A.T. Kearney

Collaborative Supplier Innovation

Working with your suppliers to generate profitable, value-building growth

Innovation is key to enabling future success. But development costs can quickly eat up the benefits of the growth in sales and profit generated. This is one reason why more companies are reshuffling their internal capabilities to rely on a cadre of well-chosen partners—especially suppliers—to pursue profitable, value-building growth.

If managed successfully, collaborative supplier innovation can produce profitable growth via improved differentiation and speed, and lower costs (see figure 1). Suppliers provide ideas, reduce development costs and time, reduce COGS, and pave the way to a price premium.

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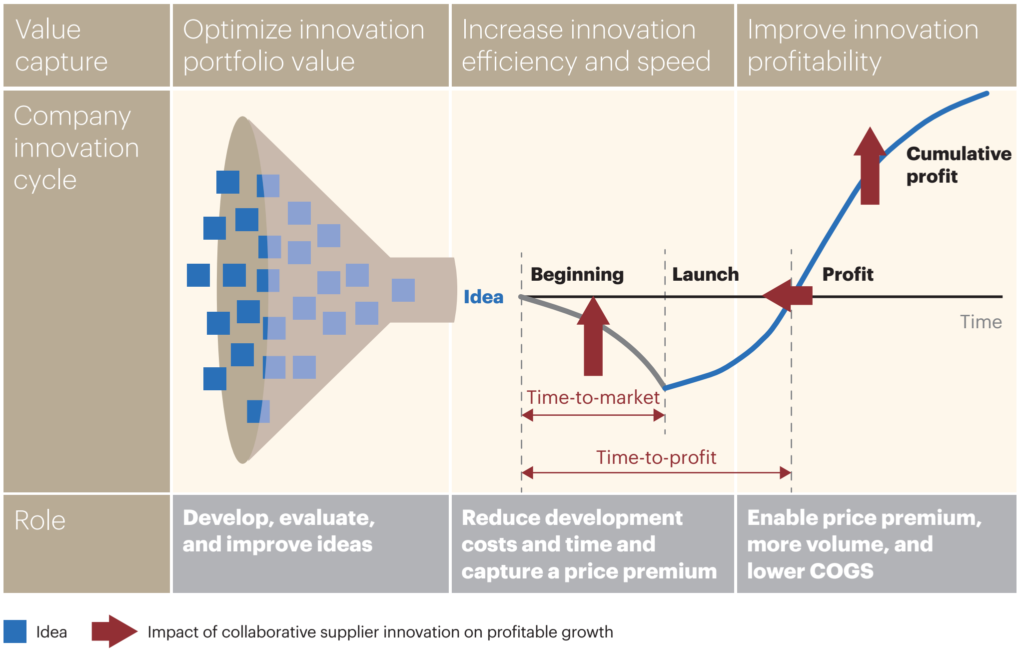
Figure 1
The value of collaborative supplier innovation



Source: A.T. Kearney analysis

While working with suppliers to generate value can have a considerable payoff, realizing the payoff requires a significant shift in a company's internal workings and in managing the supplier network. From the start, it's important to consider:

- Potential confusion about the role of internal R&D resources
- New and more complex responsibilities for the company's procurement organization
- Alignment of suppliers' objectives and approaches to support those of the company

Findings in our latest Best Innovator study indicate that best practice firms address these challenges by actively and consistently integrating external partners into their innovation activities while following three overarching guidelines.[1]

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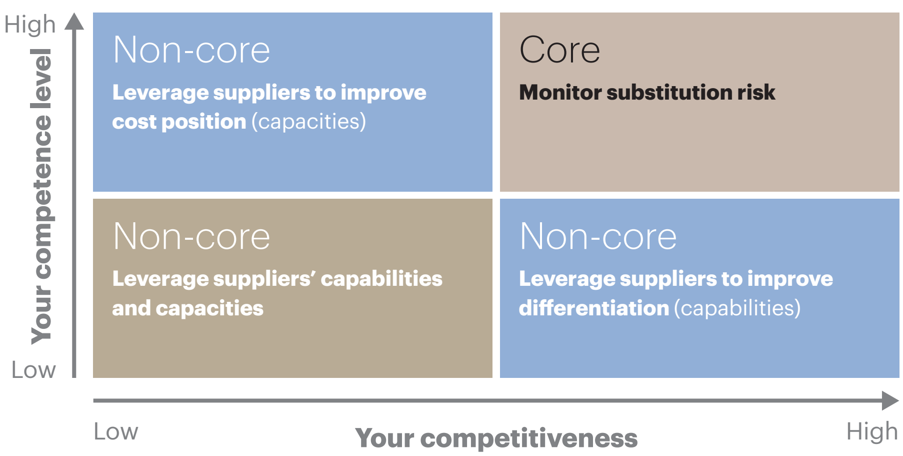
1. Apply a clear definition of core and non-core innovation activities

Pressure to significantly reduce R&D costs while at the same time improving innovation performance is akin to squaring the circle. Here, it is important to first get your priorities straight. Clearly define core and non-core activities and outsource a select number of non-core activities that are not crucial to achieving your innovation goals. A simple two-by-two matrix can be used to break out activities and determine which can be handled in-house and which can be delegated to select suppliers that provide needed capabilities more economically or effectively than can be achieved internally (see figure 2).

