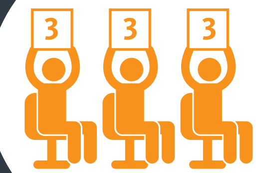
Creating Effective Supplier Scorecards



Supplier scorecards can be effective in managing and improving supplier performance. They have evolved from being used primarily by manufacturers to being widely accepted and adopted in service industries and organizations as well.

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Supplier scorecards are considered a basic tool in the supply management toolkit. When developed as a part of an integrated supplier performance management process, they can be highly effective. Yet, scorecards present a challenge to many organizations and don't always deliver on their potential. Often, supplier scorecards may be something managers like to check off on a checklist (yep, we've got supplier scorecards) than a useful, dynamic tool. The use of scorecards has exploded in the past 10 years. They have gone from being an aspiration to a reality. However, for many firms, the reality of supplier scorecards hasn't matched the promise. This white paper describes how to build a better, more effective supplier scorecard and scorecard process.

Metrics Myths and Misconceptions

Here are four common assumptions about supplier scorecard metrics. True or False?

1. Copying the metrics of other companies is the best way to choose scorecard metrics.
False. Trying to duplicate the metrics of other companies is popular, but not the best approach to choosing scorecard metrics. While formal benchmarking by outside firms does have value, as it can tell you what others in your industry are doing and give you some guidance about best practices, trying to follow others doesn't necessarily give you the best results. Copying and pasting best practices of others may not be specifically relevant to your company or practices may be out-of-date by the time they're applied. And in many cases, you may not even have the metrics you admire from others available in your company to use.

2. Qualitative measurements are not based on data and therefore do not belong on supplier scorecards.
False. Some organizations believe that the only valid scorecard metrics are quantitative metrics derived from a business system or scientifically calculated. This can be pseudo-science. Quantitative supplier metrics may be prone to error (i.e., garbage in, garbage out). In many businesses, particularly service organizations, quantitative metrics may simply not be available. And last, perception is reality. Qualitative information can add richness and depth to other information and support the results of quantitative data.

3. You need a certain number of measurements or KPIs on a scorecard to make it an acceptable tool.
False. Start with the vital few and build from there. The more metrics on the scorecard, the more resources that are needed to derive, maintain, and communicate with suppliers and stakeholders. You want to be a concierge and "curate" the best, most meaningful metrics and not a janitor, who sweeps up

everything, meaningful or not. The quality and significance of metrics trump quantity every time.

4. If you build the scorecard, they (suppliers) will improve. True. At least, this is initially true. The act of measuring supplier performance can be initially motivating. But unfortunately, it's not universally sustainable. To sustain the gains, organizations have to do more than launch scorecards at suppliers like rockets. Initially, most suppliers will strive to do well, similar to students getting report cards. But scorecards need teeth and are not effective in a vacuum. A closed-loop supporting business process will continue to make them successful.

Best practices for developing metrics

Where do you start? How do you choose scorecard metrics? Where will the metrics come from? Why use supplier scorecards? Some people lose sight of what they are trying to accomplish. They focus on finding what others perceive as the perfect or most commonly used metrics. Instead of a supplier scorecard designed to encourage performance that supports one's goals, the scorecard may become more of a collection of unrelated and potentially inappropriate metrics. First and foremost, scorecards must be actionable and produce results. Scorecards are not about finding the most commonly used metrics, the biggest assortment of metrics, or world-class metrics. They're about measuring the supplier performance that matters to a specific organization, identifying areas of opportunity, and then working with suppliers to improve.

Metrics flow from strategy

The best way to derive meaningful metrics is by starting with your company's or organization's strategy. Alignment is critical for senior executive support. To the extent that supplier performance expectations and metrics support overall company goals, executive support will be stronger and help ensure successful outcomes.

For example, if the corporate strategy is to grow international revenue, what might that entail? How do products need to be priced to sell internationally and what are the implications for product cost? What are the implications of flowing that strategy to the procurement and supply management level? It may mean removing cost from products, choosing suppliers to work with collaboratively on new product development, and choosing best value suppliers who continually strive to improve their efficiency and remove waste from their processes. And, using offshore suppliers as part of this strategy implies additional supply risks. Continuing with this example, alignment with a corporate strategy to grow international revenue would impact which suppliers are chosen, what the expectations are for their performance and often and raises supply risk challenges. Strategy alignment ultimately impacts supplier performance goals and the metrics that are used to measure supplier performance.

