

LESSON SCRIPT

5. Supplier Plotting



In this lesson, we are going to talk about supplier plotting. We'll discuss how it can impact the procurement process and how companies and organizations can take advantage of their knowledge in supplier plotting.

Once you're done with this lesson, you should have a clear definition of how plotting works and how you can plot your own products and suppliers to create an effective personal Procurement Plan.

Purchasers often hold the view that their profession is mainly a practical job and therefore should be based on experience. When browsing through the literature on the subject of purchasing anyone will find the possible harvest meager compared to the vast amount on subjects like marketing and sales. It is difficult to point the finger at the reason for this result. Perhaps it is the fact that purchasing has just recently come out of the backroom into the board room. Not long ago purchasing was often considered to be a simple job?

Present purchasing is more and more seen as a strategic tool and the actual placing of an order is just a result derived from the overall company strategy. The last action is simple and could be done by almost anyone, the first activity demands a good insight into all the aspects involved in the markets around the organization. This change is also pushed by the fact that more and more companies are reconsidering what will be part of their core business and what could be outsourced to third parties. Areas with low wages lure production away from the traditional industrial countries and this outsourcing strongly increases the volume of purchasing. Currently, more value is added by suppliers than ever before and this trend shows no tendency of slowing down. Purchasers have to be more aware than ever before that the survival of the organization depends on their ability to make the right decisions. Experience will still be in demand, but a good theoretical basis is also needed to succeed: otherwise, all knowledge could disappear in companies with the departure of a single purchaser.

Kraljic's article 'Purchasing must become supply management' was published in the Harvard Business Review in 1983. Since then this model has been around and has become one of the cornerstones of modern-day purchasing theory. The power of the model is its simplicity.

The purpose of this matrix is to set up a basis for procurement group, product, and supplier base segmentation. You can choose your own abstraction level before you start plotting. You will learn in the next step how to do that, but first, let us focus on explaining the two axes.

In the original model, the vertical axis labeled as ‘complexity of supply’, is concerned with the degree of difficulty associated with sourcing a product or service, or the vulnerability of the supplier to provide the product or service on time.

The horizontal axis, ‘Profit potential’, is used to indicate the extent of the potential of the supply to contribute to the profitability (or efficiency) of the buying concern. This profit potential might be realized by achieving lower costs, either by paying a lower price for a good or service or by introducing more efficient buying methods. Another axis that is often used instead of profit potential, is business impact.

Now you know the axes, we will explain the four quadrants of how to plot your own product, services, or suppliers in the model.

Minimize risk / Bottleneck quadrant

These are products with a limited source of supply. Their supply risk is high, but they do not have a major profit impact. This quadrant belongs in a “Supplier’s Market.” Here, the strength is in the hands of the supplier. The market consists of few suppliers that can behave freely and force prices upward. The purchasing strategy we would typically use for these types of items is twofold. Firstly, we need to ensure continuity of supply. Secondly, we need to develop plans to reduce our dependence on this supplier, by adapting our products and investigating alternative products and suppliers.

Leverage quadrant

Leverage items have a large financial impact on the organization; however, these items are in abundant supply. They are usually highly standardized and easily available. This quadrant belongs in a so-called “buyer’s market”. This means that buyers possess the balance of power in the relationship and leverage this strength to obtain greater returns. The purchasing strategies we would typically use for these types of items include tendering and competitive bidding.

Non-Critical quadrant

Non-Critical items are low risk and have a low-profit impact. They are usually the lowest on the priority list in a procurement strategy. There is a balance of power between buyer and supplier. These items cause the least problems for procurement managers because they can be purchased in different varieties and from different suppliers. By increasing product standardization, much time and money can be saved. Thus, the purchasing strategies we recommend for these types of items focus on reducing administrative costs and logistical complexity.

Strategic quadrant

Strategic items have high supply risk and high-profit impact and are bought mainly from strategic suppliers. These items are critical to the business. This power between buyer and supplier is balanced and the goal here is to ensure long-term availability. The company needs to look for a “win-win” negotiation that benefits both parties. The purchasing strategies we would typically use for these items include collaboration and strategic partnerships.

In this table, we can find the different purchasing strategies per quadrant.

	Non critical items	Leverage items	Bottleneck items	Strategic items
Procurement focus	purchasing management	materials management	sourcing management	supply management
Time horizon	limited, normally 12 months or less	varied, typical 12 to 24 months	variable, depending on availability	up to 10 years
Key performance indicators	functional efficiency	cost/price and material flow	cost management, short-term sourcing	long term availability
Items purchased	commodities and specific materials	commodities and specific materials	mainly specified materials	scarce and/or high value materials
Typical sources	establish local suppliers	many suppliers, mainly local	new global tech-savvy suppliers	established global suppliers
Supply	abundant	abundant	production based scarcity	natural scarcity
Decision authority	decentralized	mainly decentralized	decentralized, central coordination	centralized

Phase 2: Plot your procurement groups in the current situation

So now you know what we are looking for but we still have to obtain a good idea of the positions and possibilities of all parties concerned on the market. Of course, for all combinations of company and product, the position on the quadrant will be completely different and it will be subject to change over time.

