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Big Gains With Small Partners
What MNCs Look For in Their SME Suppliers

TRADE, INVESTMENT POLICY AND INTERNATIONAL COOPERATION

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Big Gains With Small Partners: What MNCs Look For in Their SME Suppliers
by *Tim Krywulak* and *Vadim Kukushkin*

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Preface

Big Gains With Small Partners examines what multinational corporations (MNCs) look for in their small and medium-sized enterprise (SME) suppliers, and how MNCs can develop sustainable value chains by effectively incorporating the key capabilities of their SME partners. The report is based on a literature review; interviews with 12 MNC procurement executives and eight owners and managers of SME suppliers; an online survey with over 70 SME owners and managers; and three multi-stakeholder roundtables with senior executives and procurement managers from MNCs, owners and managers of SMEs, representatives of industry associations, and officials from federal government departments and agencies involved in procurement and international trade policy. This report presents insights about the best practices for MNCs in partnering with SME suppliers and how MNCs can manage their supplier relationships for the benefit of both the MNC and its SME partners.

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EXECUTIVE SUMMARY

Big Gains With Small Partners
What MNCs Look For in Their SME Suppliers

At a Glance

- Multinational corporations (MNCs) that incorporate small and medium-sized enterprise (SME) suppliers into their value chains can achieve improved productivity, increased innovation, access to new markets, and other benefits.
- For MNCs, the keys to creating successful MNC-SME value chains include selecting SME suppliers based on the best fit with their needs, connecting with SMEs through a range of innovative mechanisms, and building long-term collaborative partnerships.
- MNCs, SMEs, governments, and other stakeholders can all play a role in expanding and enhancing MNC-SME value chain connections.

The success of multinational corporations (MNCs) increasingly hinges upon the strength and vitality of their global value chains. In today's world of integrative trade, leading MNCs recognize that building an effective value chain involves more than simply outsourcing a few peripheral inputs to the lowest bidders whenever a need arises. It calls for building stable and sustainable relationships with high-performance partners that have the ability to make substantial contributions to everything from product design to customer service. Small and medium-sized enterprises (SMEs) are often well positioned to make such contributions. Working with SMEs can assist MNCs in increasing productivity, driving innovation, accessing talent and markets, adapting to changing conditions, and more.

Although some MNCs have made excellent progress in developing collaborative partnerships with SMEs, there is still more that they can do. The objective of this report is to help foster such partnerships by examining what MNCs look for in their SME suppliers. The key findings and recommendations for next steps based on this research are summarized below.

KEYS TO SUCCESSFUL MNC-SME VALUE CHAINS

SELECT SME SUPPLIERS BASED ON THE "BEST FIT" WITH MNC NEEDS

When selecting SME suppliers, MNCs look at a range of product, company, and corporate responsibility criteria. The specific mix of criteria is determined by the nature of the value chain and the product in question. Price, for example, is often the main criterion for basic services and raw materials. Quality is relatively more important for complex, high value-added services and finished goods. And delivery can be essential for products in time-sensitive industries such as high-tech manufacturing and software engineering.

Although selection and performance measurement criteria vary by value chain and product, MNCs assess all suppliers using the same types of criteria, regardless of size. There are no separate criteria for SME suppliers. Indeed, most MNCs do not categorize or track suppliers by size at all. This indicates that SMEs can expect to have the same chance of winning a contract as any other company, so long as they meet the required standards of service delivery.

SME suppliers that focus on their core competencies have the best success in partnering with MNCs. As small companies with limited resources, SMEs need to target their efforts toward those areas where they can bring the greatest value to their clients. SMEs can also make the best of each opportunity for a connection by having a solid understanding of both the needs of their potential MNC partners and how their value proposition as a supplier fits in with those needs.

CONNECT WITH SME SUPPLIERS THROUGH A RANGE OF INNOVATIVE MECHANISMS

MNC methods for connecting with SME suppliers vary by product and value chain as well. Online resources—including supplier application forms, supplier portals, e-auctions, and e-tenders—are among the fastest growing methods for connecting, with their relatively low administrative costs and ability to provide readily accessible supplier information. Other methods of connection include networking, advertising, subcontracting, and supplier diversity programs.

More MNCs may wish to consider partnering with SMEs through supplier diversity programs. Although they are now well established in the United States, such programs have yet to be widely adopted in Canada. These programs provide MNCs with the opportunity for raising their profile in previously untapped markets and give minority-owned SMEs a chance to get the attention of larger customers. For these programs to succeed, however, selection and assessment criteria must remain the same as in the MNC's standard supplier relationships.

BUILD LONG-TERM COLLABORATIVE PARTNERSHIPS WITH SME SUPPLIERS

Once a connection has been made, MNC supply chain executives and managers have limited time for considering proposals from any one supplier. SMEs therefore have to make the best of those opportunities when they get the attention of these officials. To do so, SMEs should develop a realistic niche marketing strategy based on their distinctive value proposition. In other words, smaller companies need to understand not only their own strengths, but also the nature of the MNC's value chain, and then market themselves accordingly.

Diversity programs provide MNCs with the opportunity for raising their profile in untapped markets and give minority-owned SMEs a chance to get the attention of larger customers.

Finally, in order to improve the productivity and performance of their value chain, many MNCs are consolidating their supplier base and replacing short-term, transaction-based relationships with long-term collaborative partnerships with their suppliers. This trend has created both challenges and opportunities for SMEs. In consolidating their supplier base to reduce administrative costs and supply chain risks, MNCs have become more selective in choosing their suppliers. This, in turn, has made it more difficult to become their supplier. But having fewer suppliers also means that MNCs can take greater interest in the long-term success of their partners. This is reflected in the fact that MNCs are now much more likely to invest in their suppliers by providing expertise, financing, and other forms of assistance.

PROMOTING EFFECTIVE MNC-SME VALUE CHAIN CONNECTIONS

There are a range of actions that MNCs, SMEs, and governments can undertake to promote more effective MNC-SME value chain connections. MNCs can begin by increasing their awareness of SME suppliers and making a sustained effort to connect with them as sources of productivity, innovation, talent, and other benefits. They can also strengthen their own value chains by investing in supplier development and adopting a collaborative approach to supplier relationships. By working to create value with their partners, MNCs can improve their competitive position and ensure their long-term success.

An SME should seek to be the best it can be in the areas of its greatest strengths and ensure that it communicates its main value proposition.

Empowering the supply chain leadership is another component of success for MNCs. The top supply chain leaders (e.g., vice-presidents of supply chains, chief procurement officers, and those holding other similar positions) should have a place in the organization that reflects the strategic importance of their role, including a direct reporting relationship with the chief executive officer. Only then can they fully leverage their knowledge and capabilities for the benefit of the organization as a whole.

For their part, SMEs should focus on developing and marketing their core competencies. An SME cannot be "all things for all people," nor should it try. Instead, it should seek to be the best it can be in the areas of its greatest strengths and ensure that it communicates its main value proposition (i.e., the specific benefits it offers to its customers) in a clear and succinct way.

Governments can contribute as well. While this study outlines the general framework of the MNC-SME value chain relationship, governments can help to provide further research on the differences across specific industry sectors. Governments can also encourage more MNC-SME partnerships by creating opportunities for MNCs and SMEs to connect through trade fairs, conferences, and other events. Government agencies such as the Business Development Bank, Export Development Canada, the Canadian Commercial Corporation, and others can continue to assist SMEs by improving their access to financing, expanding their linkages to international markets, and assisting them in navigating the complexities of the MNC procurement process.

CHAPTER 1

Introduction

Chapter Summary

- A multinational corporation's (MNC's) innovative capacity and competitiveness are directly linked to the characteristics and capacities of its value chain partners.
- Leading MNCs have moved from an adversarial to a collaborative model of supplier relationships to build more effective value chains.
- Small and medium-sized enterprises can access international markets, increase their competitiveness, and achieve other benefits by working within MNC value chains.

