
What is Happening in Supply Chain Management? From Push to Pull through Best Value Thinking

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Introduction

In this paper we take a closer look at developments in supply management. The main change in this discipline seems to be (2011) that cooperation and risk management are taking over the classical silo based way of looking at business. Companies start to learn that transactions block the profits throughout the chain. Or, to put it the other way around, supply chain parties learn that sharing interests is earning much more money and that supply chains become ‘faster, cheaper and better’!

Information is so readily available that it becomes dominant who is the best in his field, and who is exactly the one to supply you. We now know that faster cheaper and better supply chains can be built through expert selection, based on their contribution to the whole value creating process in the supply chain. If we let the expert excel, the only parameter left to manage is the risk we cannot control, together with that supplier. Best Value Procurement is an instrument to achieve that supply chain situation.

The main research question of this paper is: ‘how can we redesign supply chains in order the create faster, cheaper and better flow through the chain, using the power from within, the expertise of suppliers?’

We will answer this question through literature research, rational thinking and using ‘dominant logic’.

In this paper we first take a look at the classic, transaction based approach of setting up supply chains. We describe the Porter way of thinking and the effects of transaction based thinking to the profits and flow in a supply chain. We then describe the BVP based changes in buyer supplier relationships, followed by a discussion on value and making way for the expert in order to let him perform his contribution. We finalize the paper with a conclusion, giving the answer to the main research question.

Classic Transaction based approach

In the classic economic theories, the organization is the starting point of thinking. Looking at Porter’s Value Chain model (Porter, 1980), an organization consists of primary (operational) functions like incoming logistics, production and sales and secondary (over headed) functions

like purchasing, ICT en R&D. The organization is aiming for maximization of profits from the supply chain (Amit et al, 1993). Margins are generated from customers (see Figure 1).

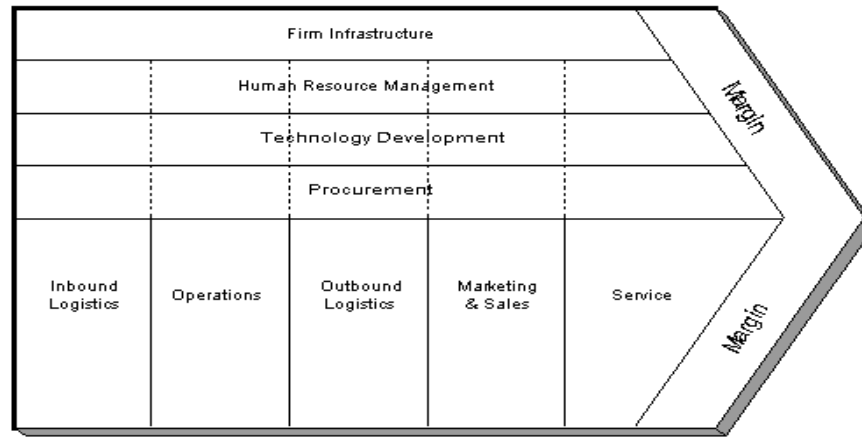


Figure 1. Porter's Way of Looking at Organizations (Porter, 1980)

Relations in the supply chain are negotiated amongst parties and written down in a contract. Transactions form the basics in this thinking, transaction cost economics is the theoretical background. Looking from purchasing perspective, the objective is to minimize the transaction price, and thus reduce the incoming costs in an organization (this is perception !). Most of the times, there is an internal customer (the actual department that needs the goods or services). The purchasing process is set out in Figure 2.