Figure 2

Determine supplier role in your core and non-core capabilities



Source: A.T. Kearney analysis

Clear agreement on crucial issues leads to more cooperation when addressing legal issues, such as who owns the intellectual property, and in reaching consensus on time and quality management. Not surprisingly, this requires additional effort that would not have been necessary had this work been kept in-house. Using standard models for intellectual capital and program management, with an emphasis on collaboration, is a good way to integrate suppliers into your value chain network.

[1] For more on the findings in our latest Best Innovator study, see "Innovation: A Solid Wager in Good Times and in Bad," at www.atkearney.com.

2. Shift the procurement mindset from "cost-out" to "profit-improvement"

In our Best Innovator study, the most important reason for involving suppliers early in innovation activities is to provide capabilities not available in-house, followed by reducing time-to-market and increasing product or service differentiation. While 90 percent of leading companies have a structured process for collaborating with suppliers, just 54 percent of the rest of companies do so (see figure 3). Once suppliers are involved in the development process, procurement takes a seat at the strategy table—going beyond reducing costs and improving efficiencies to focusing on building value and profits. The study also shows that companies expect to further rely on collaborative supplier innovation in the future.

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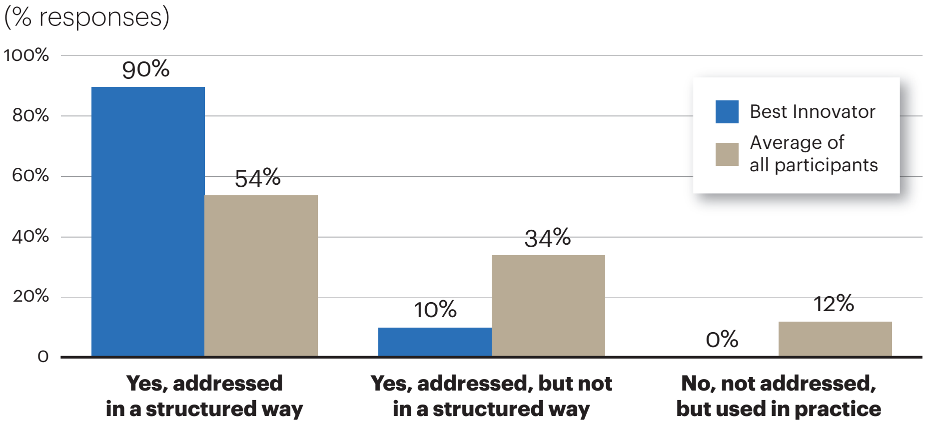
Figure 3

Is supplier collaboration addressed in your innovation strategy?



Source: A.T. Kearney Best Innovator study, 2012

Here's where procurement adjusts its roles and responsibilities and begins to:

- Hire and train staff to be more adept at evaluating supplier innovation capabilities and performance
- Introduce systematic innovation management methods to select suppliers
- Establish new key performance indicators (KPIs) to measure supplier innovation performance

This last point is essential. Your buyers must evaluate suppliers' abilities and innovation track records to determine if the supplier will make a valid collaborator. This is accomplished via systematic innovation management methods used in workshops with select suppliers, and through the use of online innovation assessment tools, such as IMP³rove, which uses objective criteria to help buyers and suppliers thoroughly assess and benchmark suppliers' innovation management capabilities.[2] In addition, procurement will need to apply new KPIs on supplier innovation performance that go beyond typical supplier relationship management KPIs to not only measure current performance but also to set a path for future development.

[2] For more information about IMP³rove, see The IMP³rove Academy at www.atkearney.com.

It is important to keep in mind that procurement cannot make this shift on its own. The entire company must be involved, working cross-functionally to ensure success. Sales and marketing, R&D, procurement, and production all have roles to play—from understanding customers' real needs and developing the right products and services, to identifying the right suppliers to bring under the collaboration umbrella.

3. Manage innovation consistently across the value chain network

Finally, the closer suppliers and procurement are tied together, the more effective their network will be in making market distinctions. This requires a common understanding of the company's innovation goals and the areas in which suppliers excel. This is accomplished by:

- Adopting a unified "language" of all innovation-related topics to clarify communication between buyers and suppliers, and among suppliers
- Establishing in which strategic search fields the value chain network is active to ensure focus and speed
- Defining how network partners will cooperate to reduce time-to-market and time-to-profit, and to manage the overall innovation life cycle

In a solid partnership, all network partners regularly check on how their participation and innovation results are affecting the company's growth targets. Partners have ambitious standards not only to develop and position their own company favorably, but also to improve the overall value chain network. Clear interfaces and obligations set the basis for trust. Common experiences and successes further strengthen loyalty. For partners that are not supporting the strategy or delivering promised added value, it is time to modify their roles or replace them entirely.

The Ultimate Outcome

Beyond the challenge to shape the network in a way that generates value for all participants, there are many smaller but equally important tasks for each partner to undertake. For example, everyone benefits when each party develops internal structures, processes, and projects and helps manage the external network for the greatest effectiveness. The network helps transform the lead company and each supplier's business—all in the pursuit of supporting innovation.

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