Positions on the market are a relative phenomenon and an advantage can easily turn into a liability if one is not careful enough. To help you out in plotting your current situation of the products, supplier or sourcing group, we made a template for you that will help you. This will help you in building your Personal Procurement Plan before the end of this Module.

To teach you how plotting could work, we will dive into the example of Gorillas again. Although Gorillas is aiming to drive their growth via all the possible groceries that households need, one of their current main sales drivers nowadays is the snack & drinks category.

Before plotting, you should always ask yourself: what is a logical clustering to plot my category? In the example of Gorillas, who are only a-brands and therefore have fewer options in supplier diversification and development, three levels could possibly apply.

Level 1 is Products: for example: beer in a can, specialty beer in a bottle, etc

Level 2 is product group: Pilsener, lager, saison, tripel, mexican

Level 2 could be Brands, like Heineken, Bud, Corona, Warsteiner

Another level could of course be suppliers: Heineken, Ab Inbev, Carlsberg, Duvel

For this example, we have plotted the beer suppliers in the quadrant.

-Since Heineken is a huge player on the market of beer and by far the biggest supplier of Gorillas, they are plotted in the strategic quadrant in the current situation.

-AB Inbev is a huge supplier, but has a small position within Gorillas, so is plotted in leverage.

Another more defensive strategy is advisable for goods where the market position is less favorable. In this case, one should look for new potential suppliers or for possible substitutes for the products. Also, more money could be spent on purchase marketing or supplier management. Perhaps it might be a sound idea to spend more on research and development (R&D) or on increasing the production capacity at the suppliers to achieve lower prices. In short, purchasing has to diversify in order to spread risks. In the remaining field in the purchasing portfolio matrix, we find the situation in which we may expect to have little or no advantage for all parties concerned. The cost could go up by a meek approach but an aggressive attitude could damage any possible relationship. A purchaser should try to find an equilibrium between these two extremes.

Phase 4: Action Plan

Finally, you know what you want and what you may expect to be able to get it. After analyzing the information you should set up a plan of action. The portfolio approach of Kraljic is very well known throughout the world of Procurement, but the model lacks an active dynamic character. Luckily, scientist Gelderman can help you out with this!

According to Gelderman, the core of all purchasers' action should be in the case of leveraging products to make the shareholders happy, by increasing profit through low costs. Instruments could be found in reverse auctions. For routine products profit is to be made through reducing handling connected with purchasing. Little or no honor is to be found with these goods, so try to do it with fewer people. The instruments, in this case, are for instance E-procurement and E-ordering. In the case of strategic articles, Kraljic proposes a partnership with a supplier. Easier said than done. Most of the attempts to set up these schemes will fail. Relationships in purchasing have a lot in common with human relationships. Trust is often the stumbling stone to building something lasting. Still, partnership is the key to success in this segment of the model. But just as with some situations with bottleneck products, you could face an impossible task. Some aspects go beyond your control and you could be too small to change them. In this case, the only thing you can do is to accept your faith and hope for a brighter future.

To complete the desired situation in the supplier plotting, you will have to add the intended movement of the suppliers within the model.

For Gorillas, it could be a smart strategy to decrease dependency from Heineken, grow with AB-InBev to counter Heineken, accept the status q with Carlsberg and add another specialty brand to the assortment to get less dependent on Duvel in the end.