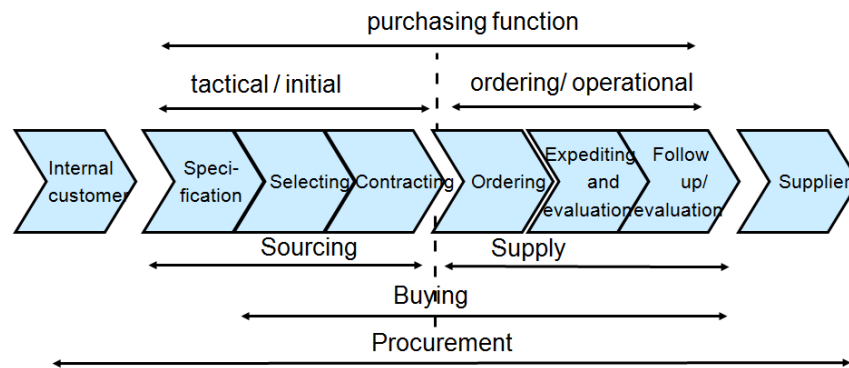


Figure 2. The Purchasing Process

Important to notice is that the purchasing function is the one that is going to specify the needs (first step in Figure 2). Later on in this paper we will see that this is value reducing step in supply chain and flow thinking. Why does the non-expert specify the needs of an internal customer that later on will be supplied by the expert? It is simply the way we are taught to think!

From sales perspective, something similar in classical supply chains happens. The objective of sales is to maximize the turnover (or sometimes profit) in a market. The typical way to do that is to push as hard as you can the available products and services from the supplier into the market towards a particular customer. The real need of a customer is subjected to the actual availability

within the supplier's organization. More sophisticated sales people even work principles like 'customer value', enabling them to maximize the turnover or profit from one customer.

Up to now we have described a nice antagonistic mechanism: sales is aiming for maximum sales in available goods or services, purchasing is aiming for the reduction of transaction costs through specifying the needs of an internal customer, illustrated in Figure 3.

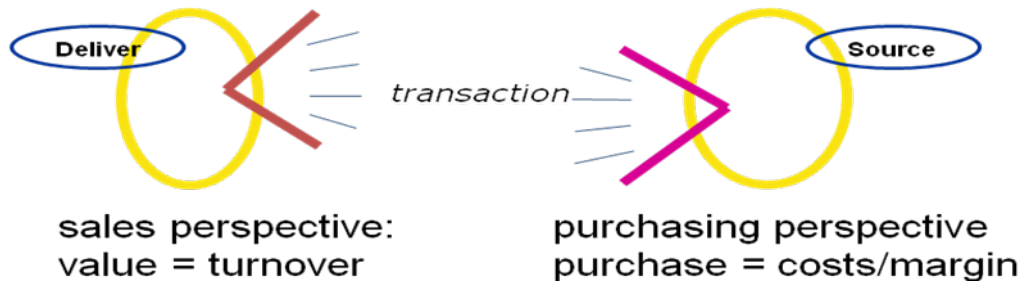


Figure 3. The Antagonistic Relation Between Sales and Purchasing

Now We Go One Step Further

If we draw up a simple supply chain with four parties involved, we have (at least) three antagonistic relations in the chain. All destroying value creation, or even worse prevent parties to generate value. If all parties in the supply chain work this way, they all have their own administration, R&D, Quality insurance and so on. All for the same output at the end of the supply chain. Imagine the waste that is generated, all being paid by the customers and in the end by the consumers (at the end of the supply chain). In figure 4 the unnecessary, non value adding costs in the supply chain are illustrated.

