

DEVELOPING EXCEPTIONAL CUSTOMER ALLIANCES



***How to stand out from competition and
entrench your company with major customers***

By Jeff Temple

INTRODUCTION

One of the most important business trends in recent years is that of forming alliances or partnerships with major customers or suppliers.

There are several key drivers for the alliance trend:

- With little ability to pass along price increases to customers, businesses turn to suppliers for cost reductions.
- The current wave of industry consolidations leads to companies seeking cost reductions through purchasing leverage with major suppliers.
- Because retaining customers is generally more profitable than developing new ones, businesses seek partnership relationships to reduce customer attrition rates.
- As alliances have produced significant returns to companies that have employed this strategy, many businesses are following suit.

The results is a massive proliferation of “alliances” or “partnerships” (at least in name. In reality, the actual substance of these relationships varies widely). Many of these are driven by a customer’s competitive bidding process, and, to a lesser extent, many are initiated from the seller. From a sales perspective, it is becoming increasingly difficult to differentiate your “alliance” as a unique relationship.

Some companies initiate alliance programs to—despite any claims to the contrary—obtain lower pricing. Other companies see extended benefits such as reducing total cost, leveraging each party’s resources, or developing new technology. Regardless of the motivation, price is generally an important component of the deal and you must be competitive. However, price alone rarely wins the deal and while price must be addressed, expanding the breadth and reach of your alliance proposal is essential in being truly competitive.

In this article we identify ways sellers can distinguish themselves with unique alliances that offer an advantage over competitors. The concepts we present are not an exhaustive list or how-to manual. We focus mainly on ideas which are unique to alliances or which are rarely employed and can be uniquely effective.

These principles can help you win a competitive process initiated by your customer. You also may want to initiate some of these ideas with key customers when everything is going well—before they think of a competitive bidding process. Either way, these

ideas are designed to capture your customers’ attention, imagination, and ultimately their business.

WHEN A CUSTOMER CALLS

A customer-initiated alliance program is a unique opportunity to put forth bold, new, non-traditional ideas, while offering exceptional value to important customers. At the same time, it is an opportunity to secure unprecedented commitments from your customers. To achieve maximum benefits, you must show why an alliance with your company is the preferable to any alternative.

The best approach might be to avoid anything that would appear to be a standard template alliance which you employ with all of your major accounts. You must design an approach to be different than every other “partnership” presentation or proposal.

Many of the following ideas may be ones that you have experience employing with other customers. Hopefully, some of these ideas represent new thinking and are beyond what you would normally consider. Some of these ideas may be outright unfeasible in many organizations. However, we offer these in the interest of sparking creative thought, and spurring you to forge new ground.

TYPICAL “PARTNERSHIPS” IN THE MARKETPLACE

“Partnership” has many interpretations. Many so-called partnerships have the following elements:

1. Primary driver is to leverage volume for price discounts (even if this is unspoken, actions often belie the words).
2. Splitting business (80%-20%) much more common than sole sourcing.
3. Endorsement contracts common at corporate level, where suppliers are approved or endorsed by corporate, but no one supplier is given a specific commitment of business greater than their competitors. For example, at the corporate level, many companies will have general contracts with every supplier in an industry, leaving operating divisions to select suppliers independently.
4. Agreements ineffectively implemented because the group that negotiates the deal is often different than the group that makes it work on an operating level.
5. Contracts may be “long term”, but must be renewed annually, resulting in extra administration.
6. Parties often insist on “easy out” clauses.

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7. Incomplete follow-through by one or both parties after the deal is struck.
8. Over-commitments made in haste to strike a deal:
 - a) Seller agrees to anything to get deal, but leaves significant “gray area” to maneuver.
 - b) Buyer uses theoretical (exaggerated) volumes, which the seller never sees.
9. Typical contract process:
 - a) Buyer develops RFP and sends to multiple suppliers, asking for “best deal up front”. RFPs contain detailed terms and conditions, which are created up front by the buyer, with no participation from suppliers; supplier is asked to agree to the terms and fill in their price.
 - b) Suppliers prepare proposals, leaving room to negotiate because they know it will be expected.
 - c) Buyers immediately look to the “price page” of the proposal, and begin forming their negotiating strategy.
 - d) Buyer and seller negotiate terms.
10. Supplier labels it a partnership simply because they have had a customer for many years. Or, suppliers claim to have partnerships with all of their customers, offering no differentiation to any.

