The new frontier of value

Supplier Relationship Management

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Foreword

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Though the procurement function is often used as a code name for cost savings and cost avoidance, the value driven by procurement is no longer limited to what can be achieved through stronger sourcing practices. I see a fundamental shift occurring in our field, one that also considers critical enablers—compliance, audit, operational efficiency, Business resiliency, innovation, and supplier relationships, to name a few—that together deliver much greater impact for the business than competitive forces alone.

The sum total of these enablers, along with traditional cost savings and cost avoidance expectations, has opened a new frontier of value that can be accessed with a well-orchestrated program such as Supplier Relationship Management (SRM).

SRM embraces audit and compliance by providing assurances that our company will not engage with suppliers who would cause operational, financial, or reputational harm to our businesses. SRM also embraces operational efficiency by using leading procurement technology platforms. Encompassing all these enablers are formal third-party relationship management (TPRM) and SRM programs which provide the policies, procedures, and controls that deliver significant new value to the business.

By investing in TPRM and SRM programs, companies can create value before *and* after the contract is signed.

By working with KPMG, we now have a holistic view of value and a better understanding of how to unlock it through a supplier- and customer-centric mindset. As a result, we've been able to unleash much greater value from cost—and, equally important—value beyond cost as well.

A new opportunity to create value

By relying on suppliers more than ever before, forward-thinking organizations can no longer afford to consider the procurement function as a zero-sum game, where one side's win is the other's loss.

Too much is at stake. Companies spend an average 15-27 percent[1], of total revenues, on external suppliers. But a full quarter or third of the negotiated value is lost over the term of the deal.

With large, complex deals hanging in balance, organizations essentially have two options: they can continue attempting to wring the last dollar of cost savings from contract negotiations, or they can invest in creating value through collaboration with the supplier by driving innovation over the course of the contract.

While the first option is risky for categories that have already gone through frequent sourcing exercises, the opportunity to generate value through the second option remains wide open.

Creating joint value for the buying organization and its suppliers will require the development of a supplier relationship-centric framework that can drive performance to new levels while fostering innovation and mitigating risk.

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[1] *According to Dryden Group, the indirect spending can account for 15-27% of the total revenues and up to 50% of the organization's total purchases.*

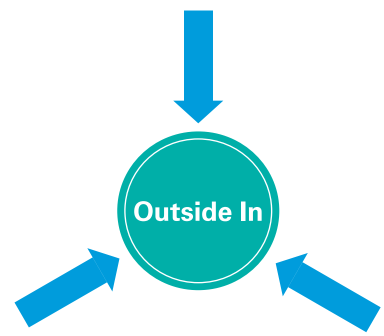
When organizations should act

With poor buyer-supplier relationships negatively impacting contract value and a significant gap between the current capabilities and the importance of SRM, the question is not whether but when organizations should establish a formal supplier relationship management (SRM) program.

KPMG has identified a number of triggers to guide your decision.

Reactive triggers

Outside-in triggers require companies to react to external market changes, such as:

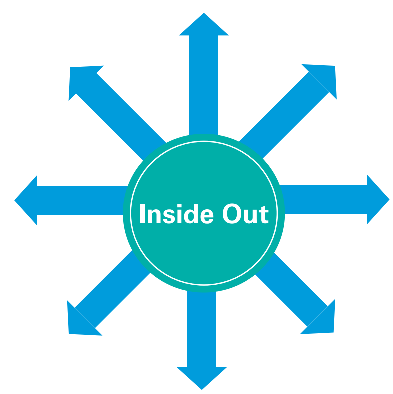


— **Regulation/compliance**—When it is imperative to comply with regulations, as in the financial services and insurance sectors, non-compliance can lead to substantial fines and loss of reputation.

— **Competition**—Competitors may enjoy an advantage through access to better resources, lower capital, or lower unit pricing, thanks to preferred pricing across key suppliers.

— **Supply/demand variations**—When shifts in supply and demand lead to excessive inventory or material constraints, the need for better supplier management becomes self-evident.

Inside-out triggers force organizations to react to internally generated changes, such as:



— **Loss of trust with the supplier**—The more critical the supplier, the more serious the repercussions.

— **Contract disputes**—Bad news doesn't get better with time. If left unresolved, escalations may turn into disputes. Large-scale disputes with third parties may lead to loss of reputation in the marketplace.