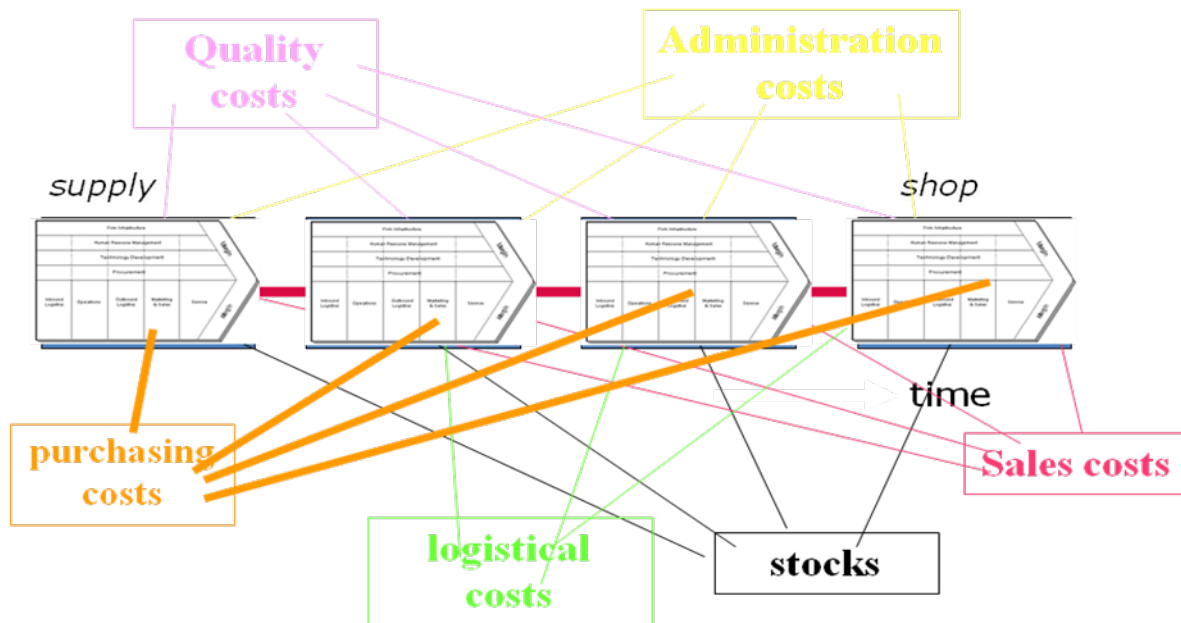


Figure 4. The Unnecessary Costs In A Classic Supply Chain

The classic transactional way of thinking in supply chains stems from the early days of economic thinking. Back then the information was trapped in an organization and related to a product or service. An order was sent through the physical mail, as were invoices and payments (through banks). Stocks (both incoming and outgoing) were safeguarding against uncertainty and non-availability of information. People had to make decisions within their own scope.

This way of thinking is called the pushed supply chain (products, services and information are pushed down the chain).

Changes in Supplier – Buyer relationships

As described above, classical relations are based on (pushed) transactions and resources that create competitive advantage (Barney, 1991). Nowadays (2011) the information of the business of the customer are known and even a few steps further down the chain, that same information is available. The same holds for purchasing information. A purchasing officer should add value to his organization by investigating availability of goods and services in earlier steps in the chain than his supplier. The crisis of 2008/9 has forced companies to invest in the knowledge of markets further up (purchasing) or down (sales) the chain. Relating this information to their own business improved their forecasting and therefore their value creation (Santema et al., 2003). But still, this is old school, push based thinking. It is about using information to reduce the risks of missed opportunities. It is still 'me' against the rest, competition thinking (Prahalad, 1990).

New school relationships between suppliers and customers is actually about pulling the products and services from the (downstream) supply chain on the moment that these goods and services are needed (preferably sold). This looks like a classic vertical integrated supply chain, consisting of independent companies. This is possible through information sharing and trust in the expert that he will do what he is good at! Which is what he was hired for anyway! From the Lean principles it is known that stocks, overproduction, logistics etc are so called 'waste' and thus not adding value. Now we are able to reduce this waste in a supply chain, simply by opening up the borders of our organizations and sharing real data, real information throughout the chain.

If we zoom in on one supplier – customer relationship, we are able to relate the operations function of the customer (the 'internal customer' in Figure 2) to the operations function of the supplier (the actual 'producer' of the goods and services needed), we extract all the cost adding (non value adding) steps in the classic transaction based thinking. That is a simple sentence that might need some more attention!

How are we sure that the supplier is going to supply what we need, or better put, what is adding value for our customers? That is where Best Value Procurement comes in. If we are able to select the expert, we do not have to specify or control what he is going to supply! In the next paragraph this mechanism is described in greater detail.