The global business environment has changed dramatically over the past three decades. Declines in transportation, communications, and information management costs have reduced the importance of distances, while reductions of tariff and non-tariff barriers to trade and investment have eased the movement of goods and services among countries. These developments have enabled businesses to reduce costs and maximize returns by strategically sourcing production to connect with innovative partners wherever they may be found.

Today's leading multinational corporations (MNCs) thus no longer operate as self-contained units that own and control most aspects of their production process; rather, they operate as the lead firms in global value chains comprising a network of other firms that contribute to everything from product design to customer service. This new way of doing business has generated dramatic gains in productivity and international trade. But it has also created new challenges for MNCs, their small and medium-sized enterprise (SME) suppliers, and the Canadian economy at large.[1]

Strategic MNCs understand that their ability to innovate and compete is directly linked to that of their suppliers.

While much has been written about what SMEs need to do to be successful, there has been less attention to the question of what MNCs can do to forge more effective value chain connections with SMEs. This imbalance mirrors the perceived asymmetry in the MNC-SME relationship. As the "leading firms" in global value chains, it is often assumed that MNCs need not concern themselves with creating effective partnerships with SMEs. Since MNCs are the few big buyers, it naturally falls to the many SME sellers to do "whatever it takes" to make the relationship work.

Our research suggests that this assumption is incorrect. Strategic MNCs understand that their ability to innovate and compete is directly linked to that of their suppliers.

1 On the emergence and expansion of global value chains, see De Backer, "Growth and Impact of GVCs," pp. 1–9; Hodgson, *Making Integrative Trade Real*, pp. 1–2; and Gattorna, "Supply Chains Are the Business," p. 43.

They also recognize that the best way to ensure innovation and competitiveness is to move from an adversarial to a collaborative approach in dealing with their suppliers, replacing short-term transactional relationships with long-term partnerships. In both good times and bad, innovative, cost-effective, and reliable partners can be hard to find.

THE MNC PERSPECTIVE ON SME SUPPLIERS

MNCs are pragmatic. They will do business with a company of any size that can help them to solve business problems. Many SMEs have the ability to do just that. Smaller operators often have lower overhead costs, specialized knowledge, innovative products, and the ability to adapt quickly to changing conditions. These benefits can give MNCs an edge in the international market, where competition is increasingly intense.[2]

Forging effective relationships with SMEs is not always easy for MNCs. Because the competitiveness of an MNC's value chain affects its viability in a very direct way, MNCs need to ensure that each value chain partner is carefully screened, selected, and monitored on an ongoing basis. No large company can be expected to take a chance on an SME just to "help it out." Nor will it maintain a business relationship with an SME if the smaller company cannot measure up to the necessary standards for quality, price, and delivery. An MNC may, however, find it beneficial to create and maintain such a relationship if the SME can provide an important innovation, resource, or product on a competitive and reliable basis.[3]

Key Definitions

Multinational corporations (MNCs) are companies that have operations in more than one country. Though MNCs can be large or small companies, the MNCs studied in this report include only large enterprises employing more than 500 people.

Small and medium-sized enterprises (SMEs) are defined differently in different countries and regions. In Canada and the U.S., small enterprises are defined as companies that have 99 employees or less; medium-sized enterprises are defined as companies that have between 100 and 499 employees. This report adopts the Canadian and U.S. definition.

Supply chains include the processes, systems, and organizations involved in producing a product for end use. Like value chains, supply chains may involve a single organization or multiple partners. Typically, however, the term "supply chain" is used to refer to the operational aspects of production, whereas the term "value chain" is used to refer to the broader range of activities involved in adding value to an organization's output (e.g., research and development, administrative support, and aftermarket service).

Value chains comprise the range of activities involved in bringing a product from conception to production, distribution, end use, and beyond, with each activity adding value to the product. Global value chains may be internal to a single organization or may involve multiple partners, but must span more than one country. This report deals with global value chains that involve multiple partners.

Sources: Industry Canada, "When Is a Business Small?"; The Conference Board of Canada.

Because the competitiveness of an MNC's value chain affects its viability directly, MNCs need to ensure that each partner is carefully screened, selected, and monitored.

THE SME PERSPECTIVE ON PARTNERING WITH MNCs

The globalization of trade and investment has also generated tremendous opportunities for SMEs, opening markets and creating possibilities for expansion. While some SMEs directly engage in foreign trade, others link with international markets by entering the value chain of an MNC. Compared with "going it alone," partnering with MNCs provides advantages such as:

- increased sales and enhanced firm reputation;
- access to new markets through the MNC's established channels;
- leveraging the MNC's technical knowledge and other expertise;
- improved quality and productivity to meet MNC supplier standards; and
- a stronger base for future growth.[4]

2 The Conference Board of Canada, Leaders' Roundtables.

3 Ibid.

4 OECD, *Enhancing the Role of SMEs*, pp. 4–5, 65.

REPORT OBJECTIVE

The objective of this report is to assist in promoting more and stronger MNC-SME value chain connections by examining what MNCs look for in their SME suppliers. To do so, it explores:

- why MNCs work with SMEs;
- how MNCs connect with SMEs;
- the criteria MNCs use to select SME partners; and
- the ways in which MNCs build effective long-term partnerships with SMEs.

MNCs will benefit from this report by learning of the best practices in partnering with SME suppliers; SME suppliers will benefit by gaining insights not only on what MNCs look for in their SME suppliers but also on the ways in which MNCs manage their supplier relationships.

A companion report, *Small Companies, Big Connections: The Benefits and Challenges for SMEs in Working with MNCs*, explores the process of forging effective value chain connections from the SME perspective. It focuses on the main opportunities and challenges for SMEs in partnering with MNCs. Together, the two reports form part of a larger project aimed at developing stronger and more effective value chains for the benefit of MNCs and SMEs alike. (See box "Project Description: Forging Effective Value Chains in the New Global Environment.")

Project Description: Forging Effective Value Chains in the New Global Environment

This report forms Part One of a two-part study on forging effective value chain connections in the new global environment. Part Two consists of a second report, *Small Companies, Big Connections: The Benefits and Challenges for SMEs in Working with MNCs.*

The overall objectives of this research project are to:

- assist MNCs in connecting and building relationships with SME suppliers;
- assist SMEs in tapping into the global marketplace through the value chains of MNCs;
- demonstrate how MNCs and SMEs can foster effective long-term partnerships with one another; and
- benefit Canada by improving the performance and profitability of its MNCs and SMEs.

RESEARCH ACTIVITIES

The research for the two reports is based upon a review of recent literature; interviews with 13 MNC procurement executives and managers; interviews with seven owners and managers of SME suppliers and industry representatives; an online survey with over 70 SME owners and managers; and three multi-stakeholder roundtables with 45 senior executives and procurement managers from MNCs, owners and managers of SMEs, representatives of industry associations, academic experts in supply chain management, and officials from federal government departments and agencies involved in procurement and international trade policy. The interviews and online survey were conducted from October 2008 to March 2009, and the multi-stakeholder roundtables were held in Toronto, Montréal, and Calgary in February and March 2009.

CHAPTER 2

MNC-SME Global Value Chains
Making the Connection

Chapter Summary

- MNCs can gain productivity, innovation, adaptability, and other benefits by working with SMEs.
- To connect with SMEs, MNCs employ traditional channels such as networking, advertising, and higher-tier suppliers, as well as newer mechanisms such as online resources and supplier diversity programs.

WHY MNCs WORK WITH SMEs

MNCs reap benefits such as improved productivity, enhanced innovation, expanded access to talent, and more by working with SMEs. (See box "How MNCs Can Benefit From Partnering With SMEs.") For both partners, the key to making a successful connection is finding the right fit between the MNC's needs and the SME's strengths.

The precise mix of benefits that an MNC looks for from its SME partners varies according to the characteristics of its value chain and the nature of the product being purchased. Different types of value chains and products result in different types of value chain relationships, MNC expectations, and potential benefits for SME partners. (See box "Differences Across the Value Chain Continuum: How Value Chains Affect Expectations, Relationships, and Benefits.")