— **Preferred supplier programs**—Implementing preferred supplier programs or most-favored supplier status may require the organization to manage supplier relationships effectively to meet and enhance the value derived from these programs.

— **Value erosion**—KPMG benchmarks show value loss can be as high as 25 percent of the value captured at the time of contract signing. An SRM program can help stop this erosion through the implementation of a structured framework for managing contracts.

— **Lack of visibility on strategic relationships** —Unstructured or no supplier management programs can lead to duplication of effort, lack of standardization, siloed program delivery, and eventually lack of visibility on the strategic relationships.

Proactive triggers

Proactive triggers allow organizations to think strategically about the value proposition before implementing an SRM program. While still in the minority, these companies can capitalize on several triggers that can lead to implementing an SRM program proactively, including:

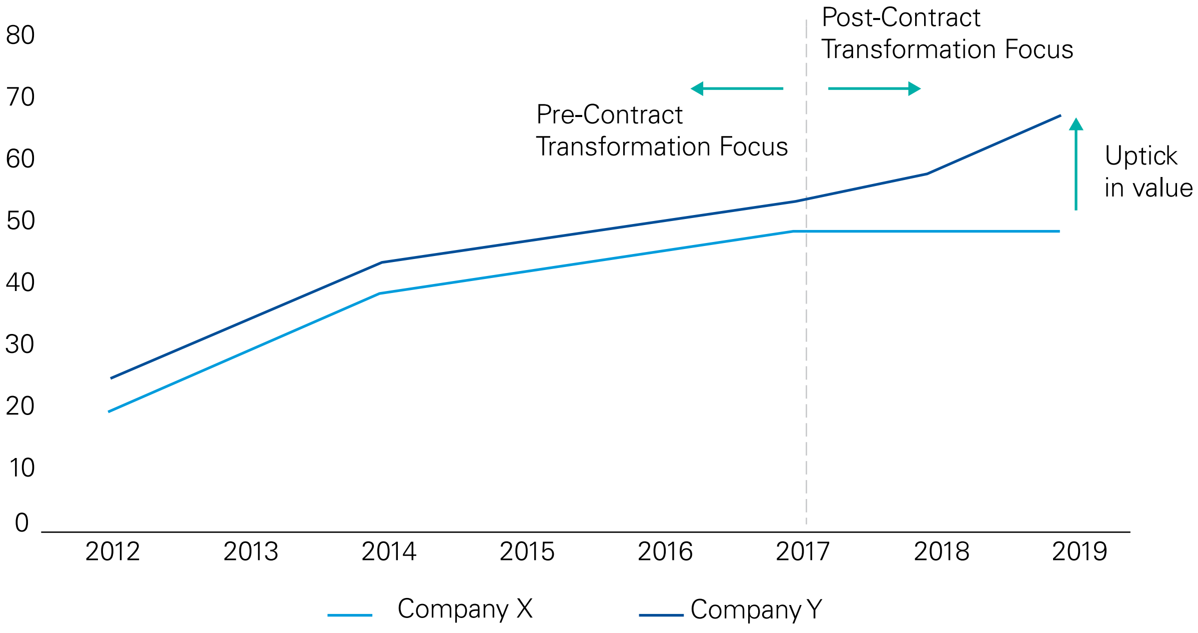
- **Additional value creation**—Over and above contract value, additional value may be gained through supplier innovation programs. Top-line impact also can be delivered by addressing balance of trade and joint go-to-market programs.
- **Strategic importance to the business**—An SRM program can drive strategic impact through initiatives such as joint collaboration, innovation, and go-to-market activities.
- **Procurement seeking to enhance value**—By promoting the implementation of SRM, the function can improve its perception in the eyes of the business, and increase the overall value to the organization.

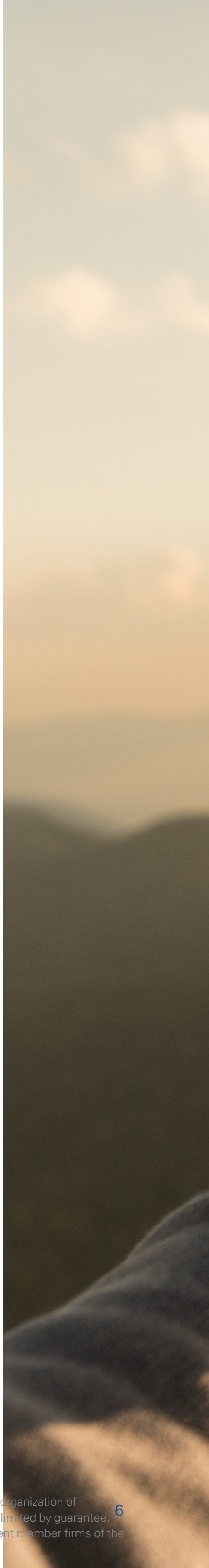
The impact of SRM programs

Organizations with established SRM frameworks can see a quick uptick in value by transforming their procurement functions.