Your eyes may be bigger than your stomach

Choosing metrics that others use or that look interesting is very common. However, it's not always possible or productive to photocopy others' metrics and paste them into your company. In the end, an organization needs to have the desired metrics available and be able use them successfully. Let's take quality. In a manufacturing environment, product quality is typically measured within the business system, i.e., incoming supplier quality and in-process quality. But in a service environment, there are not always systems that can be tapped to spit out service quality data. Instead, service organizations typically use internal stakeholder surveys. That is, they ask employees who are impacted by specific suppliers or who deal with them to respond to surveys where they rate the supplier. While there are challenges in getting sufficient responses beyond the extremes of the ecstatic and the griping, this approach is what is primarily available. In some instances, there are automated ways to gather metrics, as in call centers where the system can capture customer waiting times, number of calls abandoned, percentage answered within a given timeframe, etc. For an outsourced call center, these system-generated metrics would be used to measure that supplier's performance. When identifying supplier scorecard metrics, start with the wish list and then pare it down to the reality of what can be measured. However, take care to identify and choose metrics that matter and not just those than can be easily gathered, as you may end up measuring the wrong things. As quality guru Joseph Juran advised, choose the vital few from the useful many.

Involve internal and external stakeholders

Involving internal stakeholders and external stakeholders such as suppliers helps make the scorecard process more robust and creates the input and support that will help make scorecards successful. While Procurement may be the focal point for the customer-supplier relationship, other functions are important stakeholders in the process. They may use the suppliers and come in first-hand contact with supplier services and/or products or with external customers who may be using the products and/or services. Internal stakeholder participation and satisfaction is key to a successful scorecard process. Another good practice is to select some suppliers to be involved in developing the scorecard process. Suppliers can provide valuable input into the business process, scorecard content and effectiveness.

The quantitative vs. qualitative quandary

Some think that only quantitative data derived directly from a business system database are valid for supplier performance measurement. However, even when quantitative data are available, they may be flawed or unreliable. For example, manufacturers who delay incoming inspection and leave on-time supplier shipments sit on the dock end up with incorrect data in the system. Human error can corrupt the data of any business system. Just because data come from a computer system doesn't mean that they are flawless. One company that I worked with used to spend many hours each month preparing its case to dispute the quality metrics on its customer's scorecard, which was created electronically. This supplier, by the way, finally decided to address its quality problems instead of spending resources attacking customer scorecard results.

At the other end of the spectrum, many organizations are still creating their scorecards using spreadsheets and manual data entry. Such scorecards are highly prone to error and to supplier challenges and disputes. Plus, most companies don't have the organizational discipline to maintain spreadsheet scorecards over time. Once the keeper of the scorecards leaves the position, the performance management system can fall apart. On the other hand, the extent to which human intervention is not required to produce a supplier scorecard can save a lot of time, especially if the scorecards are sufficiently accurate to avoid disputes with suppliers. This was the case for The Toro Company, which transitioned from a scorecard system that required manual interventions to a simpler, but more automated approach.

There are two reasons for throwing qualitative data into the mix. One is that an organization simply does not have access to sufficient, accurate quantitative data. The other is that qualitative data adds a richness of additional insights into performance by people who interact with a supplier. For example, qualitative information about performance may help customers understand both good and poor supplier performance in more detail. **Here are a few comments from a customer satisfaction survey as examples:**

- **Strength:** When we needed additional help, they sent staff from home office to be sure it was completed.

- **Opportunity:** Customer service must do a better job of identifying which projects are critical versus just regular orders

Or, in a scaled response supplier performance survey where deployment of best practices is rated on a scale of 1 to 5:

- The supplier uses a proactive rather than reactive approach to quality
- Suppliers are evaluated before being added to the approved supplier list

Scorecards can be structured with KPIs that reflect both quantitative and qualitative information. The quantitative and qualitative scores can be weighted to reflect their relative importance in order to create the KPI. For example, one can take quality scores and combine them with quality business practices:

KPI: Supplier quality = 96.6%

Quantitative: defect percentage –> 99.5% [weight = 80%]

+ Qualitative: quality best practices deployed –> 85% (scaled response scores) [weight = 20%]

When a multi-function supplier management team composed both of supply management and stakeholders reviews both qualitative and quantitative information, the breadth of their knowledge and experience can add the reality check about the accuracy and value of supplier scorecard results.