PRODUCTIVITY

MNCs look for SMEs that are reliable, cost-efficient suppliers of goods and services that the MNCs cannot provide for themselves at a lower price.

Because of their lower overhead costs, smaller companies can often do some things more efficiently than larger ones.

A common business axiom says that companies should focus on what they do best, as doing so enables them to channel their resources into those activities that generate the greatest return. An information technology (IT) company, for example, can maximize its productivity by concentrating on its primary area of business while hiring suppliers to provide for marketing, payroll management, building maintenance, and perhaps even some of its non-core IT business, rather than trying to do everything for itself. The suppliers of this company, in turn, also benefit by focusing on their particular strengths, making all firms in the value chain more productive.[1]

SMEs are particularly well positioned to collaborate with MNCs to improve productivity. Because of their lower overhead costs and ability to specialize in certain niches, smaller companies can often do some things more efficiently than larger ones. In fact, in a survey of more than 50 representatives from 12 MNCs by the World

1 The Conference Board of Canada, Interviews with MNCs.

Business Council for Sustainable Development (WBCSD), 60 per cent of the respondents said that achieving lower costs was among the benefits their company derived from engaging with SMEs.[2]

How MNCs Can Benefit From Partnering With SMEs

- **Productivity**—increase efficiency by focusing on core competencies and reducing costs.
- **Innovation**—incorporate groundbreaking ideas, products and services.
- **Managerial talent**—access new sources of knowledge, skills, and abilities.
- **Adaptability**—improve abilities to respond to changing conditions.
- **Firm reputation**—enhance the firm's stature in the community.
- **Risk mitigation**—reduce threats to corporate performance and profitability.
- **Market access**—branch into new foreign and domestic markets.

INNOVATION

MNCs look for SMEs that clearly and succinctly demonstrate the business value of their innovative ideas, goods, and services.

MNCs can achieve higher efficiency, increased sales, and other business goals more effectively as a result of innovations provided by SME partners. To access such benefits, however, they must be open to providing SMEs with opportunities to earn their business. Conversely, SMEs must be prepared to earn such business by backing up their product claims with hard evidence.

The partnership between a large mining and manufacturing MNC and an SME supplier of pump seals shows how such partnerships can emerge under these conditions. The MNC was experiencing difficulties with some of the glycol pumps used in the temperature control system within its mines because of the accumulation of

Differences Across the Value Chain Continuum: How Value Chains Affect Expectations, Relationships, and Benefits

There are three main types of value chains: producer-driven, buyer-driven, and hybrid. The value chain that develops in each case depends on the industry, product, and lead firm in question. Some industries and products encourage long-term and close-knit relationships between partners; others involve shorter-term transactional relationships. There are also differences among firms, with some preferring long-term and close-knit partnerships more so than others. Then there is the question of where each supplier "fits" into the value chain of the MNC—whether this may be in research and development, production, marketing, or some other area. All of these factors influence the lead firm's expectations, the nature of its relationship with the suppliers, and the main benefits received by the suppliers. The table below illustrates the differences in buyer expectations, relationships, and benefits in the "production branch" of typical producer-driven, buyer-driven, and hybrid value chains.

	Producer-driven value chains	Buyer-driven value chains	Hybrid value chains
Industry examples	• automobiles • communications	• apparel • food processing	• electronics • semiconductors
Main buyer expectations	• technical capabilities • research and development • capital investment	• design capabilities • marketing capabilities • competitive costs	• responsive and information-driven production and distribution capabilities
Essential features of supplier relationships	• highly integrated • lead firm exercises close control over production process	• decentralized • lead firm purchases products from largely independent suppliers	• multiple power centres working in collaboration • no dominant firm
Main benefits for suppliers	• acquisition of knowledge • stability of demand	• opportunities to access new markets	• flexibility

Sources: Abonyi, *Integrating SMEs*; The Conference Board of Canada, Leaders' Roundtables.

2 The Conference Board of Canada, Leaders' Roundtables; WBCSD, *Promoting Small and Medium Enterprises*, pp. 12, 14.

particulate matter and subsequent corrosion, requiring regular checkups and frequent (sometimes monthly) replacements. The MNC's procurement manager was approached by a small business that claimed to make a better seal. The manager was initially skeptical, but accepted an offer to have a free sample seal installed by the supplier on a trial basis. The results were impressive. "We tried the seal," the manager explained, "and after three months it was still in perfect condition. Now this supplier services all our five operations, and normally seals last even longer than three months."[3]

Another reason why MNCs value innovation is that the most innovative SMEs also tend to be the most competitive and adaptable partners over the long term.[4] In fact, according to the vice-president of a large retailer, innovative capacity was "the one thing above all else" that he looked for in his SME suppliers. As he put it, "Just because a supplier is meeting our needs today does not mean that they will meet our needs in the future—unless, that is, they innovate. They need to have a culture that encourages talent development and innovative approaches to business."[5]

MANAGERIAL TALENT

MNCs look for SMEs with talented personnel that contribute to the success of the value chain.

Talented small and medium-sized business owners and managers can bring tremendous entrepreneurial, managerial, and leadership skills to their MNC partner. At the same time, SME entrepreneurs can profit from the increased revenues, resources, and reach that come from partnering with an MNC.

Geek Squad's partnership with Best Buy demonstrates the possibilities for mutual gain in combining an SME's talents with an MNC's resources. Robert Stephens founded Geek Squad in Minneapolis in 1994, with the idea of supplying computer support services to businesses and consumers that did not have the time and expertise to set up and maintain their computer systems. Stephens developed a winning business model by creating a distinctive brand and offering quality service, fast turnaround times, and competitive flat-rate pricing.

Negotiations for a partnership between Best Buy and Geek Squad began in 2000. For Best Buy, the main attraction was the opportunity to turn its computer support services, something that made very little money for the company and tended to annoy its customers, into a profit centre that would keep customers happy. The collaboration succeeded. When Best Buy acquired the company in 2002, Geek Squad had 60 employees and $3 million in annual revenues. Four years later, it had more than 12,000 employees and $1 billion in revenues, more than $280 million of which went directly toward Best Buy's bottom line. Furthermore, in Stephens, Best Buy acquired a leader who, as Best Buy CEO Brad Anderson put it, became a major contributor to "the service culture" that was being built across its entire organization.[6]

Stephens developed a winning business model by creating a distinctive brand and offering quality service, fast turnaround times, and competitive flat-rate pricing.

Studies by The Conference Board of Canada, the Organisation for Economic Co-operation and Development, and others have shown that managerial talent is a key factor in an SME's success.[7] Not surprisingly, SMEs with high levels of managerial talent are better able to seize opportunities, such as entering international markets, and meet a host of business challenges, such as increasing productivity and mitigating risks. As several interviewees noted, these skills and abilities are critical for meeting the high expectations of MNC partners.[8]

3 The Conference Board of Canada, Interviews with MNCs.

4 See Fischer and Reuber, *Survival of the Fittest*, p. 8.

5 The Conference Board of Canada, Interviews with MNCs.

6 On Best Buy, see Smith, "Geek Squad;" and Tapscott and Williams, *Wikinomics*, pp. 239–248, 336.

7 Fischer and Reuber, *Survival of the Fittest*, pp. 12–15; OECD, *Management Training in SMEs*; Expert Group on Future Skills Needs, *SME Management Development in Ireland*.

8 The Conference Board of Canada, Interviews with MNCs.

ADAPTABILITY

MNCs look for SMEs that have the capacity to assist MNCs in adapting to change.

Customer needs and business conditions can change rapidly, and MNCs sometimes rely on SME partners to assist in responding to these changes. This is why the need for "adaptability," "agility," and "flexibility" were cited as supplier requirements by several interviewees. The form of adaptability required varied across companies and included the ability to expand capacity, develop new product lines, change product specifications, and speed up product delivery.[9]

Access to a large and diverse network of potential SME partners also helps MNCs adapt to change. Companies that employ fewer than 100 people represent 97.8 per cent of all businesses in Canada, while those that employ between 101 and 499 account for another 1.9 per cent.[10] These businesses provide a wide range of goods and services to all sectors of the economy, enabling MNCs to benefit from competition and choice among suppliers. Moreover, as one interviewee noted, in tougher economic times, struggling MNCs can be especially inclined to look toward leading-edge SMEs for breakthrough product ideas to help them cuts costs and increase sales.[11]

FIRM REPUTATION

MNCs look for SMEs that contribute to achieving business objectives while strengthening the local community and enhancing the MNC's reputation.