In the example below, Company X and Company Y, each with similar revenues, began their transformation in 2012. While both companies focused squarely on cost impact through initiatives such as strategic sourcing, category management, supplier consolidation, and tail-spend management, Company Y anticipated the need for implementing additional initiatives that would affect how suppliers were managed post contract.

Over the next couple of years, this additional focus led Company Y to drive additional value compared to Company X—not to mention achieving qualitative benefits as well, such as improved supplier collaboration and customer satisfaction.





What good SRM looks like...

KPMG's experience in helping organizations design and implement supplier relationship management programs shows that six key attributes distinguish leading-practice SRM programs from mediocre ones:

1. **Value management framework**—Leading organizations have a clear methodology in place to capture, monitor, and track value from their SRM programs. There is clear alignment on the methodology among finance, procurement, and SRM organizations, which in turn ensures clear understanding of the investments (e.g., resource addition) and the return on investment (ROI) available from the program. The financial impact, coupled with qualitative impact, can pave the way for the organization's future growth.

2. **Organizational structure**—A well defined organizational structure that describes roles and responsibilities explicitly among the sourcing, SRM, and business partners, with minimal overlap.

3. **Opportunity for future growth**—Growth can be anticipated throughout the SRM function because there is a clear understanding of resources and responsibilities required to meet the larger goals of the business. Such goals include cost savings, revenue generation, and total quality management improvements through lower defects, improved customer satisfaction, and shorter go-to-market lead times.

4. **Executive sponsorship**—Senior leadership supports SRM when issues are escalated because the function's value is aligned with the strategic goals assigned by the leadership team.

5. **Proactive strategy**—SRM implementation is based on a thoughtful, proactive strategy, rather than simply reacting to market needs, which helps ensure that the solutioning and approach are aligned to business needs.

6. **Culture of Trust**—Such a culture can help unlock the potential of internal resources and external suppliers alike. People in high-trust companies report 74 percent less stress, 106 percent more work energy, and 76 percent higher engagement. Organizations with leading supplier relationship management programs effectively extend a culture of trust from their internal organization to their strategic supply base—to the point where it's difficult to differentiate between organization and supplier resources. All are working in a unified manner for one common goal.

[4] Zach, Paul. J., "Neurosciences of Trust," *Harvard Business Review*, January–February 2017.

How you can get there

KPMG has developed a six-step process to help organizations just beginning their SRM journey. Our approach is distinguished by the strategy and planning that goes into establishing an SRM program so that both quantitative and qualitative targets can be met.

1. **Assess your current state.** Have a good understanding of how your organization compares to its peers in terms of SRM leading practices so that you can create a baseline and then measure improvements achieved during the transformation. A sample current-state assessment may involve a detailed understanding of the organization's performance across the service delivery model, technology, and processes, to name a few areas. If your company already has established an SRM program—regardless of maturity—assess your current state as a reality check to help guide you on areas that need improvement.

