models, we may finally understand the true costs. If we made these costs part of the analysis of our supplier costing decisions, we would see a very different picture painted for us. Instead of just looking at the piece price of the parts we pay for, we would then make decisions based on the overall lifetime costs of our supplier relationships. For most of our supplier decisions, this will lead to different decisions, more long-term decisions.

New leverage can be found not in ultimately temporary price-cuts, but in changing the systems that bind customers and suppliers. Effective structures for supplier relationships include savings-sharing programs, supplier development and improved integration.

Savings-sharing programs have not been that popular because they require significant coordination and leadership. Instead of antagonistic relationships on cost, suppliers bring cost-savings ideas to their customers and the customer agrees to split the savings with them. These ideas may require changes in the product, the process or other parts of the infrastructure. The most vigilant cost-cutting suppliers are then given first-advantage for future contracts. Tom Stallkamp and Chrysler pioneered this approach in the mid-1990s resulting in billions of dollars saved and others have followed including examples in other industries such as Detroit-based electric and gas utility DTE Energy.

Supplier development isn't an automatic win, but helping your supply base improve their operational ability using either internal or external resources can build a more capable supply base and ultimately make the buyer more competitive. No one does this better than Toyota. The Toyota Supplier Support Center trains and supports their suppliers' development particularly in the application of the Toyota Production System. At the same time, they use internal operational resources that get to deepen their own understanding through the teaching process. Not only has this approach made Toyota's supply base the most competitive in the industry, but Toyota's suppliers have been known to be more willing to bring new technologies to Toyota before other OEMs because they know they won't get crushed on the price. That gives Toyota another advantage that even they never imagined.

Lastly, there is tremendous waste in the systems that manage the supplier-customer relationship. By redesigning the system, particularly the information and material flows, using lean systems principles, we can reduce the overall cost of our supply base without touching the value-added product for which we truly want to pay. We have even seen in the structures of internal customer-supplier relationships tremendous waste based on batching of information that changes before it is used and material flows that not only carry too much protection but also still don't get the right part to the right place at the

right time. By applying the principles and rules of lean to the customer-supplier relationship, we can drive out waste without taking short cuts on the all-important product.

Suppliers are neither friends nor foes, but they are part of the overall system that delivers value to our own customers. If we weaken our supply chain we will eventually weaken ourselves. Look hard at the structure of how you deal with that supply base and you will find tremendous waste and incredible opportunity without trying to re-slice the cost-pie.

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