Flaws With Most “Partnerships”

These characteristics of some would call a “partnership” often have unintended and detrimental consequences. These include:

1. Time and energy spent on haggling over terms (who pays for the cost?) vs. working to lower total system costs (how can we improve the process?).
2. Competitive threats mandate that supplier spends significant time selling.
3. Lack of 100% commitment results in significantly less than 100% information sharing.
4. Ineffective implementation leads to great agreements on paper, without ever fully realizing benefits.
5. Divisions rarely embrace corporate agreements.
6. Willingness of buyer to back out at first sign of a possibly better option.
7. “Easy out” clauses mean that suppliers must always hedge their risk of losing business. This hedge comes at a cost. Also, the easier the out, the less information the two parties will tend to share.
8. Never complete trust and understanding between two parties.
9. Focus on price, delivery, and other basic terms, without ever considering more creative opportunities that may have greater total impact: strategy, marketing, research, etc.
10. Rigidity of RFP process reduces options for creating value.

CREATING YOUR PROPOSAL

Strategic Fit

Alliances can be particularly attractive when they address basic strategic interests. You must write a proposal that addresses the customer’s overall business direction. For example, your customer may focus on being the low cost producer. If you are not the low *price* seller, you must clearly demonstrate why your product’s performance is a bigger driver of overall costs than the actual item price.

On the other hand, your customer may seek to bring many products to market very rapidly. If this is the case, you may need to demonstrate manufacturing speed, flexibility, or advanced logistics capabilities.

Furthermore, you should attempt to demonstrate why your company’s strategic direction makes us a good fit for them. For example, we have found that companies looking for sole-source alliances rate market leadership as an important consideration. If you have specific plans to be a market leader in technology, service, product performance, or other areas, you can advance your cause by telling and selling your story. Points to emphasize include:

- New technology, products, and services
- Specific acquisitions that might relate to the customer
- International capabilities
- Research and development: What does the customer get in return for your investment (which comes out of their sales dollar)?

Term of Agreement

First think of a bold scope. Offering a broad, aggressive scope to the agreement gives you the opportunity to catch the customer’s attention, as well as garner a significant volume of business. We suggest looking at a minimum of five years, without the typical annual renewals. We also suggest limited “out” clauses for both parties. The greater the commitment, the more each party will be willing to commit in terms of resources, risk, capital, etc.

Capital Investment

Can your company target any capital investment specifically towards your customer? We suggest a thorough review of capital investments that are already planned, and include in the proposal a description of how this investment will translate into benefits for the customer. For example, you may have money targeted for new equipment at a specific plant, adding to the truck fleet, or upgrading field equipment. Could the spending be directed towards customer sites? Could the trucks be dedicated to the customer’s account?

It also helps to ask your customer to invest any capital as part of the deal. While some may shy away from making demands on an important customer, it can be done tactfully with tremendous benefits. First, it helps you determine whether your customer is serious about an alliance, or merely shopping the market for the best price. Second, a capital commitment will further embed the relationship over a long period of time (it is not easy to unwind from a capital investment). Finally, and most obviously, it can help your company defray your capital investment.

Why would the customer agree to this? Answer: you must make it worth their while by offering a total package that is compelling.

Risk Sharing and Management

Some of the more innovative and successful customer alliances involve sharing gains and risks. While gainsharing is not a new concept, risk sharing makes companies uneasy—most business people are risk averse. Often, however, the total system risk can be minimized by shifting burden from the higher-risk party to the lower-risk one. More importantly, willingness to share a customer’s risk is an important signal that you are committed to their success, understand their unique problems, and are willing to closely tie your financial interests to theirs.

Since most business people are trained to shun risk, it goes against almost every instinct to offer, up front, meaningful risk sharing. However, this represents an outstanding opportunity to offer something valuable which your customer might otherwise

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have to negotiate vehemently to obtain. This creative offer thus sets you apart from the pack, while providing additional negotiating leverage when it comes time to finalize the deal.

