

External supplier performance management

External suppliers are the firms that provide you with products and services to assist you in manufacturing your products. Having the ability to measure and manage the performance of your key external suppliers is vital to the overall success of your firm. Key measures that best in class companies adopt to measure their external supplier performance include:

- on time delivery
- percentage of orders with damages or shortages
- cost reduction initiatives.

Supplier performance management involves determining whether your supplier is delivering to the required standards during the contract. Much of the risk associated with supply chain management arises from the failure of external suppliers to deliver and meet the requirements of the buyer.

In order to reduce these risks and pre-empt supplier failure, you must have a formal mechanism for determining whether the supplier is meeting the performance levels established and any corrective action required.

There are a number of aspects that should be considered in this process including managing supplier performance and assessing the strength of the relationship.

Supplier performance metrics

A starting point in supplier performance management is considering the metrics you intend to use.

Generally, you should focus on performance metrics related to quality, delivery, cost and service. You should also establish targets for each of the performance metrics. Table 1 outlines some of the commonly used metrics in this process.

The approach to this assessment will depend upon the type of relationship you have with the supplier.

- In the case of adversarial relationships, you will focus primarily on the quantitative performance metrics as shown in Table 1. Although price is still the dominant factor in supplier performance management in adversarial relationships, factors such as the relative importance of quality and service have become increasingly prominent.

Get Supply Chain ready for Brexit

Table 1. Commonly used supplier performance metrics

Area	Key performance indicator (KPI)	Performance target	Measurement
Quality	Fit for purpose	Product meets requirements with no rework required	Number of products received subject to rework
	Meets specification	Product delivered to specification % of the time	Number of products rejected as unsuitable for usage
Delivery	In full	% of products provided in correct quantity	Number of orders received incomplete
	On-time	% of products provided on date or time required	Number of orders received later than expected or required delivery time
	Undamaged	Less than % of products defective on receipt by date	Number of orders received defective and unsuitable for usage
Cost	To contract	All product invoiced at contracted rate or less	Number of rejected invoices due to incorrect pricing
	To industry benchmark	Price paid at industry/market benchmark +/- 2%	Periodic industry benchmark of all unit pricing
Service	Responsiveness to needs	Supplier attends to urgent orders % of time	Number of urgent orders met within customer expectations
	Issue resolution	% of operational issues resolved within X hours of notification	Number of issues unresolved within objective timeframe.

- In the case of collaborative relationships, the approach to performance management differs considerably. In this case you have to consider much more than the supplier's capability to deliver at the most competitive price, and at the right level of quality, delivery and service.

As well as being able to deliver the product, the supplier must be willing to develop a close collaborative relationship that involves cross-functional interaction and joint problem solving.

The importance of managing performance in a collaborative relationship is emphasised by the increased dependency between the buyer and supplier. Table 2 highlights some of the criteria that you can use to evaluate supplier performance, and as you can see, these are mainly qualitative criteria.

Get Supply Chain ready for Brexit

Table 2. Supplier performance criteria

Area	Criteria
Strategic commitment of supplier to the buyer	<ul style="list-style-type: none"> • Willingness to integrate supply chain management relationship • Supplier has strategic importance to buyer firm • Buyer annual orders as a percentage of overall business • Supplier's ability to make a decent profit for supplying buyer • Supplier's willingness to share confidential information
Ability to meet buyer needs	<ul style="list-style-type: none"> • Ability to meet delivery due dates • Honest and frequent communications • Commitment to quality • Commitment to continuous improvement in product and process • Reserve capacity or the ability to respond to unexpected demand • Flexible contract terms and conditions
Capability	<ul style="list-style-type: none"> • Technical expertise • Industry knowledge • Testing capability
Buyer-supplier fit	<ul style="list-style-type: none"> • Geographical compatibility and proximity • Cultural match between the companies • Past and current relationship with supplier
Honesty and integrity	<ul style="list-style-type: none"> • Insurance and litigation history • Open to site evaluation • Supplier's effort in eliminating waste

Performance management in collaborative supply relationships is a joint process with both you and the supplier attempting to identify and deal with the causes of poor performance in any areas. With both the buyer and supplier being responsible for the success of the relationship, the focus is on *improvement*. This focus on improvement not only centres on cost reduction but also can encompass any area of operations.

There is also an onus on you to achieve *performance improvements*. You should try to achieve improvements that can assist the supplier in meeting the required performance levels.

Use the resource in the [Do More](#) area to assess the performance of a number of key suppliers where Brexit is likely to have a significant impact.

Get Supply Chain ready for Brexit

Analysing the strength of the relationship

In collaborative supplier relationships you should consider the *strength* of the relationship with the supplier. Evaluation of the strength of the supply relationship will be guided by the initial objectives you have established for selecting the supplier.

Monitoring the strength of a collaborative relationship will involve you analysing the presence of intangible factors such as:

- joint problem solving
- high levels of information exchange
- top management commitment from both the buyer and supplier.

Table 3 provides a useful categorisation of the factors that describe the strength of collaborative relationships.

Table 3. Factors indicating the strength of a collaborative relationship

<i>Factor</i>
Economic factors <ol style="list-style-type: none">1. Volume or financial value of purchases as an overall percentage of supplier turnover2. Strategic importance of the buyer to the supplier3. Exit costs
Character of the exchange relationship <ol style="list-style-type: none">1. Types of information exchanged2. Willingness to share information3. Frequency of communication4. Level and number of personal contacts5. Duration of the relationship
Co-operation between buyer and supplier <ol style="list-style-type: none">1. Co-operation in areas such as new product development and cost reduction2. Willingness to integrate systems3. Integration of management
Distance between the buyer and supplier <ol style="list-style-type: none">1. Social distance2. Technological distance3. Time distance4. Geographical distance

Get Supply Chain ready for Brexit

The strength of the relationship describes the factors that create bonds between you and the supplier.

- **Economic factors** describe the level of dependency you have on the buyer. Exit costs relate to the level of investments made by the supplier that are specific to your needs. These high exit costs limit the ability of the supplier to transfer these investments to other buyers.
- The **character of the relationship** describes the characteristics that create stronger bonds between you and the supplier. For example, a high frequency and wide range of information exchange between the people in your firm and the supplier interface can facilitate the development of a strong relationship. Also, these bonds will be further strengthened if these relationships have been developed over a long period of time.
- **Co-operation between you and the supplier** indicates the level of collaboration at various levels at the buyer-supplier interface. This can also include co-operation in area of integrating processes and systems to facilitate greater transparency between the buyer and supplier.
- **Distance between the buyer and the supplier** is refers to the following factors:
 - **Social distance** relates to the familiarity of people who manage the relationship in both your firm and the supplier.
 - **Technological distance** relates to the differences between product and process technologies of your firm and the supplier.
 - **Time distance** describes the cycle time between order placement and order fulfilment of the product or service involved.
 - **Geographical distance** refers to the physical distance between your firm and the supplier.

Use the resource in the **Do More** area to assess the strength of your collaborative relationships with your suppliers.

Supplier performance management challenges

You should be aware of some of the challenges of supplier performance management:

- **Over emphasis on measurement** - an over-emphasis on specifying requirements and measurement rather than understanding the influences on performance creates difficulties. This is particularly prevalent in outsourcing arrangements that are dominated by cost savings motives. In this case, the contract is dominated by obligations that are over-specified and the flexibility of the supplier is constrained.
- **Opportunism potential** - ineffective performance management can lead to supplier opportunism. Difficulties with measuring performance can create problems in the relationship as you must expend additional resource on monitoring supplier performance. The buyer-supplier relationship can be damaged as a result of disputes in relation to the performance measures chosen and the measurement process.