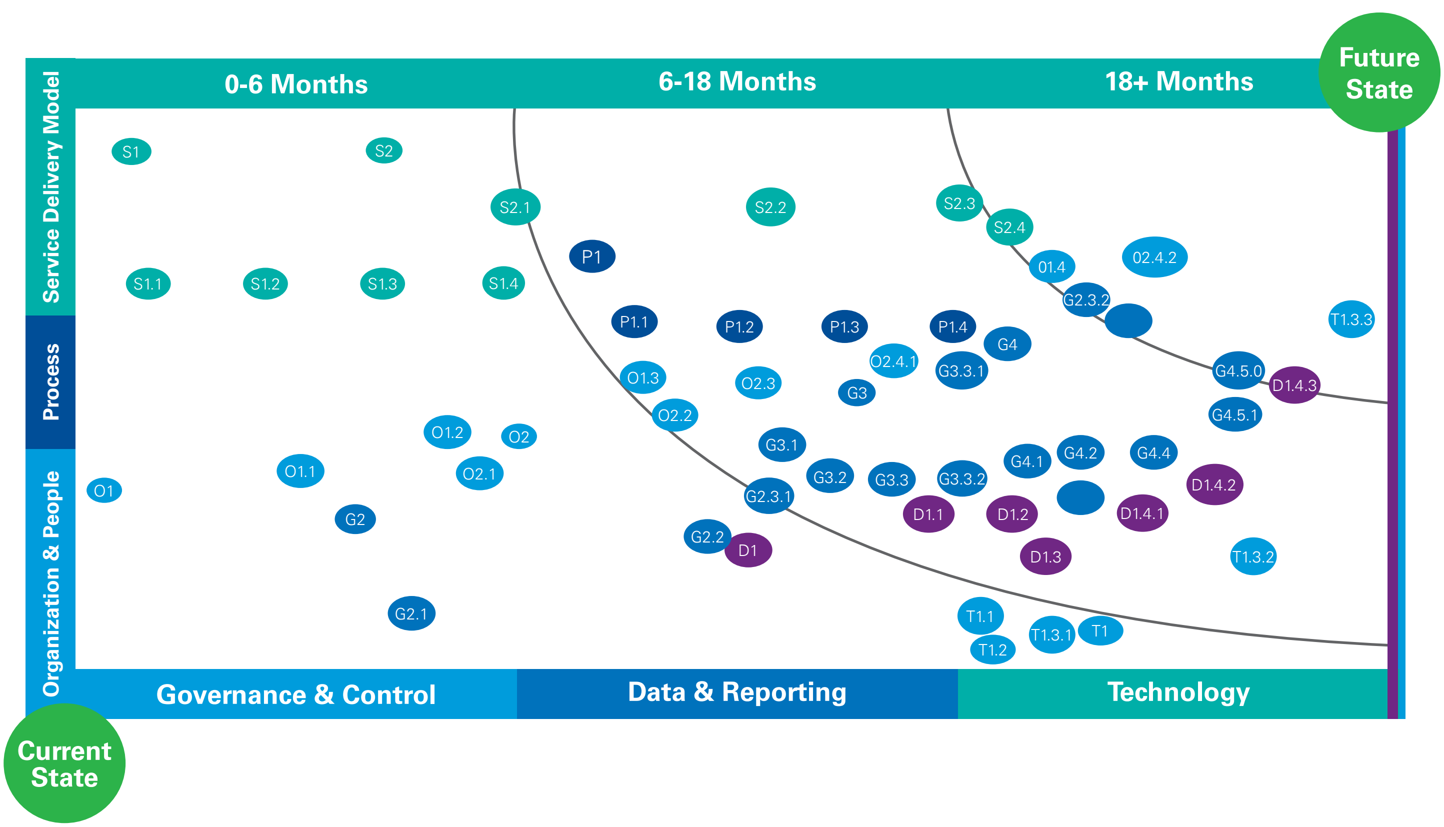
2. **Map your opportunities.** Now you need to understand what opportunities exist across different areas, ranging from how your SRM organization is structured to expected changes in processes. Opportunities should then be translated into action statements that are SMART (specific, measurable, assignable, relevant, and time based). Realize, too, that opportunities may require a thorough round of validation among procurement, finance, and other business partners to ensure consistent support for the transformation across stakeholders.

3. **Prioritize your opportunities.** Not all opportunities will have the same value or implementation complexity. Prioritizing through extensive discussions with internal stakeholders and senior leadership will surface the vital few that can provide maximum impact for your particular organization.

4. **Consolidate a business case.** Realistically understate intended SRM benefits so that you can forecast future growth (e.g., headcount) and calculate the return on your investment. Not only will this help improve credibility with your leadership team and finance organization, it also will help you stay on track. In addition, regular reporting on your business case can improve the perception of the SRM organization.

5. **Create a roadmap.** Assemble a roadmap to showcase when each opportunity will be addressed. A visual representation of a roadmap through sundials (shown below) or a Gantt chart can go a long way to explain the sequence of each project and activity to stakeholders. The roadmap also can help you understand the various dependencies you need to consider before the sequencing can be completed.