In looking at some of a customer's primary risks, you want to address specifically how you can either share or help manage these. For example, machine down-time might be a major business risk for many industries. If your company provides a critical part or service, you likely can have significant impact on a customer's down-time. Are you willing to share this in a meaningful way? You might be willing to pay a percentage of the customer's down-time cost. This would certainly focus your and the customer's interests in the same direction.

At first, this may appear to be a contract clause you would work hard to avoid, since it is so clearly in the other party's interest. However, this also represents an opportunity for you to stand out from the crowd. A commitment to risk sharing would show that you are serious about exploring the frontier of customer-supplier alliances.

In a long term alliance, another risk your customer faces is being locked into buying from you while another company develops superior technology (typically, better, faster, or cheaper products). Whether stated or not, every buyer factors this when making a long term commitment. You can mitigate this risk for your customer by guaranteeing the right to cancel the agreement should you not be able to offer a comparable product or service within six months. Your company is motivated to stay current. Your customer has an out, but the switching costs would give them the incentive to work with you first; the six month time frame affords that window.

What are the seller's primary risks associated with this type of agreement? First, the customer might not be sole source, giving you a fraction of the business upon which your proposal is based. Second, they might switch business to a competitor, or in some other way not live up to the agreement. You might be able to enforce the agreement, but then again, few companies survive on a strategy of strong-arming major customers. Another, more subtle aspect of this risk is the customer's mere *threat* of switching business from you to your competitor. This would cause you to react to the situation and divert resources into selling activities. You need to let your customer know that this commitment is important, and your ultimate package of services will be driven by the sincerity and depth of this commitment.

Best Practices Knowledge Sharing

If it is one of your top 2-3 customers, you could consider forming an internal Global Best Practices Council for your customer's industry, and offer them 2-3 membership seats—something you would not offer to their competitors. Your customer would feel they get the direct benefit of sharing this knowledge, exclusive of their competitors. You could justify this exclusivity in two ways. First, you could demand something significant in return—all of their business, as well as all of the other unique terms of the ultimate agreement. Second, it would not prevent sharing ideas with other customers; it merely would discourage it.

Joint Marketing

You can really catch a customer's attention by offering something they have never seen from any other vendor, such as a joint marketing program. This can take many forms.

Advertising: You commit a specific dollar amount towards advertisements featuring you and your customer. Parker-

Hannifin has employed this technique for years. The ads might convey how you minimize your customer costs and add value to *their* customers. The implied message is that you are a superior company. Both companies would gain marketing benefits from the ads. More importantly, you would create the impression that you are willing to try different and innovative things to help both businesses be more successful.

Targeting key customers: Are there any specific accounts that you share with your customer? Imagine the benefits you would get by simply spending a few days with the customer's sales people who have had success with a major target of yours. There may even be a creative way to structure a joint sales call.

New markets: Could your customer use their marketing channels to help you develop new markets (e.g., consumer products)? What would this be worth?

Joint Purchasing

You also might be able to explore opportunities to combine purchasing leverage to gain additional value with *other suppliers*. Often, companies find overlapping purchases in strategic areas, as well as common products and services: electricity, telecommunications, computer technology, freight, small package delivery (FedEx/UPS), travel services, maintenance supplies, etc.

Customer Surveys

You also might offer to survey key people within your customer's organization (purchasing managers, engineers, operators, accounts receivable clerks, etc.) every quarter. You could compile the results, then identify any necessary action steps to address issues identified in the survey. This would all be compiled into a report presented to management. This has several benefits. You get direct feedback from key people. Also, you have a chance to regularly demonstrate a proactive approach to identifying and solving problems. Finally, it will set you apart from competitors.

Another option might be to offer to fund a survey of your customer's customers. This type of survey has some obvious and direct benefits for your customer. In addition, there are two less obvious but important benefits for the seller. First, this survey would allow you to gain farther-reaching insights into what drives your customer's business. This is knowledge your competitors would not have. Second, by incorporating this unique knowledge into your formal and informal communications, you can speak to your customer with a voice that will resonate with their senior management.

International Collaboration

Does either party have international knowledge or expertise that might benefit the other? For example, you may have distribution channels into countries that your customer desires. This could include trading relationships with private businesses, or key government officials. It may also include warehousing, preferred freight contracts, or other logistics services.