In the WBCSD's survey of more than 50 MNC representatives, 71 per cent of the respondents cited "improved reputation with the local community" as a benefit of working with SMEs.[12] Mining corporations have become leaders in MNC engagement with local SMEs, a practice that helps them support the communities in which they operate, promotes sustainable development for the future, and enhances the firm's standing in the local area. As many of these companies now recognize, working with the local community in this way is not just "the right thing to do," it is also essential for generating the goodwill that enables them to carry on their work.

Diavik Diamond Mines Inc., a Rio Tinto subsidiary based in Yellowknife, is one example of successful local partnering. Early in the project development, Diavik committed to providing significant training, employment, and business opportunities to residents of the Northwest Territories and the West Kitikmeot region of Nunavut. Diavik formalized these commitments in 1999 in a socio-economic monitoring agreement (SEMA), which it entered into with five local Aboriginal groups and the Government of the Northwest Territories.

The form of adaptability required varied across companies and included the ability to expand capacity, develop new product lines, and change product specifications.

Under the SEMA, Diavik agreed to maintain a 40 per cent northern workforce and a 38 per cent ratio of northern purchasing during the construction phase of its project. In the end, Diavik actually reached 44 per cent northern employment and 74 per cent in northern purchasing. The result was the direct creation of hundreds of local jobs and contracts worth $900 million with northern companies, including approximately $600 million with Aboriginal companies.[13]

RISK MITIGATION

MNCs look for SMEs that manage their own risks and assist MNCs in doing the same.

Because of the global scope of their operations, MNCs have a heightened exposure to risk. In a 2006 survey of 151 large U.S. companies by Accenture, 73 per cent of the respondents reported experiencing a supply chain disruption in the previous five years. Of those, 32 per cent took between one week and one month to recover and 36 per cent took more than one month. Ninety-four per cent said

9 Ibid.

10 Industry Canada, "How Many Businesses?"

11 The Conference Board of Canada, Interviews with MNCs.

12 WBCSD. *Promoting Small and Medium Enterprises*, pp. 13, 14.

13 See Diavik, "Community Investment" and "Building Northern Communities."

that the disruption had a negative impact on profitability and customer expectations. Problems related to suppliers, raw materials, and natural disasters were the most commonly cited causes of supply chain disruption.[14]

According to interviewees and roundtable participants from several industries, SMEs can help MNCs mitigate risk in several ways. To begin with, since MNCs are likely to be among their largest customers, SMEs have a strong incentive to manage the risks to this relationship and provide their MNC partners with priority treatment during a crisis situation. Secondly, because many smaller firms are "owner/operator" enterprises, the person hired is often the person who actually does the work. There is much less chance for what is sometimes referred to as a "bait-and-switch," in which a senior person negotiates a contract with a buyer but a junior person is tasked to do the work. And thirdly, by having multiple SME suppliers for strategic resources, MNCs can have greater assurance that such resources will be available even if one of its suppliers is unable to deliver for some reason.[15]

MARKET ACCESS

MNCs look for SMEs that can help tap into markets that may otherwise be difficult to access.

SMEs often have connections and knowledge that can assist MNCs in reaching new markets. Those that have links with foreign affiliates provide one such example. In addition to having established relationships with other companies in foreign markets, these SMEs typically have a solid understanding of the prevailing languages, cultures, and conditions in such markets. The opportunities in this area for MNCs are considerable. Sales by Canadian-owned, non-bank foreign affiliates reached $371 billion in 2001. Foreign affiliates in the U.S. accounted for 63 per cent of these sales, while those in the European Union accounted for 21 per cent and in other countries accounted for 11 per cent. Large companies with over $500 million in market capitalization represented 3 per cent of the total number of foreign affiliates, but accounted for 46 per cent of total sales; smaller companies accounted for 78 per cent of foreign affiliates and were responsible for 13 per cent of the total sales.[16]

14 Accenture, *Keeping Ahead of Supply Chain Risk*.

15 The Conference Board of Canada, Interviews with MNCs; Leaders' Roundtables.

16 Marth, *Foreign Affiliates Trade Statistics*, pp. 6–9.

HOW MNCs CONNECT WITH SMEs

Once an MNC has identified a new sourcing need or decided to switch suppliers, the next step is to reach those companies that can supply the required product. This can be done using traditional channels such as networking, advertising, and higher-tier suppliers, or through newer mechanisms such as online resources and supplier diversity programs. (See box "How MNCs Connect With SME Partners.") The methods employed in each case vary, depending on which best serves the MNC's business strategies and needs.

NETWORKING

MNCs connect with SMEs through contacts established via business associates, personal acquaintances, and industry associations, as well as conferences, trade shows, and other events.

Since MNCs are likely to be among their largest customers, SMEs have a strong incentive to provide their MNC partners with priority treatment during a crisis situation.

Networking includes connections through prior contacts, or at conferences, seminars, trade shows, industry fairs, and other events. These connections enable MNCs to identify potential suppliers and explore options for forming new partnerships. As one procurement executive in the tourism industry explained, "It is up to our purchasing managers to know their areas of business, and to know who can supply the products that meet our needs in those areas."[17]

Making a connection through networking offers two main advantages. First, suppliers thus identified usually have an established relationship or track record with the

17 The Conference Board of Canada, Interviews with MNCs.

How MNCs Connect With SME Partners

- **Networking**—formal and informal networks of contacts.
- **Advertising**—postings in newspapers, trade journals, and other publications.
- **Higher-Tier suppliers**—subcontracting work to other large, medium and small-sized suppliers.
- **Online resources**—Internet-based supplier application forms, portals, e-auctions, and e-tenders.
- **Supplier diversity programs**—developing connections with minority-owned SMEs.

purchaser, or at least a reference from a trusted source. These factors can be essential in providing the purchasing firm with the confidence it requires for dealing with suppliers in sensitive areas such as accounting or legal services, and can also be useful in ensuring a smooth supplier relationship in procuring important basic services such as snow removal. Second, when a reliable supplier is needed quickly, networking can be a cost-effective method for finding one in an efficient way.

There are, however, some instances where networking is less than ideal. It requires the purchaser to have a contact with a supplier in the industry in which it is seeking a particular good or service, which may not necessarily be the case. It also may not provide a wide enough pool of potential suppliers for instances in which the purchaser wants to engage a large number of bidders to arrive at the optimal combination of product, company, and corporate responsibility criteria.

ADVERTISING

MNCs connect with SMEs through ads in newspapers, trade journals, and other publications.

Many MNCs find suppliers by advertising requests for proposals (RFPs) or requests for quotes (RFQs) in newspapers, trade journals, and other publications. Advertising can be a particularly effective tool when an MNC wants to cast a wide net in search of potential suppliers, in the hope of either generating the best value or of connecting with suppliers in an area of business where it may not already have extensive contacts.

The downside to advertising is that it can result in a very large number of potential suppliers to be assessed, thereby increasing the costs of supplier selection. MNCs can narrow the field of prospective suppliers by requiring more detailed proposals and setting higher minimum standards for size, prior experience, and other selection criteria. This raises the costs of bidding on a particular quote and assists in assuring that only serious and well-qualified firms will apply. With that said, though, some SME owner and manager interviewees and survey respondents have cautioned that going too far in this direction can potentially dissuade some good suppliers from applying. This would be particularly true for those that have difficulty meeting the elevated application requirements (which are sometimes well in excess of what is necessary for doing the job) or those that cannot afford large upfront investments in tending on contracts they may not win.[18]

HIGHER-TIER SUPPLIERS

MNCs connect with SMEs through higher-tier suppliers that subcontract work to other large-, medium-, and small-sized companies.