6. **Begin implementation.** We call out this final step separately to help ensure that all the minimum checks and balances are in place before implementation is begun, including approval from the leadership team and alignment with stakeholders and human resources (for headcount additions). A careful communication and change management strategy also should be activated during this phase to address questions and concerns from different stakeholders and help improve acceptance of your SRM program.



Case study

Insuring its future as a "customer of choice."

Client: CNA Insurance
Sector: Insurance
Project: Procurement Transformation

Client challenge

Senior executives at CNA Insurance, a leading provider of commercial insurance, knew they faced significant challenges in the procurement function. Frequent changes in the strategic supplier ecosystem, decentralized operations for managing suppliers, and ineffective responses to regulatory pressures had led to significant value leakage—in excess of $9 million per year. The lack of a supplier-centric model would continue to penalize company profits and deny procurement leaders a seat at the table unless they revitalized their supplier relationship management (SRM) and third-party relationship management (TPRM) programs. A thorough assessment could address pressing issues and also point the way to increased bottom- and top-line impact.

Benefits to client

CNA expects its new SRM and TPRM programs to improve relationships with strategic suppliers, reduce risk, improve governance, and increase regulatory compliance. Aligning the new programs to larger business goals also improved executive support. By becoming the "customer of choice," the company expects to achieve incremental value of $7 million to $12 million over 24 months.

KPMG response

Leveraging KPMG's in-depth understanding of the procurement function and deep experience in the insurance sector, we used our target operating model methodology to assess CNA's current state, evaluate opportunities, and develop a roadmap for a successful 24-month transformation journey.

Interviews with more than 50 internal and external stakeholders and reviews of past actions helped us identify opportunities and make recommendations based on the six layers of the KPMG target operating model: service delivery, organization and people, business processes, governance and controls, reporting, and technology. The resulting roadmap was socialized extensively within the procurement function and with business partners to gain alignment and gauge the need for change, sponsorship, and investment.

Change management programs were implemented at every step of the transformation to help the program gain support from the larger organization, which would be part of the new supplier-centric implementation or see its results.

In addition, a risk management tool was integrated to address regulatory compliance issues.

KPMG insights

A roadmap is imperative when undertaking transformational initiatives.
A roadmap helps the organization examine each opportunity, approach implementation logically, and understand how long the project will take and when results can be achieved.

Executive sponsorship—and engagement—is critical to keep the focus on speed, value, and execution.
CNA executives were fully engaged throughout the assessment, prioritizing processes and deciding on the right technologies to deliver business benefits. As a result of their involvement, the assessment provided a clear path for driving benefits throughout the transformation journey.

Creating mutually beneficial supplier relationships

Gone are the days when simply managing spend and finding the best deal possible within your supply base was enough – or easy. The focus today is on relationships. Managing the supply base means strengthening relationships that can make or break your business.

That's why supplier relationship management has come into its own. SRM does not simply provide another negotiating weapon to use against suppliers. Rather, it demands that buyers fundamentally shift their mindsets to understand the possibility of alternative partnership dynamics.

As with any change of view, the move to supplier relationship management can be difficult to make. But our experience shows that successful SRM can yield faster time to market, transactional efficiency, enhanced competitiveness, improved risk management, and significant financial gains—for your organization as well as your suppliers'.

