

Supplier Rationalization: How to Implement A Strategy



Whether you're a mom-and-pop shop or a global conglomerate, your company's supply chain is its lifeline.

Goods and services flow in, money and products flow out—and when your supply chain is well optimized, this exchange nets you profits, competitive strength, and value from reduced risk, lower total cost of ownership, and opportunities to collaborate and innovate with your best suppliers.

But in order to optimize your supply chain, you first must *rationalize* it, i.e. streamline your supply base to ensure you have the right number of suppliers, providing the right number of goods and services, at the right quality, price, and terms (and without any unwanted redundancy, risk, or revenue loss).

The process of supplier rationalization requires careful consideration of your company's goals for supplier relationship management (SRM), your overall business process management plan, and your strategic sourcing strategy.

But with the right tools and best practices, you can craft a paradigm for getting the best possible return on investment (ROI) for every purchase, forging an agile and resilient supply chain, and building strong, strategic supplier relationships

that help you meet your company's goals.

What is Supplier Rationalization?

Every business pursues a mix of short- and long-term strategies in the course of business process management.

Supplier rationalization is an especially important long-term strategy, as it involves finding ways to not only improve supply chain visibility and performance now, but *continue* to refine and optimize the supply chain for even better performance in the future.

Traditionally, supplier rationalization has been focused on choosing the right number of suppliers, with the right kind of performance, price, and reliability, to support an efficient sourcing strategy.

This used to mean that supply base rationalization, and spend management, were both focused on *supply base reduction*, trimming the supply base to the absolute minimum to encourage competition and turn that competition to the company's advantage at the negotiation table through fewer suppliers providing greater savings (albeit minimal resilience and agility should a major supply chain disruption occur).

But as more and more organizations discover the power of digital transformation and artificial-intelligence-adjacent technologies such as process automation and deep data analytics, many procurement teams are looking to glean insights from their data stream to optimize their supply chains for more than cost savings alone.

The bottom line remains a priority. However, the modern rationalization process prioritizes value creation as well as savings opportunities.

It leverages supplier relationship management to consolidate the supply base using a model built around a core of key suppliers supported by an indefinite number of additional vendors who can be called upon to address specific needs when required.

The result? A responsive, contingency-aware, data-driven supply chain that's constantly monitored, updated, and refined to:

- Maximize supplier performance and compliance while minimizing risk exposure.
- Prioritize strategic sourcing through analysis, collaboration, and continuous improvement.
- Identify and take advantage of savings opportunities as well as opportunities to collaborate and innovate with key suppliers.
- Build both resiliency and agility into the supply chain in order to protect business continuity and competitive performance, better insulating the company against global economic upheaval, natural disasters, and worldwide crises like the COVID-19 pandemic.
- Improve spend visibility and the accuracy and completeness of spend data to support and improve financial analysis, forecasting, reporting, and audits.
- Minimize the risk and impact of value-draining problems like maverick spend (also called tail spend, rogue spend, etc.) and invoice fraud.
- Speed and improve the performance of internal procurement processes like process automation and spend analytics, which in turn enhance your procurement organization's procure-to-pay (P2P) workflows and, by extension, improve future iterations of your rationalization process.

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The Supplier Rationalization Process

What if you could build and execute a simple, four-stage process to ensure your supply chain is streamlined, responsive, and resilient, with strong, collaborative supplier relationships (rather than exclusively competitive ones)?

And what if, once you set it up, you could run it in endless iterations, refining it further each time to achieve greater cost savings and value?

That's supplier rationalization in a nutshell.

Consider the four stages, and how they fit into the process as a whole:

1. Preparation

The goals of this phase include:

- Forming a team to oversee and execute the supplier rationalization process. This team brings together team members from IT, sourcing, procurement, and supplier relationship management who have direct experience and contact with suppliers.
- Performing spend analysis.
 - Historical spend data, along with vendor performance and compliance data, is analyzed by type, category, etc.
 - Special emphasis is given to identifying sources of maverick spend, underperforming or high-risk suppliers, and redundant suppliers.
- Working to develop a supplier rationalization strategy.
 - The team decides which approach to take between:
 - Product standardization, which replaces multiple products with a single new product with similar or identical functionality.
 - Supplier elimination and consolidation, which sets a specific set of criteria (e.g., compliance, performance, etc.) used to evaluate and then reduce the total number of suppliers. These criteria may include:
 - Suppliers with rising prices.
 - Suppliers with inconsistent or decreasing performance, service levels, and compliance.
 - Suppliers who don't meaningfully contribute to or participate in collaborative opportunities for innovation and growth.
 - Suppliers who present increased risk due to their location, logistics issues, or the potential for significant reputational harm.

The challenge during this phase is to educate stakeholders and demonstrate the value created by whichever supplier rationalization strategy is chosen.

Spend analysis will prove helpful in this endeavor, as it makes it easier to organize and present information that clearly connects supplier characteristics to value, cost savings, and the bottom line.

2. Development

In this phase, the team formalizes the criteria for the suppliers they want to retain, as well as the criteria for those they plan to eliminate from the supply chain, based on the supplier rationalization strategy they've chosen.