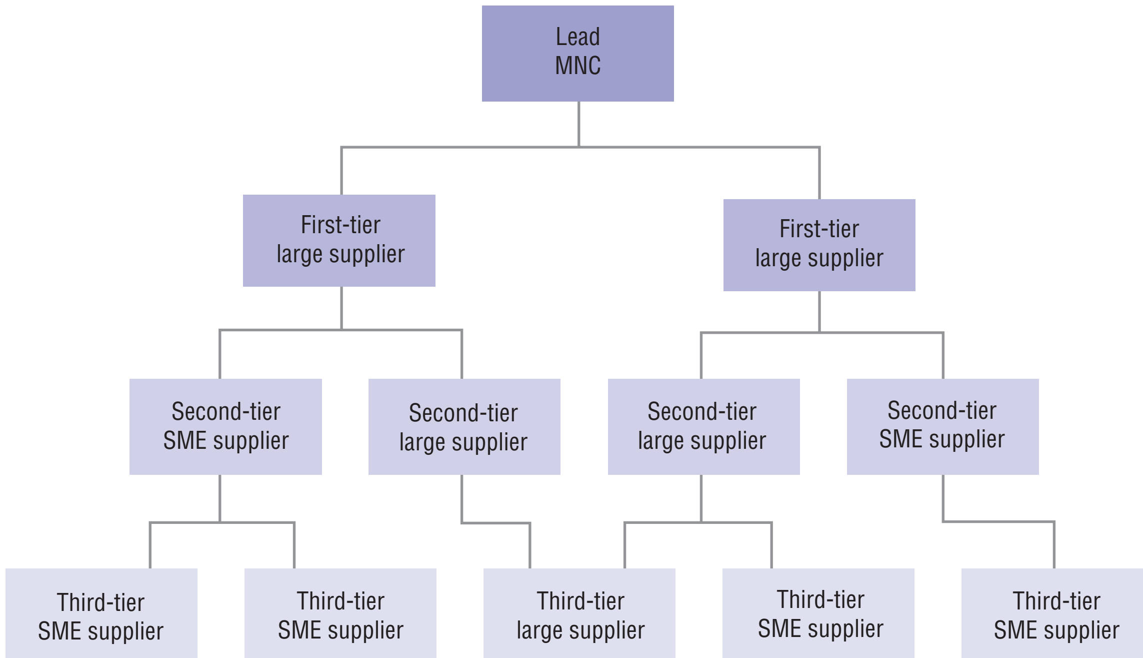
MNCs can narrow the field by requiring more detailed proposals and setting higher minimum standards for size, prior experience, and other selection criteria.

A growing number of global value chains are evolving in a tiered structure, led by an MNC with an established brand, a solid base of customers, and considerable physical, human, and financial resources. The first tier of suppliers usually consists of other large firms that deal directly with the lead MNC, and that purchase and combine inputs from other lower-tier suppliers. SME suppliers are usually found further down in the second or third tiers, supplying smaller components of the larger products that are produced by the entire value chain. (See Exhibit 1.)

Value chains that include system integrator (SI) companies are one example. SIs are companies that combine various components and subsystems, and make sure that all of

18 The Conference Board of Canada, Interviews with SMEs; Online Survey of SME Suppliers.

Exhibit 1
A Multi-Tiered MNC-SME Global Value Chain



Sources: Abonyi, *Integrating SMEs*; The Conference Board of Canada.

them work together in an integrated whole. These firms are typically found in industries such information technology and aerospace manufacturing, where complex components and systems made by different companies are usually incorporated into a final product such as an inventory control system or an airplane. Since SIs are often responsible for procuring the various components and systems used in these products, there are opportunities for SMEs to link into an MNC's value chain by becoming a supplier to such companies.[19]

Multi-tiered value chains are also common in the apparel, automotive, and retail industries, where their popularity is driven by the advantages they provide. By becoming the lead firm in a multi-tiered value chain, an MNC can garner the productivity gains of outsourcing while eliminating the logistical hassles of dealing with a large number of suppliers. It need not work with multiple suppliers; it need only work with a select group of first-tier suppliers.[20]

In following this route, however, the critical task for the MNC is to ensure that it continues to get the best value from its first-tier suppliers. Traditional supply management methods typically achieve this by driving up competition among suppliers and filtering out those who fail to perform. And although competition is not completely absent from the higher tiers of modern-day value chains, its effect is somewhat mitigated because only so many firms can provide the higher level of goods and services that MNCs purchase from their top-tier suppliers.

19 The Conference Board of Canada, Interviews with MNCs.

20 Ibid.

ONLINE RESOURCES

MNCs connect with SMEs through online mechanisms such as supplier application forms, portals, e-auctions, and e-tenders.

The use of Internet resources to maximize the effectiveness of purchasing operations, known as e-procurement, has created a variety of new opportunities for MNCs and SMEs. In the era of the global electronic marketplace, "cold calls" and paper-based supplier applications are often being supplemented by electronic methods of connecting suppliers with buyers.

While e-mail has become a standard tool for small and large companies alike, a growing number of MNCs and SMEs now also use more sophisticated e-procurement resources to find each other.[21] Some of these resources include the following:

- **Online supplier application forms**, which represent the most basic level of electronic purchasing management used by MNCs. Such forms may vary significantly from company to company, but at the very least, suppliers are asked to provide information about their company and briefly describe the products or services available for sale.
- **MNC supplier portals**, which are a more advanced form of e-procurement. The more sophisticated portals may contain a variety of supplier information and tools, including (but not limited to) corporate procurement manuals, codes of supplier conduct, and access to current RFPs. Some of this information may only be accessible to existing suppliers who have an online account with the company, but not to new or prospective suppliers.
- **E-auctions (or reverse auctions)**, which first appeared in 1998 and have since become a common form of e-procurement. In an e-auction, invited suppliers place successively lower bids for a contract. E-auctions may take various forms—from auctions where a single parameter (e.g., price) is considered to "value auctions" where multiple parameters, such as delivery and payment terms, can be negotiated simultaneously. The practice of e-auctions was pioneered by automotive and aerospace companies, which used them to procure parts. Today, MNCs use e-auctions to buy everything from paper clips to employee health-care plans.[22]
- **E-tendering**, which refers to the use of Internet-based platforms to advertise tenders, issue bidding documents, receive and evaluate bids, and award tender contracts. E-tenders are especially popular in sourcing for services, such as construction or applied research.

Individual companies may find some of these resources better suited to their needs than others. For instance, while e-auctions are often considered a best practice by MNC procurement officers, many small suppliers find the associated levels of uncertainty and stress too high. Overall, however, the use of e-procurement resources streamlines the functioning of value chains and creates benefits for both vendors and buyers, including shorter order cycles, lower inventory and warehousing expenses, and faster turnarounds on payment.[23]

SUPPLIER DIVERSITY PROGRAMS

MNCs connect with SMEs through supplier diversity programs that help them to link with small and medium-sized, minority-owned enterprises.

In the era of the global electronic marketplace, "cold calls" and paper-based applications are often being supplemented by electronic methods of connecting suppliers with buyers.

Supplier diversity is the process of reaching out to minority-owned businesses that have traditionally been under-represented in corporate value chains. It helps ensure that firms owned by Aboriginal people, visible minorities, persons with a disability, women, and other minorities have the same opportunities as other suppliers to compete for contracts.

The majority of large multinational corporations operating in the U.S. and the United Kingdom have introduced supplier diversity programs. In Canada, supplier diversity is still a relatively novel concept; however, as the example of

21 The Conference Board of Canada, Interviews with MNCs; Interviews with SMEs.

22 Chafkin, "Reverse Auctions."

23 Ibid.

3M Canada demonstrates (see box "Pioneer in Supplier Diversity: 3M Canada"), a growing number of Canadian-based MNCs are also beginning to understand the economic and social value of supplier diversity.