Currency hedging may be another opportunity. Your company—either because of its size, particular expertise, or breadth of international operations—may have experience employing hedging strategies to reduce the risk of currency fluctuations. Your customer could benefit by either learning from their experience, or even possibly directly piggy-backing onto a hedging transaction. This could be a way that the customer could benefit from your abilities, at essentially no additional cost. This strategy can be employed even the business deal is entirely

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domestic and the hedging would apply to other areas of the business that are unrelated to the alliance.

Communication Channels

We have found great success by establishing formal communication channels as part of a supplier alliance program. This would include things such as annual executive reviews—the higher level each company can commit the better. It also might include operations performance reviews at each plant, as well as key contact people in both companies.

Asset Utilization

Another aspect of the proposal might be to have both companies, after signing the deal, compile a list of under-utilized assets: warehousing space, truck fleets, production capacity, etc. Then, the two companies could brainstorm to find creative ways to leverage each other's assets, providing value to both companies. As with many other points in this article, the opportunities to truly accomplish this might be rare; but, if you find them, the benefits can be tremendous. Furthermore, asking questions and proposing ideas on all of these issues can have a cumulative, positive effect on your customer: showing that you are creative and willing to "think out of the box."

Finance

In many "partnerships" we see buyers who use their leverage to stretch payment terms out as long as possible, demanding 60 or even 90 days. Some even take this to an extreme: if the seller offers 1%10, net 45 days, the customer will pay in 45-60 days *and* take the discount. This one-sided approach of forcing market power on a supplier may work if you are an important customer, yet it often does not lower costs. Sellers are generally very skilled at making up the difference elsewhere, which gives the buyer hidden costs.

We recommend a different approach. The company with the lower cost of capital and more debt flexibility can bear a stretch in payment terms at the least cost (whether extending terms when the seller has lower capital costs, or shortening terms when the buyer's costs are lower). The seller and buyer are then faced with the task of dividing the savings, rather than using buying leverage to raise the other party's cost of capital. This thinking can be extended beyond payment terms to financing inventory, again based on the party who has the lower cost of capital.

If you plan to make creative finance part of your alliance, be prepared to do some selling. Payment terms that go outside the norm (e.g., net 7 days if you are the buyer; or net 75 days if you are the seller) will often require involvement and approval from senior financial executives—both yours and your customer's. In addition, financing inventory for a customer is not a common practice, and will require additional administration. However, in a large commercial deal, the benefits are often well worth the extra work.

Research and Development

Another possibility would be a joint research and development program. Researchers from both companies could work together on specific projects that would provide value to both companies. There might even be opportunities to license technology that this joint research produces. Another aspect of R&D might be combined support of university research programs. If this is something both companies invest in today, why not consider a joint program?

CATCHING YOUR CUSTOMER'S ATTENTION

When formally presenting your alliance proposal to your customer, you may consider trying a non-traditional format to catch their attention. The key is to set this apart from other alliance programs, including "partnerships" offered by your competitors and other non-competing suppliers. We have seen suppliers have the greatest degree of success by making the deal look and feel truly unique.

It may be obvious why you would want to distinguish your company from competitors, but why be interested in your customer's non-competing suppliers? Most companies that seek to form supplier alliances look to multiple areas. If your customer has approached you about a potential alliance, chances are they are looking to do the same with other suppliers. Even if you are not competing in terms of products and services, you are competing for your customer's vision of what a standard-setting alliance should look like. We have seen many cases where a supplier has captured this vision, creating an atmosphere where senior management compares every other supplier against this benchmark. You can even create an expectation in senior management that it would be risky and foolish to do business with anyone else.

If you have alliances with other customers, you should also look to set this apart. If a customer perceives that you have a standard formula and packaging for an "alliance," they will not feel that they are achieving anything truly unique.

CONCLUSION

Customer and supplier alliances are a reality of today's marketplace. Most of these alliances center around purchasing volume leverage and order administration processes. Very few alliances extend outside the bounds of the seller's accepted policies and procedures. However, buyers are willing to offer long term contracts and sole supplier relationships, provided they gain something significant in the process. While price reductions are generally a key aspect of what buyers are seeking, we have seen many sellers miss significant opportunities to distinguish themselves and win major business through alliances. By including some of the concepts we have outlined (along with a competitive price), you can set yourself apart and capture the attention, imagination, and ultimately the business of major customers.

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