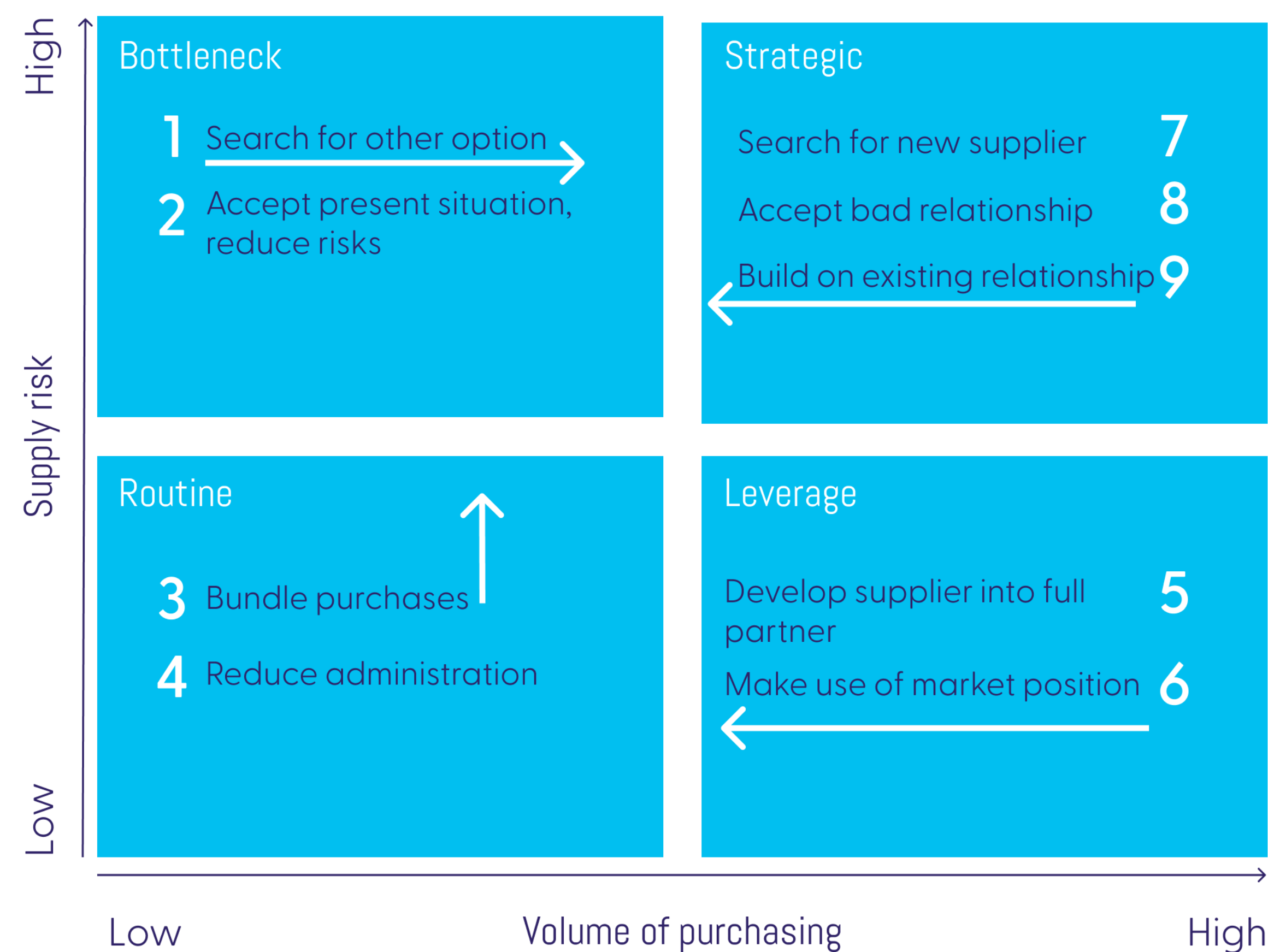
To help you out in plotting your desired situation of SKU, supplier, or sourcing group, the team at Procurement Tactics made a template for you that will help you.

So there you have it—the keys to plotting a supplier and forming an action based on the plotting. Of course, The matrix needs to be reviewed frequently due to year-over-year supply base changes. Please have in mind that suppliers can also make segmentation analyses on their customers. Despite its age, even today, this matrix is one of the most powerful segmentation tools used across various industries and companies.

In this lesson, you’ve learned what the Kraljic Matrix is and how to use it to your advantage.

You learned about the process and the 4 phases of supplier plotting. You learned which questions to ask yourself before the plotting. Next, you started plotting yourself. Finally, you learned what to do in order to get the desired results.