Visible minority and Aboriginal suppliers in Canada are represented by the Canadian Aboriginal and Minority Supplier Council (CAMSC), which operates as a private sector-led, non-profit organization with membership comprised of major multinational corporations. Firms with at least 51 per cent of their assets owned by visible minority or Aboriginal persons are eligible to receive certification from CAMSC. Certified suppliers are entered into an online database, which can be searched by companies looking for suppliers in a specific product or service area. CAMSC has an agreement on certification reciprocity with the National Minority Supplier Development Council in the U.S., which allows CAMSC-certified businesses to have access to U.S. supplier diversity programs.[24]

Pioneer in Supplier Diversity: 3M Canada

3M Canada is a multinational corporation that has successfully cooperated with the Canadian Aboriginal and Minority Supplier Council (CAMSC) for several years. In 2008, 3M had 16 CAMSC-certified small and medium-sized suppliers with purchases totalling $1 million. The company guarantees a response to inquiries from CAMSC-certified firms, but bases its decision to work with these businesses on the same criteria as it uses for other potential suppliers. "I am satisfied with our CAMSC-certified suppliers," says Jeff van Geel, the 3M Canada sourcing manager interviewed for this study. "We have gone from investing in CAMSC businesses to realizing savings from dealing with them." 3M attempts to have at least two or three requests for proposals (RFPs) every month specifically for minority and Aboriginal businesses. The company's procurement department is currently introducing an online portal where CAMSC-certified businesses can access and apply for RFPs.

Source: The Conference Board of Canada, Interviews with MNCs.

WEConnect Canada, an independent non-profit organization launched in September 2008, is another organization dedicated to promoting supplier diversity. It is a leader in the ongoing campaign to introduce certification procedures for women-owned businesses that are similar to those provided by CAMSC. According to its estimates, women-owned businesses in Canada constitute less than 5 per cent of all domestic and international suppliers to corporations and governments.[25] Obtaining certification from an internationally recognized agency is expected to significantly increase opportunities for Canadian women-owned firms to enter the value chains of large multinational corporations.

Because minority-owned businesses tend to be small or medium-sized, supplier diversity programs can give some SME suppliers a chance to be noticed by multinational corporations. How well they use this chance, however, depends on their ability to meet the rigorous standards that MNCs apply to their suppliers. While these programs may provide a minority SME with a shortcut to corporate procurement departments, the ultimate success of its partnership with an MNC is determined by the economic value that the smaller company brings to the table.[26]

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24 CAMSC, Who We Are.

25 WEConnect Canada, *About WEConnect Canada*.

26 The Conference Board of Canada, Leaders' Roundtables; Interviews with MNCs.

CHAPTER 3

Selecting SME Suppliers
What MNCs Expect

Chapter Summary

- MNCs use the same criteria to evaluate all suppliers.
- An MNC's supplier selection criteria can be broadly divided into three categories: product attributes, company attributes, and corporate responsibility criteria.
- The relative emphasis placed on each criterion varies across companies and industries, depending on the types of products being purchased, the corporate strategies of the purchasing company, and other factors.

A company's ability to produce high-quality products at lower costs heavily depends on its value chain management skills and the capabilities of its suppliers. Effective assessment and selection of suppliers is therefore essential to the success of any large business organization, particularly at this time, when over 50 per cent of the total cost of goods sold worldwide is derived from purchased materials.[1]

1 Oberoi and Khamba, "Strategically Managed Buyer-Supplier Relationships," p. 280.

The consolidation of value chains, which has been a global trend among multinationals in recent years, has important implications for suppliers. The majority of MNCs are reducing their supply base in favour of forming strategic partnerships with key vendors.[2] This development particularly affects SMEs, which are facing higher expectations from their MNC partners. It heightens competition among suppliers, especially in areas where suppliers have no specific technological advantage and can be easily replaced. As criteria for supplier selection are becoming more rigid, knowing what MNCs expect or require from suppliers assumes critical importance for a smaller company seeking to enter an MNC's value chain.

Previous studies have determined that the buyer's size has little impact on the criteria used in selecting vendors. In other words, multinational corporations and small firms evaluate their suppliers in similar ways. Conversely, the size of the supplier firm also does not seem to be an important factor in determining the selection process. MNCs generally use the same criteria to evaluate small, medium-sized, and large vendors. These criteria can be broadly divided into three categories:

- **Product attributes**, which include a set of criteria related to quality, price, and delivery. These criteria are usually assessed first and serve as a baseline in supplier selection decisions.

2 Pearson and Ellram, "Supplier Selection," pp. 53–54.

- **Company attributes**, which relate to the characteristics and capabilities of the supplier firm. The company attributes that have been found to be the most important to MNC supplier selection are financial stability, compliance with standards and certification, production capacity, flexibility, geographic location, electronic capability, and market niche position.
- **Corporate responsibility criteria**, which are used to assess the supplier's conformity with socially responsible ways of conducting business, including business integrity, fair employment practices, and commitment to environmental protection.

The ranking of supplier selection criteria varies across companies and industries. Several procurement officers interviewed for this project emphasized that their companies did not have a "one-size-fits-all" matrix in selecting suppliers. Which criteria are given top priority largely depends on the type of product or service being purchased. Because MNCs buy a large variety of products, it is natural that the same company may use different criteria rankings when it evaluates, for instance, the suppliers of high-end computer equipment and the providers of cleaning services.

To verify supplier performance on quality, large companies use a variety of assessment tools, including product testing.

PRODUCT ATTRIBUTES: THE "ETERNAL TRIAD"

Product quality, price, and delivery are fundamental to all supplier evaluations. Compared with other product- or firm-related characteristics, they are also the easiest to measure with precision, which has led some researchers to call them "hard" criteria.[3] Together, quality, price, and delivery form an "eternal triad," which buyers have traditionally applied to all suppliers before assessing their performance in other areas. (See box "Product Attributes That MNCs Expect From SME Suppliers.")

3 Ellram, "The Supplier Selection Decision," p. 8; Kannan and Tan, "Supplier Selection," p. 11.

Product Attributes That MNCs Expect From SME Suppliers

- **Quality**—product is well designed and free of defects.
- **Price**—product provides excellent value for the cost of purchase.
- **Delivery**—product is delivered at the right time and to the right place.

QUALITY

MNCs expect products that are well designed and free of defects.

A popular definition of product quality identifies its two major aspects, both equally important for assessing suppliers: conformance quality (defined by the absence of defects) and design quality (measured by the degree of customer satisfaction with a product's characteristics and features).[4] A recent analysis of post-1966 literature on supplier selection concluded that the majority of purchasing staff surveyed for various studies consistently ranked quality among the top three criteria. Moreover, in comparing the surveys for the 1996 to 1990 period to the 1990 to 2001 period, it found that the relative importance of quality increased by 47 per cent.[5]

The interviews conducted with MNC senior procurement officers for this project support these findings. All interviewees indicated that product or service quality was a top priority in selecting value chain partners. It is not surprising that quality is considered particularly essential in purchases of technologically complex, high value-added products such as electronics or aerospace systems. Suppliers' ability to match product specifications (conformance quality) with precision is viewed as critical in such industries as food processing and pharmaceutics, which put a premium on the health and safety of customers. To verify supplier performance on quality, large companies use a variety of assessment tools, including research, reference checks, quality audits, and product testing.

4 Blackstone, *APICS Dictionary.*

5 Cheraghi et al., "Critical Success Factors," pp. 95–97.

PRICE

MNCs expect products that are competitively priced.

Product price is usually assessed in tandem with quality, as every buyer seeks to achieve the right equilibrium between the two. Over recent decades, many researchers have noted a decrease in the overall importance of price in supplier selection.[6] In many industries, the price of technology-intensive products has become more or less a "given," limiting buyers' ability to bargain. In addition, attempting to go outside the "normal" pricing bandwidth may entail making unwanted sacrifices on quality.