The changes in supplier – buyer relationships are enormous, due to the availability of (dominant) information. The real value of sales and purchasing functions becomes clear. For sales it is finding potential customers and relating them to the core process of the supplier. For purchasing it is about finding the expert and give him (or her!) the room he needs to excel! Another great example lays in the financials in the new school approach of supply chain management. What is the added value of sending invoices as the order is already containing all the dominant information of the transfer and thus for payment possibilities? And what is the added value of not paying invoices as to upswing the cash flow? In the classic transaction cost (or shareholders value) approach it is adding value to the single company that is doing that. The shareholder's value is boosted and so are the bonuses of the managers! In supply chain terms there is no value generated, only costs. In some smart supply chains, the money is wired at the moment the goods are delivered, based on the order generated by the operations function of the buyer. That is smart (waste reduction) thinking!

The 'Me and Us' Paradigm: From 'Win Win' Towards 'Winning'

Porterian thinking is related to 'me' thinking. The main objective of an organization is to maximize its own turnover or profit. Transactions are negotiated on so called 'win win' mechanisms. You give some, you gain some. It is about the one 'me' negotiating with the other 'me'! Is it really possible that they both can win, given the fact that the supplier supplies what the customer wants? Can two parties really win over one transaction and one (volume of) goods and services transferred between them? It is dominant that this is not possible! As long as 'me' is the dominant organizational principle, supplier – buyer relationships cannot maximize value.

The 'winning' paradigm suggests that relationships are for the benefit of both parties, suppliers and buyers. That is why we call this the Best Value Relationships. Both parties win!

Creating Downstream Value

The main goal for sales people in modern supply chains is to help customers to find (new) markets. That is where his expertise lies. Through the creation of new potential for the customer, the supplier gets more volume on his expertise and thus more profit. Knowing what the unique selling propositions of the supplier are, a sales person should change from a transaction creator (see above) towards a flow generator, creating value for his customers. The more the customer earns, the more the (connected) supplier earns. This is called 'downstream value'. We even know sales people that are helping customers to develop other (=more) customers, in order to make the customers more robust and thus reduce the risk of the fluctuations in the volume of this customer. Smart thinking, which is not about the product or service itself, but about the processes around it. The real expert knows these things and develops supply chains into value creating flow oriented relationships.

Creating Upstream Value

The same is valid for the purchasing people. The main, value oriented, goal for them is to help suppliers to get more value in, not from the particular buyer, but from other markets or buyers. If the volume (for other customers) of a supplier is raised, the risk of being too large a customer for that supplier is reduced. Also there is economy of scale potential, as one might expect that larger volumes generate lower prices. This is called 'upstream value'. It is the role of modern purchasing people to generate that kind of value.

The Role of Best Value Procurement

Best Value Procurement helps the purchasing function to find a supplier that best fits the operational needs of the buyer's firm. And it also enables the supplier to think 'with the end in mind'. So downstream and upstream value are generated at the same time. Purchasers create more value for suppliers, whereas suppliers create more value for customers. There is one aspect yet to discuss. That is the flow of information. Corporations still tend to think that information is proprietary. Which is not true, look for any subject on the internet and you will find all the information needed. So opening up on information is the new name of the game.

Opening up the operational needs, the end result of the customer's organization enables the (potential) suppliers to translate that added value result into their contribution, using the RAVA plan to illustrate that. The past performance of the (potential) supplier is a license to operate and the interviews assess the capabilities of the operational people involved in the delivery of value. Obviously the price has to be correct, but why would the price be wrong if a supplier knows what his added value is in terms of the value creation is for the customer. If his price is not correct he will not be the supplier and therefore will not be the expert. Or, to put it in other words, only the expert can have risk, price and quality in place at the same time. The best performer in the chain has the lowest price, because he is knowing what he is doing! For that reason we believe that the real Best Value supplier also has the best price, otherwise he is not the expert we want him to be.

On the other hand the buyer should think of his potential for the supplier, creating up stream value. If the buyer knows with which supplier he can create the most value, he also knows that with that specific supplier his risk will be the lowest and his (cost) price will be the lowest.