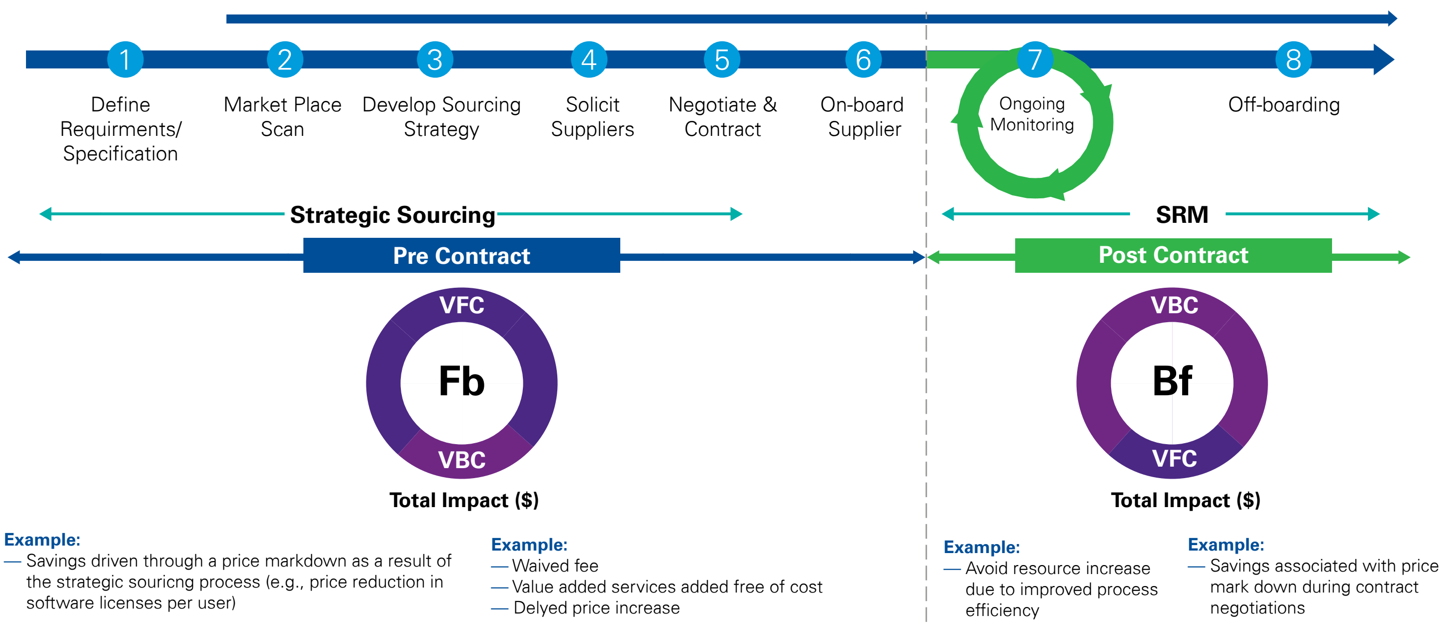
Contact KPMG today to get started.

Appendix: How value is created

A closer look

Quantifying the value from your supplier relationship management (SRM) initiative is perhaps the most significant challenge you'll face during program implementation.

For the sake of simplicity, we view value from two perspectives—pre-contract and post-contract—because, for example, there may be separate teams (strategic sourcing vs SRM) managing pre-contract and post-contract activities, and they may be required to report value separately.



While it's possible to impact both value from cost (VFC) and value beyond cost (VBC) during pre-contract and post-contract activities, the overall impact may differ. The focus in pre-contracting activities is on cost reduction and hence the value from cost is substantially higher (capital F and small b). However, there is a greater possibility of driving value beyond cost through post-contract activities (capital B and small f).

Total procurement value (TPV) is the sum total of the value that can be driven through pre- and post-contract activities.

Value is comprised of a list of activities that can be driven through the full procurement lifecycle, from defining requirements to off-boarding suppliers. Most companies focus only on driving value through the first part of the equation—largely through the strategic sourcing exercise.

The important question, however, is this: why are you realizing only partial value)? Aren't you doing a disservice to your organization by just focusing on one part of the value equation? Why shouldn't you maximize the value from the procurement function through tighter review and control of value during the entire course of the contract?

Impact of innovation

One area that is frequently brought up during client discussions is the impact of innovation on supplier relationship management—how to foster innovation in the supplier ecosystem and what value can be generated through innovation, along with the methodology to capture this value.

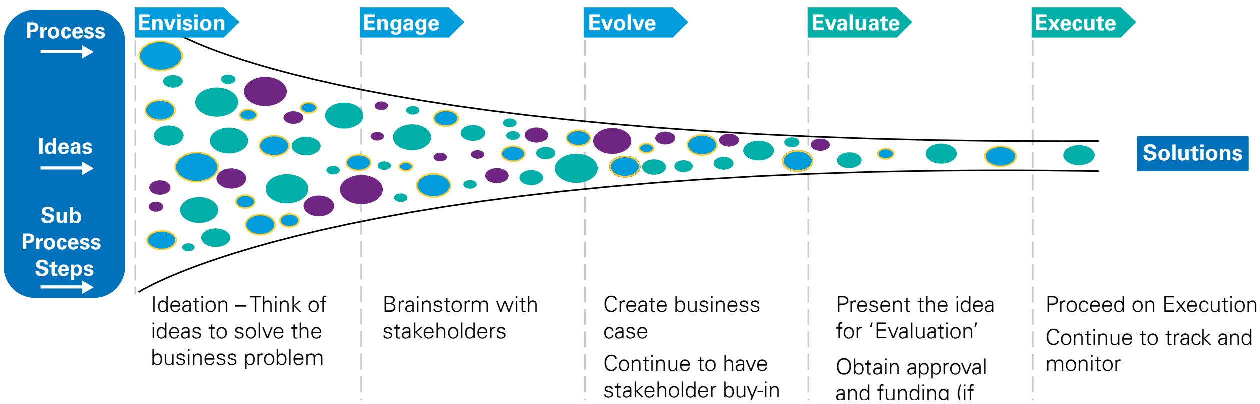
The key is to create an environment and incentives for inculcating innovation. Suppliers should be viewed as a source of knowledge and expertise that can be leveraged for competitive advantage and mutual benefit.