It is, however, premature to conclude that price no longer counts in supplier selection. For the majority of the interviewees, price still holds its place among the key considerations that influence their choice of supplier. To remain competitive in the era of global sourcing, multinational companies operating in Canada have been increasingly outsourcing purchases to developing countries in search of lower cost. According to the vice-president of an IT corporation, approximately 95 per cent of his company's supply chain is currently located in China.[7]

The ability of leading MNCs to source globally presents a difficult challenge for Canadian SMEs, which are not well equipped to compete on price because of high domestic labour costs and taxation levels. The need for Canadian suppliers to decrease costs was a recurrent theme in nearly all the interviews. The vice-president of a major hotel chain, for example, said that prices offered by Canadian furniture manufacturers are sometimes 30 to 40 per cent higher than those of their international competitors.[8]

In his seminal work on supplier selection, Dickson (1966) concluded that the importance of price as a criterion is inversely related to the complexity of the product or service being purchased.[9] The Conference Board's research supports Dickson's observation: the procurement officers interviewed saw price as less important in buying complex, technologically sophisticated products and more important in purchases of simple goods or routine maintenance services.

The interviews revealed different expectations of SMEs when it comes to pricing. The purchasing manager of a mining corporation pointed out that his company expects SME suppliers to be capable of offering better prices than large companies offer because SMEs tend to have lower overhead costs. Other interviewees expressed skepticism about SMEs using market strategies based exclusively on price reduction. "It is not all about price, it can be about something that is valued," said the director of corporate purchasing for a food-processing corporation. "If you try to make inroads [into the market] based only on lower price, you will always be at a disadvantage compared with larger companies, which can use economies of scale."[10]

To increase their attractiveness to large companies, Canadian SMEs may need to consider outsourcing a larger part of their operations to lower-cost regions.

Geographical proximity to the customer may be one of the few factors that allow some Canadian SMEs to remain competitive on price by saving on freight and tariffs. However, such opportunities are likely to become more limited in the era of global sourcing. To increase their attractiveness to large companies, Canadian SMEs may need to consider outsourcing a larger part of their operations to lower-cost regions, becoming the lead firm in their own global value chain.

DELIVERY

MNCs expect products that are delivered in a timely and accurate manner.

Always a prerequisite in any vendor selection, delivery has become even more important in today's highly competitive economy. As the vice-president of an IT corporation noted, "time is the main enemy" of any

6 See, for instance, Ulaga and Eggert, "Value-Based Differentiation," p. 133.

7 The Conference Board of Canada, Interviews with MNCs.

8 Ibid.

9 Dickson, "An Analysis of Vendor Selection Systems," pp. 5–20.

10 The Conference Board of Canada, Interviews with MNCs.

multinational business organization.[11] The ability to get a product where it needs to be when it is needed is critical to maintaining production schedules, minimizing inventory and warehousing costs, and reducing overstocks and spoilage.

Interviewees identified two key components of delivery performance. First, suppliers are expected to meet delivery schedules (on-time delivery), shipping required quantities of products to designated locations at specified times. Only one interviewee indicated that his company expected SME suppliers to offer shorter delivery times compared with large firms; the majority did not differentiate their delivery expectations by the size of the supplier.

To gain the attention of a large corporation, SME suppliers may need to identify two of the three areas that they consider critical to their success and focus on improving their performance in these areas.

Second, MNCs expect product delivery to be accurate, both in terms of what is being delivered and where it is delivered. Several interviewees mentioned negative experience with suppliers delivering wrong parts or shipping goods to the wrong facility. Excellent mastery of delivery logistics becomes especially critical in the case of international shipments, which require suppliers to have a thorough knowledge of tariffs and other regulations.[12]

In summary, finding an optimal balance of quality, price, and delivery is not always easy and tradeoffs may be necessary. While MNCs expect their suppliers to be good on each of the product attributes, they also recognize that achieving equally stellar performance in all three areas may be difficult, especially for a smaller firm with limited resources. To gain the attention of a large corporation, SME suppliers may need to identify two of the three areas that they consider critical to their success and focus on improving their performance in these areas.[13]

11 Ibid.

12 Ibid.

13 Ibid.

COMPANY ATTRIBUTES: MOVING BEYOND THE FUNDAMENTALS

When several suppliers excel on quality, delivery, and price, how does the buyer go about selecting the best partner? This is where the characteristics of the supplier firm come into play. The company's financial stability, compliance with industrial standards and certifications, production capacity, flexibility, geographic location, and electronic capability are among the most important benchmarks that MNCs use to assess potential suppliers. (See box "Company Attributes That MNCs Expect From SME Suppliers.") Some of these criteria, such as the firm's financial standing, can be measured with a high degree of precision, while others, such as flexibility, belong to the less "tangible" class. Similar to the product attributes, the precise mix of company-related criteria applied by different MNCs depends on the industry and product or service being sourced.

FINANCIAL STABILITY

MNCs expect SMEs to be financially sound.

The stable financial footing of a supplier minimizes the risk for the buyer and makes for a lasting business partnership. A company that is struggling financially will have more difficulty contributing to the success of the business

Company Attributes That MNCs Expect From SME Suppliers

- **Financial stability**—suppliers must be financially sound.
- **Compliance with standards and certifications**—the quality and compatibility of suppliers' production processes may need to be certified by recognized third-party agencies to comply with MNC corporate standards.
- **Production capacity**—suppliers may need to demonstrate sufficient production capacity to meet MNC needs.
- **Flexibility**—suppliers should have the ability to vary demand volumes or alter product specifications.
- **Geographic location**—suppliers are based in close geographic proximity to MNC facilities, when necessary.
- **Electronic capability**—suppliers have the capabilities for electronic data exchange and other Internet-based solutions.
- **Market niche**—suppliers should be able to communicate a distinctive value proposition to potential customers.

relationship because it will need to allocate more time and resources to improving its financial performance.[14] An assessment of the supplier's financial standing and management is therefore a standard element of all supplier evaluations. Prior to offering a contract, MNCs conduct thorough audits of the supplier's financial standing and credit history.

In addition to in-house assessments, MNCs obtain financial information on suppliers from reputable external sources. Several corporations interviewed for this project use the services of Dun and Bradstreet (D&B), a leading international provider of information on credit, marketing, and data solutions for businesses. D&B operates a global database of 140 million companies, in which each company is assigned a unique nine-digit D&B D-U-N-S Number. The D-U-N-S Number is an industry standard for business identification and is recommended by the United Nations, the International Organization for Standardization (ISO), and more than 50 industry groups. It serves as an identifier for gathering and storing information about businesses and as a tool for D&B clients, who use it to access information about suppliers, customers, and trading partners.[15]

COMPLIANCE WITH STANDARDS AND CERTIFICATIONS

MNCs expect SMEs to meet required standards and certifications.

There are a number of universal and industry-specific standards and internationally recognized certifications that buyers may expect or require from their suppliers. It is important for a would-be supplier to conduct research on these standards and certifications well before approaching potential buyers.

The ISO promulgates a variety of technical and commercial standards, which have been adopted by businesses worldwide. One of the best-known families of ISO standards is ISO 9000, which defines requirements for a company's quality management system. The essential principles of ISO 9000 include implementing a systematic and fact-based approach to quality management, adopting a commitment to and processes for continual improvement, and striving to exceed customer expectations.[16]

Although most globally operating corporations today are certified under ISO 9000, the majority of MNCs interviewed for this study do not require the same from their suppliers. Having ISO 9000 certification is considered a desirable asset rather than a "core" requirement. Large corporations also appear to recognize that the time and expense involved in the ISO certification process may be too onerous for a small firm.[17]

Another internationally recognized set of standards is the Good Manufacturing Practice (GMP), which refers to the management of manufacturing and quality control testing of foods, pharmaceutical products, and medical devices. Some companies, particularly in food processing and pharmaceutics, require their suppliers to be GMP-certified, but overall GMP is not a common standard in most industries.[18]

Large corporations also appear to recognize that the time and expense involved in the ISO certification process may be too onerous for a small firm.