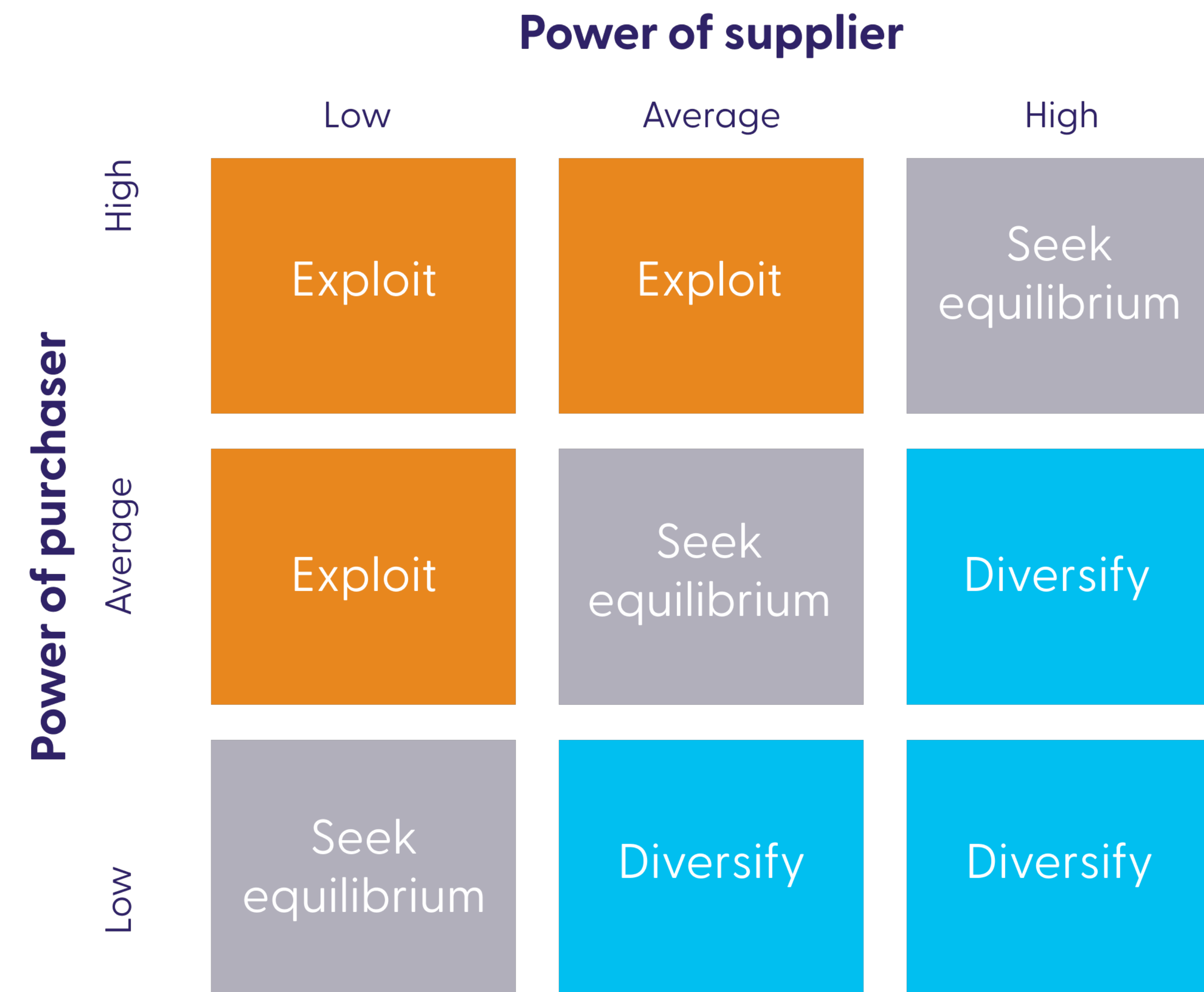
Now it’s time to conclude your final procurement performance plan yourself!



-Carlsberg is plotted within Non-critical: sales, margin, and supply risk are low.
-Duvel, relatively small in comparison with the big three earlier mentioned, has only limited volumes year over year available and is not that critical to the business of Gorillas and is therefore plotted in the bottleneck.

An important disclaimer to this example is the fact that a procurement manager of Gorillas will always have limited power towards the branded suppliers versus the power he or she will have when they list multiple own brand beers. It is in that case when there is the choice of 100 possible suppliers will be the one brewing the gorilla brand, that real power over suppliers could be achieved: the consumer will buy the beers, and procurement can switch suppliers every year to make sure to guarantee best price and quality.

After plotting your current situation, you have to ask yourself the question: which procurement strategy to use in which quadrant? To answer this question we could make use of the matrix as given below. It depicts the possible situations of the power position of the supplier compared with the power of the purchaser.



Once you discover that your own company possesses a dominant position on the market and that in comparison, the position of the selling party is relative weak, a reasonable aggressive approach is advisable. In this way, you can exploit its good position in the market. In this situation, a purchaser should be able to achieve a positive contribution by aiming for low prices and favorable contracts. The approach should be not too aggressive as it could have a negative impact on long-term effects.

Kraljic divided his model into 4 phases. The team of procurement tactics simplified them in order to make his model easier to understand for you.

Phase 1: Reflection

Phase 2: Analysis to determine the bargaining position

Phase 3: Plotting to identify the opportunities

Phase 4: Action plan: what to do?

For this lesson, we will use the same route.

Phase 1: the start.

Kraljic states that new strategies for purchasing could emerge if questions are answered like:

-Does my company use all possibilities for combined purchasing by all departments and divisions?

- Could anticipated disturbances and bottlenecks in supply be avoided? What level of risk is acceptable?

-What is the best balance between costs and flexibility when considering procurement decisions?

-How could cooperation with suppliers or even competitors strengthen long-term relationships with suppliers or could these shared sources be better capitalized?

The model build-out of these questions is known as by the figure as shown below:

