

## **Leveraging Vendor Rationalization & Strategic Relationships**

### **Executive Summary**

Rationalizing poor performing vendors in favor of more strategic relationships with a smaller vendor base allows businesses to leverage scale for benefits in cost, quality, service, and speed. Rationalizing vendors can be done in three steps:

1. Rank all vendors based on actual performance and historical spend
2. Leverage strategic partners for cost, quality, service, and / or speed improvements
3. Rationalize bottom vendors with tact and professionalism

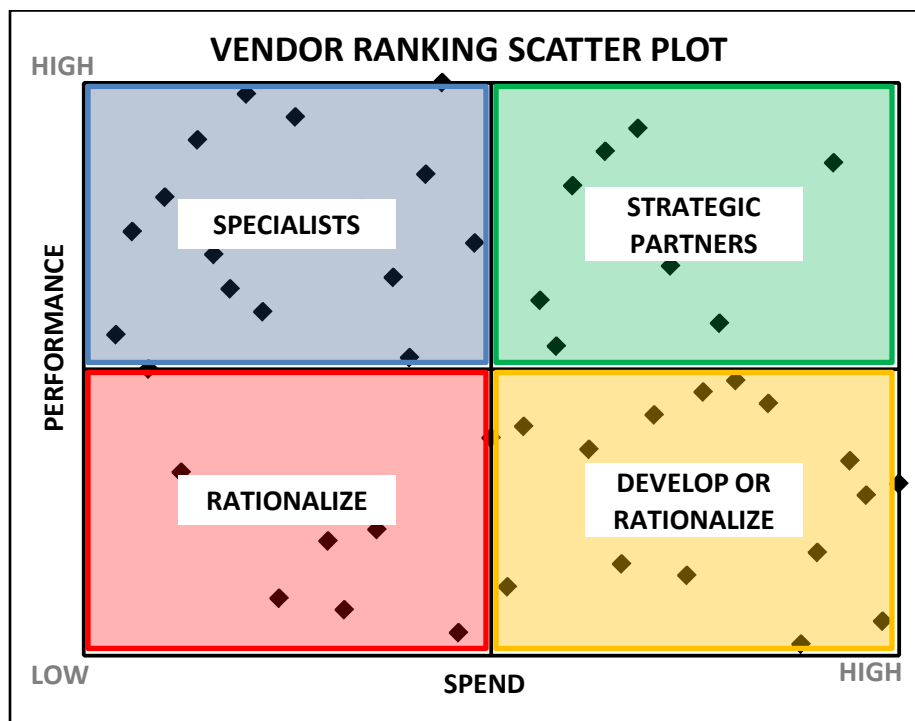
### **Business Cycles Necessitate Continuous Vendor Evaluation**

As business cycles turn, some vendors improve and innovate while others stagnate and contract. With a tactical and continuous vendor rationalization process in place, your business can take advantage of the cycle rather than fall victim to it.

### **Evaluate Current Vendor Relationships and Recent Performance**

First rank vendors by dollars spent over a given time period. Usually the past 12 months is a reasonable horizon. As a first pass at vendor rationalization, moving large amounts of spend can be a headache. As the organization grows, more sophisticated performance based metrics should be developed to continuously evaluate vendors. Once the list of vendors by spend is compiled, choose the next most critical metric to your business. For example, if the cost of a stockout is very high – vendor on-time delivery may be the best metric, while if your business is heavily regulated, vendor quality and yield performance may be best. A key here is to use actual performance ratings. If vendors have not historically been scored on the metric you chose, take the time to review recent orders from the vendor and assign a score. Clearly this would also be a smart time to implement a standard vendor scoring system going forward. Additionally, it is important to rank vendors from first to last. That is, if you have fifty vendors, one and only one vendor must be number one, and one and only one vendor must be number fifty.

Now that all vendors are ranked, plot them on a chart to visualize and group vendors. Use the annual spend ranking as the horizontal axis, with lowest spend on the left and highest spend on the right. The performance metric is the vertical axis, with the worst performing vendors at the bottom, and the best performing vendors at the top. With all vendors plotted, divide the plot area into four equal quadrants. The top right quadrant contains vendors in both the top 50% of spend and the top 50% of performers. These should be considered as prime candidates for strategic relationships, and where to move the spend, which is currently diluted by your worst vendors – all vendors in the bottom half of the plot area.



From here proceed with caution. Businesses are often quick to publish this chart, opening risk of unmanaged communication to the organization, and worse the vendors. For vendors at risk of rationalization this information could spur an immediate abandonment of the performance levels, and maybe worse – top performers could play hard ball when you look to negotiate a benefit for sending more business their way. In fact, the sequence of the next few steps will maximize the benefits of the act of vendor evaluation and rationalization.

### **Set Up Strategic Partnerships**

Arrange a formal, preferably face to face meeting between representatives in your organization knowledgeable of the details of each vendor, and strong negotiators with representatives of the top vendors capable of making decisions on discounts and service agreements. At the meeting, explain to the vendors that your organization is looking to consolidate vendors and are interested in a proposal from them to take over more business.

Do not forget that you have the upper hand in this negotiation, but also do not be afraid to put some chips on the table. For example, the increased volume alone may not be enough to leverage vendors into strategic partners. They may ask for clearer demand forecasts, access to your engineering resources, or increased transparency in quality inspection procedures.

Also, do not forget that cost can mean a lot more than just the unit price paid. Consider the benefits of establishing a vendor managed inventory agreement to reduce safety stock required on hand. By asking for example, that the vendor deliver not only monthly usage, but also keep one month of demand on hand at their facility with the understanding that you can call to order it at any time if your sales exceed the forecast. The obvious benefits include freed up cash flow and lower inventory carrying costs. Other potential partnership agreements that would reduce total cost could include specific packaging standards to reduce workload at receiving, fully documented quality inspections up to your standards to reduce receiving quality inspection workload, and direct raw material sourcing options in cases where your organization provides raw materials to the 3<sup>rd</sup> party (strategic partner to be).

Above all else though, remember what matters most to your organization, the levers of cost, quality, service, or speed, and negotiate hard for significant improvements on those levers in exchange for the increased share of business.

### **Actively Manage the Vendor Breakups**

Finally, as you transition to your new strategic agreements, do not burn bridges with the bottom vendors that are losing the business. Indeed these vendors may feel slighted, desperate, and even act irrationally. Practically, it is likely that individuals at these vendors have developed personal relationships at some level with your buyers or other staff. Therefore, there is serious need to be proactive in alerting vendors losing business that your organization is buying elsewhere. Do not allow a vendor to learn of their losing business through a sudden halt in incoming purchase orders.

Keep in mind that these vendors may be needed again in the future, whether due to poor performance at the recently selected strategic vendors or based on innovation or improvements on their own. Not to mention the all too common occurrence where a pivotal employee may move from



the rationalized vendor to the strategic vendor. Whatever the case, being professional and proactive in communicating the business decision of vendor selection will pay off in the immediate term through a smooth disconnection, and in the long run in the form of vendors excitedly competing for your business.

Best practices are to be clear in how bottom vendors were evaluated, but to be professional in resisting vendor comparison or naming the vendor to which the business is moving.. Further, professional tactics such as setting a future date for the bottom vendor to provide a quote to win the business back will only be beneficial to your business.

### **Competitive Vendor Relationships Pay Off**

The costs of setting up a strategic relationship are by no means small, and can even involve taking on risk in the form of reduced diversification, but with a methodical and thorough due diligence ,this risk can be minimized allowing for optimization on the key levers: cost, service, quality and speed.