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Purchasing Leadership

Secure Your Supplier Alliances Through a Gain-Sharing Practice

By Steven J. Trecha and James C. Byrd

Ten years ago, supplier alliances were heralded as the solution to driving true value in buyer/seller relationships. However, while a number flourished, most failed. Why?

For most, supplier alliances simply were extending blanket orders to multiple-year agreements after raking the supply base through aggressive competitive bidding and negotiation.

In some supplier alliance agreements there were provisions for continuous improvement. Yet, actual results did not meet contracted expectations, and most organizations found themselves lapsing back into competitive bidding once the longer-term agreements expired.

One motivator for successful supplier alliances: gain-sharing. Georgia-Pacific Corporation (editor's note: Byrd served as corporate director of purchasing at the time) had a solution, one that takes the true concept of supplier alliance and ensures continuous value for both the buyers and sellers through time. The supplier alliances were structured on gain-sharing, a means of driving and sharing the financial results of continuous improvement.

The concept provides an incentive to both the buying and supplier organizations to focus on continually re-evaluating, re-energizing, and enhancing their business relationship. All aspects of value delivery are scrutinized, including specification design, order processing, inbound transportation, inventory management, obsolescence programs, material yield, forecasting and inventory planning, product performance and reverse logistics. The focus is on driving out limited value cost while protecting profit margins.

"Concept to reality" approach for developing successful gain-sharing programs. Based on the experience gained at Georgia-Pacific, plus other engagements, the following are the steps to a successful supplier alliance and gain-sharing:

- **Obtain senior management attention and active support.** Too many supply deals are done at the senior management level with only a limited focus on total cost and continuous improvement.

Instead, senior management should be helping to deliver a continuous improvement expectation message internally and externally. Gain-sharing is an excellent way to use the supply chain as a competitive advantage. Well-defined expectations and proper execution of the strategy creates a profitable opportunity for everyone involved.

- **Establish an alliance development process.** Firms need a systematic, aggressive approach to establish and operate their gain-sharing alliances. The appropriate use of cross-functional teams is critical.

Too frequently we see a cross-functional grouping that brings together maintenance, operations, purchasing and materials management people who think that by getting together one time, holding hands, and reciting chants or mantras, their problem will be resolved.

Instead, the alliance development process is tough, hard work. Team members must be trained on how to establish internal expectations, cost out their supply chains, identify and evaluate supplier capabilities, select suppliers, develop gain-sharing agreements, and operate and execute to the agreement's terms and conditions.

Based on what we've experienced, 30% of the work effort involves establishing the agreement, while the balance, or 70% of the work, is in executing it. Suppliers are willing to get involved with programs that deliver value, as this outcome benefits both buyer and supplier.

- **Develop performance measure and gain-sharing metrics.** Without a doubt, performance measures are critical to continuous improvement and gain-sharing agreements. The goal is to have metrics that affect the bottom line. Soft value measures should be excluded.

Measures must be established upfront in all dimensions of the cost and customer service relationship. The gain-sharing is set up so both the buying and suppler organization benefit from the improvements.

The delicate part of this process involves the sharing of the savings. The profit splits vary depending upon the opportunity, complexity, and business change required by either the buyer or supplier organization. However, it is not uncommon to have a 50:50 gain-sharing split at the beginning of the relationship.

- **Assign accountability.** Once past the euphoria of establishing a new gain-sharing agreement, buyers and suppliers alike begin to realize the hard work that is involved. Specific roles and responsibilities bust be documented and assigned as part of the alliance agreement.

There will be a changing of operating personnel behavior based on the gain-sharing agreements. These newly defined accountabilities are included both in the alliance agreements as well as in the employee's annual performance goals. Ensure that the alliance accountabilities are placed in the personnel files of the team members participating in these continuous improvement agreements.

We have seen too many situations where companies and people commit to performing, yet their "real job" takes over and the commitments to continuous improvements are never made.

The accountabilities are cross-functional. Purchasing alone will be unsuccessful in driving the continuous improvement results. By definition, the supply chain is pervasive across all functions, and therefore, appropriate representation and commitment to ensuring gain-sharing performance is required across all functions.

- **Remember to mentor and monitor, then don't forget to celebrate.** For these alliances to actually bring the value that they are reported to bring, then ongoing mentoring and monitoring is required.

Mentoring can come in the form of coaching and education and training. When attempting to shift human behavior, personnel development programs must be in place so that individuals understand how to operate within their new roles and responsibilities.

Many organizations establish templates of performance. These templates help team members to be continually successful in carrying out their new roles. For many of our clients we establish mentoring and monitoring alliance web sites, which actually track the performance improvements of the gain-sharing programs.

In addition to having graphical displays of tasks, timing, accountabilities and performance to plan, they also have thumbnail sketches of profitability being returned in the alliance programs.

Senior management likes nothing more than being able to continually check their status, and the Web site application allows global 24/7 access to the alliance performance.

We found that celebrating success not only increases the probability of further success, but it also drives closer relationships within out internal and external cross-functional teams---and, everyone appreciates a nice thank you every now and then.

What kind of results can you expect? Research shows that up to 60% of the costs in an organization's supply chain is based upon uncertainty and waste. The hidden value of the continuous improvement and gain-sharing relationship becomes evident through time.

Both the buying and supplying organizations become remarkably better in their performance. From a buyer's perspective, products are produced at a lower cost and end item customer service drastically improves. From a seller's perspective, they have the ability to take these new improved skills and offer them across a broader marketplace.

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