This is why we think that creating new supply chains, using BVP mechanisms, can really create a lot of value for both supplier and buyer ! Planning with the end result in mind is one of the prerequisites to harvest the potential value that is hidden in classical chains, see Figure 5.

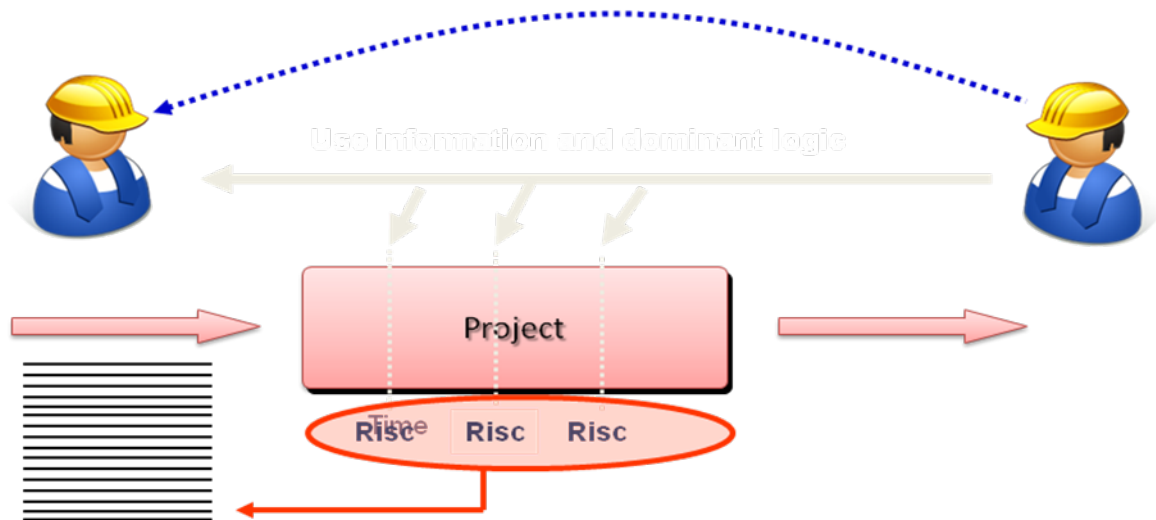


Figure 5. Planning With The End In Mind

Conclusion

The main research question of this paper is: ‘how can we redesign supply chains in order to create faster, cheaper and better flow through the chain, using the power from within, the expertise of suppliers?’

The answer lies within two things:

- Give way to experts in the chain
- Free flow of information

The first item is addressing the issue of customers specifying what suppliers have to supply, whereas after the trade the supplier has delivered where ever his competences have lied. He cannot do anything else (by definition). Incorporating knowledge of the markets of the customers, the suppliers could add even more value. The contributions to the adding value mechanism of the customer is a wonderful rephrasing of the word ‘supply’. A real expert will know what his contribution to that can be, and thus generate more value for his company (and respective supply chain).

The same holds for the customers. If customers know better what expertise is needed in the supply market, it is easier for them to harvest the potential value that is available in the chain. It means inviting different (or other) suppliers to illustrate their potential.

The free flow of information part is potentially old school anyway. The generation of managers that is coming up (2011) is so used to social media, that covering, beholding or prohibiting information flow is useless, even for patents (which are public anyway !!) or company restricted. There is a pretty large chance that somebody else in the world is inventing the same product or service at the same time as we have ‘invented’ it. So moving forward, the end market is in favor of all parties in the chain, and maximal value is generated!

More precisely, we would suggest the following with regards to the research question: ‘How can we redesign supply chains in order to create faster, cheaper and better flow through the chain, using the power from within, the expertise of suppliers?’

- Redesign of the supply chain:
 - Free the supplier from specifications and let him excel his expertise
- Faster, cheaper and better flow:
 - As soon as the expert is able to perform at his best (which is what he wants !), value will come in, as well as our value creation potential will flow back into the chain.
- Speeding up the supply chain:
 - Through the chain, using the power from within, the expertise of suppliers and the potentials if information exchange, such as internet

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