Suppliers may be eliminated based on:

- Their status as one-off suppliers.
- The amount purchased from the supplier
- The number of goods and services provided by the supplier

Suppliers may be retained based on:

- Capacity for, and consistency of, performance and service.
- Pricing (including incentives and potential discounts captured).
- Compliance with industry, governmental, and environmental regulations.
- Reputational and corporate social responsibility factors

Once the criteria have been confirmed, the procurement team can provide analysis based on each vendor's potential for retention and elimination and generate reports broken out by (for example):

- Spend categories.
- Potential for future partnerships.
- Redundancies and fragmentation of the supply chain requiring consolidation or the addition of new vendors to provide contingency support for business continuity purposes.
- Vendor longevity and consistent adherence to internal controls and policies as well as regulatory and other compliance requirements.

3. Advanced Supplier Analysis

Suppliers you've cleared for retention and consolidation, or who provide the goods and services you've selected for standardization (as applicable) can now be

further vetted before beginning the supply base rationalization process in earnest.

During this phase:

Product Standardization

Goods and services are analyzed and organized based on their value within your supply chain (e.g., direct and indirect spend).

Suppliers who provide these goods and services are further analyzed to identify the amount of risk exposure, potential value creation, and overall importance to operations and business continuity.

Those who score the lowest across all criteria may be slated for elimination from the supply chain.

Supplier Consolidation and Elimination

Similar to the process for product standardization, suppliers are compared to determine which are key suppliers (i.e., those who provide core and essential goods and services, such as raw materials, components, or production-related services).

These key suppliers' contracts are then compared in order to rank them based on a number of factors, which include but aren't limited to:

- The length of the supplier's relationship with the company.
- Intellectual property and confidentiality obligations between the two parties.
- Environmentally responsible and sustainable sourcing.
- Engagement with the company's software environment and procurement processes (i.e., do the vendor's systems mesh with the company's to allow for data sharing, electronic invoicing, real-time monitoring of performance and compliance, etc.).
- Reputational excellence and responsible corporate citizenship.

In both scenarios, it's important to keep stakeholders informed of the team's decisions, and also participate in frequent and open discussions between all parties to consider issues that may fall outside the criteria used when choosing suppliers.

This ensures everyone is on the same page while also allowing for procurement to adjust evaluation criteria based on new information.

4. Consolidation, Elimination, and Evaluation

With the entire supply chain now categorized and ranked, the team can now start to consolidate products and vendors within the supply chain to optimize the supply chain and (at last) ensure the right number of vendors are providing the right products at the right prices and terms.

One way to organize suppliers is by their role within the supply chain itself.

- **Strategic Suppliers** provide essential raw materials or provide goods and services in research and development (R&D), capital expenditures (CAPEX) such as equipment and facilities, etc.
- **Collaborators** are key suppliers with important collaborative relationships, providing goods and services to marketing, logistics, social media and internet services, product and package design, etc.
- **Standard Suppliers** provide goods and services for human resources, finance, legal, and operational expenditures for maintenance, repair, and operations (MRO).
- **Contingency or Conditional Suppliers** provide goods and services for indirect spend categories such as office supplies, janitorial services, food services, etc.

Once the supply chain rationalization is complete, the team and relevant stakeholders evaluate its impact on company cost savings, operational improvements to efficiency, supply chain resiliency, and overall value creation as compared to the previous paradigm.

This sets the stage for the next iteration of the process, which is repeated at least once every year but may be repeated more frequently if market trends, global economic events, etc. make it necessary to do so.

Best Practices When Implementing Your

Own Supplier Rationalization Program

Ready to begin rationalizing your supply chain? Following a few simple best practices can make the process a swift and successful one.

- 1. Choose the right software solution.** In order to manage the data necessary to effectively streamline your supply chain, you need the right tools. Choosing a comprehensive, cloud-based procurement solution like PLANERGY ensures your team has:
 - Centralized data collection and management for data sets from internal and external sources.
 - Intelligent and intuitive data analytics and process automation powered by machine learning, providing iterative, continuous improvement that supports value creation and helps lower costs.
 - An easy way to build a closed spend environment that provides total spend visibility, eliminating maverick spend and making it easy to identify products and suppliers for consolidation or elimination to streamline your supply chain.
 - Powerful supply chain, contract management, inventory management, and supplier relationship management tools they can use to handle a complex global supply chain that allows for contingencies and protects business continuity.
 - Easy and effective collaboration and communication between all stakeholders, along with role-appropriate, on-demand access to crucial data and data analysis tools for real-time updates.
- 2. Connect, Collaborate, Communicate.** The most effective team for supplier rationalization is one that frequently engages with all stakeholders not just for updates, but to hear and address their questions and concerns.
- 3. Measure Twice, Cut Once.** Before you trim your supply chain, make sure the vendors who remain have the ability and capacity to meet your needs for lead times, compliance, and quality. And don't forget to include contingency/conditional suppliers for essential goods.
- 4. Focus on value, not price.** The immediate cost savings that come with an untested vendor offering deep discounts might seem tempting, but

truly effective supplier rationalization relies on data analysis to ensure other factors with a much greater impact on value—risk exposure, long-term opportunities for savings, economies of scale, quality and consistency, total cost of ownership, etc.—don't fall by the wayside in the quest for a short-term boost to cash.

Supplier Rationalization Streamlines Your Supply Chain

Don't let your organization's lifeline get tangled by redundancy, bloat, or needless risk and waste. It's time to move past cost reductions alone and toward value-centric supplier management.

Develop and implement a supplier rationalization program, and make sure your supply chain is helping you eliminate waste, build strong and strategic supplier relationships, and boost your bottom line.

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