Leading and lagging indicators

Look at most supplier scorecards and you'll find metrics are

Measurement	Relevant	Measurable	Actionable	Leading/Lagging
Number of supplier inventory turns per year	0	1	0	Lagging
% on time delivery	3	3	3	Lagging
Customer satisfaction	3	3	3	Leading and/or Lagging
Number of supplier quality escapes to customers	3	2	3	Lagging
Number of new supplier partnership (FY to date)	3	3	3	Leading

0 = Does not apply   1 = Poor   2 = Acceptable   3 = Good

mostly lagging indicators. That is, the metrics reflect what has happened in the past and are not predictive of future performance. Quality and delivery are typically lagging indicators. Ideally, a supplier scorecard should contain some metrics that predict future performance. This allows an organization to anticipate and mitigate supplier performance issues rather than just react to them. For example, high levels of employee training and low employee turnover can be predictive of how motivated and capable the workforce is of contributing to a company's success and how well a supplier is run.

Leading indicators work best when viewed over time and in relation to a particular context. For example, customer satisfaction can be lagging (as in, how satisfied have our customer been in the past) as well as leading (when it can be correlated with another metric, such as customer retention). In a scaled-response scorecard, deployment of best practices can be predictive of future performance. The advent of big data and predictive analytics is well suited to developing leading indicators by crunching larger amounts of data in a system. For example, analysis of big data is beginning to be used to gain insights into supply chain risks embedded in the performance of key elements of supply chains and predicting the weak links and the most likely points of failure.

Three key criteria for choosing supplier metrics
The above table illustrates an approach to rating and choosing scorecard metrics. When choosing metrics, applying the following criteria helps support a scorecard process that gets results. Applying these 3 criteria to each proposed metric will help determine which will be the most productive. Review each proposed metric and ask whether a metric is:

1. Relevant
- Addresses an operational or strategic performance issue
- Relates to specific supplier performance expectations
- Is results or outcome focused
- Provides useful information to enable decision making by getting at the causes and issues behind problems

2. Measurable
- Quantifiable
- Enables analysis
- Can be done in a timely manner
- Data are available and collectable

3. Actionable
- Relates to a specific outcome
- Relates to process inputs and variables that can be controlled/ adjusted to address concerns
- Solves or prevents specific problems

One size doesn't fit all

One supplier scorecard may not be suitable for every supplier. Therefore, segmenting the supply base for performance management is important. In segmentation for performance management, one looks at the type of supplier, relative importance to the business, performance expectations for that type of supplier and then decides which metrics are needed to determine if the supplier is meeting expectations. Some scorecard customizing may be required for different types of suppliers, depending upon their importance and criticality. For example, supply managers are likely to have different performance expectations for an indirect supplier versus a direct supplier and thus will require different flavors of metrics.

One would expect more detailed performance monitoring and potential supplier development activities for a strategic supplier than for a bottleneck supplier. Strategic suppliers are the ones to look to for partnering, collaboration, performance improvements and reducing TCO (Total Cost of Ownership). Metrics for strategic suppliers would focus, for example, on quality, responsiveness, and reliability. Opportunities for supplier development and performance improvement might be important. Custom suppliers, on the other hand, are those suppliers who usually provide basic, but important services and products. Dependence upon them and switching costs are high. For these suppliers, close monitoring of service, availability and reliability metrics is most important. These suppliers typically lend themselves to dual sourcing.

Supplier Scorecards: a business process

Supplier scorecards are not effective as a standalone tool. They are part of an overall supplier evaluation and performance management business process. Many organizations focus primarily on developing and gathering metrics and designing the scorecards and give little or less thought to the business objectives, purpose and expected outcomes. The purpose of supplier scorecards is action and real supplier performance improvement, not to create a metrics museum to past performance. Scorecards can help enable relationships, productive dialog and improvement activity between customers and suppliers. Without a closed-loop business process supplier scorecards will be less successful and hard to sustain. Scorecards work best as part of a supplier performance management (SPM) business process. The follow summarizes the SPM process:

Closing the loop – SPM Business Process

The following are actual reasons that been given as to why supplier scorecards have not been successful in various organizations. When you think about them, they point to some of the traps you can fall into:

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What they said	What they meant
We do have scorecards, but we don't have time to give them to the suppliers.	Supplier performance management is an afterthought
We don't have time to calculate them [because we have to create them manually]	Our management hasn't fully committed to supplier evaluation
I'm the only one with access to them [because they reside on my computer] and they get distributed when I have time [which I rarely do]	Supplier scorecards aren't part of any regular business process
The data needs a lot of massaging first [and is not ready for supplier viewing before we manipulate it]	There's a real desire to have good scorecards, but they need further work to make them scalable and accurate
The suppliers will only argue about the data [because the data integrity is suspect]	We haven't committed to making our evaluation system really effective yet.
No one ever followed through on the action items, so we lost momentum	Only part of the process was put in place.
Our senior management never understood the ROI and value and disbanded the effort	We never had real senior management support

A word about implementing SPM software solutions
Some firms buy SPM software solutions as a way to implement supplier scorecards and performance management. SPM solutions provide much-needed workflows, analytics, tools, structure and scaling to the SPM process. They form a foundation that will help make SPM more sustainable and support a more robust ROI. These solutions are, however, an answer looking for a question. The scorecards are empty, waiting for metrics, KPI selection and data. These solutions derive their power from supporting a good business process. They work most effectively when organizations think through the business process and then use the software solution to support it.

Scorecards – carrots or sticks?
Some companies use supplier scorecards as sticks. For example, some integrate supplier scorecard metrics into the service level agreements in supplier contracts. If suppliers do not meet the SLAs, financial penalties are levied. Others use scorecards to weed out poor performers and reduce the number of suppliers. These are perfectly acceptable approaches. However, all sticks and no carrots may create a negative atmosphere and strained relationships with suppliers. And under the stick scenario, deriving the scorecard metrics better be airtight or scorecards will incite time-consuming conflicts and disputes rather than promote cooperation and add value. How about providing some carrots as carrots as well? By defining acceptable performance baselines and performance targets as well as what constitutes high performance, firms can use recognition and even rewards (such as the chance to pursue additional business when available) instead of fear to inspire better performance.

Where does your scorecard process stand?

Beginner	• Reactive approach to supplier performance problems • Little or no visibility into performance • Performance tracked inconsistently • No supplier segmentation • No stakeholder involvement outside of Procurement
Advanced Beginner	• Some supplier performance expectations identified • Stakeholder buy-in • Performance data sources identified • Metrics & KPIs identified • Limited scorecard deployment
Intermediate	• Scorecards developed to measure key suppliers • Scorecards regularly distributed • Some performance reviews with suppliers • Some performance improvement planning
Expert	• Regular performance reviews with key suppliers including 360° reviews of customer • Stakeholder participation • Corrective/preventive action process in place • Supplier recognition • Results inform qualification & selection process

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Key element to ensure success

- **Performance expectations should be communicated to suppliers.** Scorecards are more effective when suppliers are clear about the specifics of their customers' performance expectations.

- **Measure high-impact and important items.** Typically less meaningful metrics end up on scorecards because they are the most readily available. Scorecards should measure the "vital few" rather than the useful many.

- **Measurement with action.** The secret to successful scorecards is action. Action requires tracking and follow-up to ensure it occurs. Without it, supplier scorecards are ineffective.

- **A good performance feedback process.** Lobbing scorecards at suppliers goes only so far. Just as cornflakes are part of a complete breakfast and you can't live on cornflakes alone, scorecards are only as effective as the business process they are part of. Scorecard reviews with suppliers in a two-way flow of conversation is essential to success.

- **Communications and involvement.** Good communications with and involvement of stakeholders, including suppliers, is essential – before, during and after scorecards are implemented. Celebrate success.

- **Measurable results.** Senior management and stakeholders need to understand the ROI of supplier scorecards on a continuing basis. Capturing the value, such as tracking costs saved, costs and risks avoided, good ideas that are implemented (such as new offerings, improved products, improved processes, etc.) arising from supplier performance feedback meetings is an important part of an effective supplier scorecard process. Results should be shared regularly with senior management and stakeholders. If value is not captured or communicated to management, even when supplier scorecards work well and suppliers improve performance, scorecards can still fail if no one knows they're successful.

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