- Establish cross functional innovation teams with dedicated resources to nurture and advance ideas
- Provide support to suppliers to improve their cost and quality competitiveness

- Demonstrate trust to build relationships, reinforcing them by an understanding and respect for each other's business and position in the marketplace
- Involve suppliers early on in strategic planning activities for key inputs. Demonstrate openness and share information in a timely manner, providing clear and honest information about a company's plans and expectations

- Improved product performance
- Increase long term competitiveness in the market place
- Joint product solutions and "Go to Market"

In the context of our framework around total procurement value, supplier innovation can be considered as a part of value outside contract. Joint innovation can be driven through the concept of idea buckets, which involves the lifecycle from idea generation to idea execution. These joint innovation ideas can be used to capture value inside as well as outside the contract.



Here is the concept of idea buckets used to capture ideas:

Idea Buckets

	High Impact	Medium Impact	Low Impact
Classification Criteria	— ROI: 2X or higher — Should impact one or more Tactical Business Priorities (Dept. Level Goals)	— ROI: 2X or higher — Should impact one or more Tactical Business Priorities (Dept. Level Goals)	— ROI: 1x or higher — Should impact one or more operational business priorities (Team Level Goals)
Participants	— Client stakeholder representation: Cross department (e.g., Finance, Legal, IT, Procurement, SRM) — Supplier Representation- Account managers and senior leadership	— Client stakeholder representation: SRM, Business Owners — Supplier Representation: Account managers responsible for the client as an account	— Client Stakeholder Representation: Domain specific (e.g., Internal Infrastructure Team) — Supplier Representation: Domain specific (e.g., Customer support team)
Reporting Forums	— Internal forums & supplier specific forums — ABR-Annual Business Review — SABR-Semi Annual Business Review — QBR-Quarterly Business Review	— QBR—Quarterly Business Review — MPR—Monthly Performance Review	— MPR- Monthly performance review — WPR Weekly performance review

Use a simple in-house tool to capture the value created as a result of innovation.

Track, Monitor & Report

Innovation Tool-Sample Interface

Project Level Interface

- Source
- Supplier Name
- Idea Name
- Summary
- Potential Value
- Potential Investment
- Strategic Business Priority
- Department Level Priority
- Team Level Priority
- Business Case Ready
- Incentives Finalized
- Status

Program Level View

Health Check

Total Projects: 75
- **Open: 60**
- **Closed: 15**

Investment: $10
Return: $20
ROI 2X

Source	Supplier Name	Idea Name	Summary	Potential Value	Potential Investment	Strategic XX	Dept Priority	Team Priority	Business Case Ready	Incentives Finalized	Status

Changing relationships from traditional supplier management to one that supports and promotes innovation requires a paradigm shift and does not come without risks.

Traditional Relationships

- A general distrust in the relationship drives limited information sharing
- Lack of understanding of each other's needs and capabilities
- Conflicting objectives within the buying organization impacts the messaging to the supplier and limits their ability to understand the needs and proactively work to meet them
- Excessive and late specification changes by the buyer without regard for the potential negative impact on the supplier
- Buyers place price-reduction pressures on suppliers that consider only the customer's financial needs, not the potential impact on the suppliers

Innovative Relationships

- An environment of teaming throughout the product and demand lifecycle is established between both companies
- Suppliers invest in technology to create innovative product or processes that could support potential future business
- Improved communication to ensure both the buyer and the supplier have the same information and direction and know how relate with each other
- Buyers are price sensitive but respectful of the supplier's cost structure and limitations

Why should suppliers play ball?

Gone are the days when meeting contractual obligations was considered the cornerstone for client success. In today's competitive landscape, meeting contractual obligations is just table stakes, enabling suppliers to complete the contract without losing business and/or client trust. However, the ability to show value during the course of the contract can ensure that suppliers are well placed to gain more business at the end of the contract.

As an example, look at Supplier X and Supplier Y, which both have strategic clients of similar-sized revenue and scope. While Supplier X has focused on meeting its contractual obligations, Supplier Y was able to provide additional value through the innovation program in place at the client's organization. Supplier Y further showcased this additional value to leadership during touch-bases in the form of quarterly business reviews and semiannual business reviews.

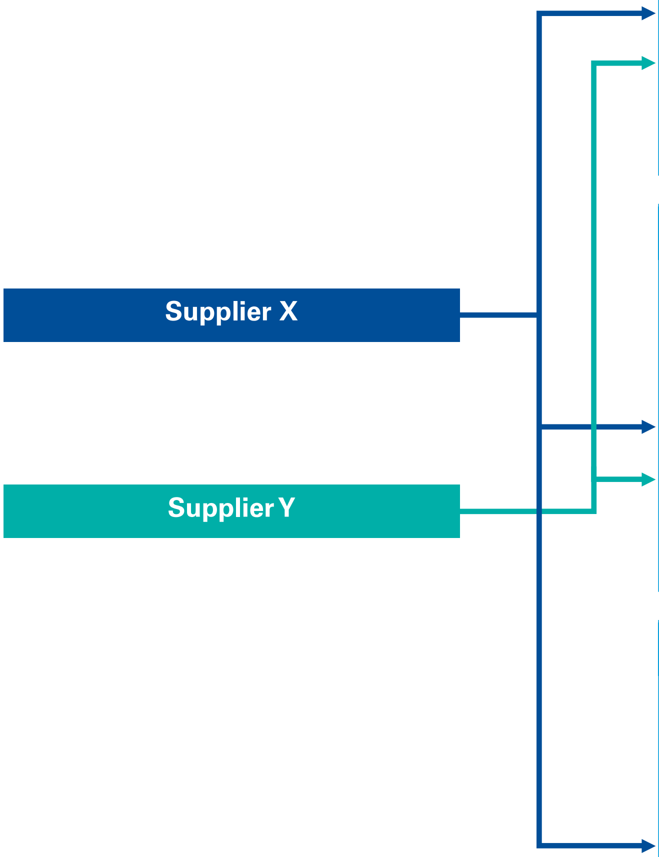
At the end of three years, Supplier X addressed all its contractual obligations and had a great relationship with the client stakeholders. However, Supplier Y had an even greater advantage by way of year-over-year impact through the innovation program. The client had a much greater focus on leveraging the first two options (renew and renegotiate), rather than going to the market (RFX) for Supplier Y. However, all of these three options were on the table for Supplier X.

Stage	Year	Contractual obligations met		Additional value (% of TCA/annum)	
Sourcing (Precontract)	2017	NA	NA	X%	X%
Post contract	2018	✓	✓	0%	1%
	2019	✓	✓	0%	1.5%
	2020	✓	✓	0%	2%

Supplier X

Supplier Y

Clients possible options when the contract comes up for renewal in 2021



A. Renew

Overview
This is the "Best Case" scenario for any supplier. The Buyer strongly believes that their organization is receiving the best value (both Tangible & Intangible) from the supplier and hence would like to renew the contract without renegotiation

Trigger
Contract obligations have been met and exceeded along with high level of trust

B. Renegotiate

Overview
This is the "Mid Case" scenario for any supplier. The buyer feels there is good value from their existing relationship with the supplier but more incremental value can be generated through negotiations

Trigger
Contract obligations have been met with mediocre level of trust. Buyers believes that there is more value that can be driven through negotiations

C. RF(X)

Overview
This is the "Worst Case" scenario for any supplier. The buyer is not pleased with the product/services and prefers to explore that market for other suppliers.

Trigger
Significant issues around contract obligations and lower level of trust. Buyer believes that more value can be generated through a different supplier

Of course, the client may still decide to go for RFX due to procurement policy that requires them to launch a bid at the end of the contract, change of scope, major changes in market conditions, etc. However, the chances of this happening are considerably lower if the supplier has shown significant value during the course of the contract.

Considering how much value can be added beyond the contract, contact KPMG to learn more and get started today.

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