In addition to the universally applied certifications, different industries have their own product- and process-related standards that suppliers may be required to follow. Food producers, for instance, require suppliers of raw materials and packaging to meet Hazard Analysis Critical Control Point or American Institute of Bakery (AIB) standards, which ensure sanitation and anti-microbial control. Aeronautics firms use an elaborate system of international quality standards known as ISO 19100, which is required of all suppliers. Some firms also employ international standards to evaluate suppliers' performance on corporate responsibility issues (see the following

14 Ellram, "The Supplier Selection Decision," p. 8.

15 D&B, About D&B; History; D&B D-U-N-S Number.

16 For further information, see ISO "Quality Management Principles."

17 The Conference Board of Canada, Interviews with MNCs.

18 GMP Institute, "What Is GMP?"; USFDA, *Good Manufacturing Practice.*

section on corporate responsibility criteria). An example of such practices is Alcatel-Lucent, which uses SA8000, a global standard for decent working conditions, developed and overseen by Social Accountability International.[19]

PRODUCTION CAPACITY

MNCs expect SMEs to have adequate production capacity.

The stability and reliability of supply sources are key considerations for large corporations, which can face great financial losses from even the smallest disruption in the production process. As a result, having adequate capacity to meet the customer's demand is critical for any smaller company looking to partner with an MNC. One purchasing manager from a large mining company pointed out that he is always concerned that giving a large contract to a smaller firm might result in overwhelming it with order volumes. To address this issue, some companies require their suppliers to provide them with "safety stock" on short notice to match sudden increases in retail sales. A sourcing director in the food processing industry, for instance, explained that her company's suppliers are expected to have broad sources of supply for their own products in order to minimize the effects of potential performance problems and ensure the smooth functioning of the value chain.[20]

FLEXIBILITY

MNCs expect SMEs to be flexible in adjusting to changing needs and conditions.

Many large companies see flexibility as one of the most important assets that SMEs have to offer. SMEs are viewed as more responsive to service and support requests and more willing to offer on-site service, particularly if they are located close to the customer. MNCs also expect SMEs to demonstrate capability for growth, including quick adjustment to sudden increases in demand.

The interview data show that this process of adjustment can sometimes be a challenge for smaller firms. To increase their attractiveness to large buyers, SMEs need to improve their scalability (i.e., the ability to scale production outputs to meet changing demand). While much of the responsibility for identifying potential problems in this area lies with the buyer's purchasing team, smaller firms should make an assessment of their ability to scale before approaching an MNC customer.[21]

GEOGRAPHIC LOCATION

MNCs expect SMEs to be located in geographic proximity, when necessary.

Advances in global communications and logistics have made the location of the vendor relatively less important.[22] As the interview data suggest, location and distance have become relatively less important in purchases of technologically complex products, where freight expenses stand at a fraction of the cost of the product being shipped.

SMEs are viewed as more responsive to service and support requests and more willing to offer on-site service, particularly if they are located close to the customer.

At the same time, proximity to the customer can still give SMEs a competitive edge in certain situations. High oil prices and the drive to cut shipping costs may also lead an MNC to seek out local suppliers, particularly for basic commodities. Large companies often do local sourcing for maintenance and technical support operations as well. As one purchasing manager put it, "You can't outsource your lawn-mowing to China." [23]

Many MNCs manage strategic sourcing from their head offices while buying less important products and services locally. As illustrated by the following example, the same products may be outsourced on a national scale by some MNCs, but purchased locally by others. One Canadian chartered bank recently consolidated its recycling operations, moving from contracting small local recyclers to hiring a nationwide recycling firm for all branches. Yet

19 Alcatel-Lucent, "CSR in the Supply Chain."

20 The Conference Board of Canada, Interviews with MNCs.

21 Ibid.

22 Cheraghi et al., "Critical Success Factors," p. 99.

23 The Conference Board of Canada, Interviews with MNCs.

the same bank continues to procure janitorial services on a local basis. By contrast, another chartered bank interviewed for this study manages cleaning services from its head office and uses the same cleaning company for all branches.[24]

Ability to visit the customer's facilities can be an important asset for SMEs seeking to enter multinational value chains. Many large companies look for prompt on-site service and personal communication, which they rarely get from larger providers. One purchasing manager said that "each plant has its own idiosyncrasies," which are important to know in order to ensure its smooth operation.[25] By leveraging their geographical advantages, Canadian SMEs can create value for their MNC customers and improve their chances for long-term partnership.

ELECTRONIC CAPABILITY

MNCs expect SMEs to possess electronic capabilities.

Recent advances in telecommunications have created a new phenomenon known as e-procurement, which encompasses the purchase and sale of goods and services through the Internet as well as other networking systems, such as Electronic Data Interchange and Enterprise Resource Planning. E-auctions (or reverse auctions), where suppliers bid electronically on the buyer's RFQ, have become a common form of international procurement. Most multinational organizations have completely eliminated paper-based procurement and "wet signatures," creating integrated electronic processes for managing supply operations throughout their value chains.

Becoming part of these networks requires advanced electronic capabilities and the adoption of electronic data exchange. A 2004 study showed, however, that only 50 per cent of Canadian SMEs had adopted Internet Business Solutions.[26] Although a relatively larger proportion of SMEs were utilizing stand-alone solutions—such as websites and e-mail—fewer companies had introduced complex integrated systems that involved supply chain management. To work effectively in the global electronic marketplace, Canadian SMEs need to continue developing their capability for electronic supply management.

MARKET NICHE

MNCs expect SMEs to develop a clear and distinctive value proposition.

While meeting the criteria discussed above is a prerequisite of successful partnership, MNCs often expect SME suppliers to offer them "something extra"—a competitive advantage that goes beyond the mechanical combination of product and company attributes. Many interviewees emphasized that the most successful SME suppliers are "niche players"—companies that occupy their own unique segment of the market.

A relatively larger proportion of SMEs were utilizing stand-alone solutions, but fewer companies had introduced complex integrated systems that involved supply chain management.

To become "visible" to large multinational organizations, smaller businesses need to identify their market niche and work on building competencies that create differentiation and asset specificity. A smaller company considering a partnership with a multinational should first define what constitutes its uniqueness in the market so that it can come up with a "true value proposition." Since there are many SMEs seeking MNC business, developing a highly specialized competency significantly increases a smaller company's chances of becoming noticed by a large buyer.[27]

CORPORATE RESPONSIBILITY CRITERIA: BUILDING ETHICAL VALUE CHAINS

Suppliers in Canada and elsewhere are increasingly required to follow the principles of corporate responsibility (CR) established by their MNC customers. In 2007, for instance, Scotiabank reviewed its RFP procedures to

24 Ibid.

25 Ibid.

26 Johnston et al., *Net Impact Study Canada*, pp. 1–2.

27 The Conference Board of Canada, Interviews with MNCs; Leaders' Roundtables.

include corporate social responsibility (CSR) standards. Scotiabank RFPs can now require applicants to describe their social and environmental management policies, relevant CR or environmental accreditations, programs to deliver energy-efficient products and services, recycling and disposal methods, and employment practices that support diversity.[28] Some MNCs now have formal codes of socially responsible conduct, which they apply both internally and to their partners across the value chain.

Each company establishes its own CR criteria, but most MNCs expect suppliers to comply with three major groups of criteria: 1) business integrity, 2) fair employment practices, and 3) environmental protection. (See box "Corporate Responsibility Criteria.") Some MNCs monitor and enforce supplier CR performance on a reactive basis (if it appears that something has gone wrong), while other MNCs have established proactive procedures to monitor and enforce CR performance on an ongoing basis. (See box "Monitoring Supplier's Performance on the Environment: The Case of Alcatel-Lucent.") Those that are more proactive have a competitive edge in mitigating risk and improving value chain sustainability.

BUSINESS INTEGRITY

MNCs expect SMEs to conduct themselves with integrity.

Compliance with existing laws and regulations, promoting fair and free competition, and avoiding conflicts of interest are all important aspects of business integrity. Many MNCs also explicitly prohibit their business partners from giving bribes or accepting personal gifts. Nortel's *Supplier Code of Conduct*, for instance, states that "under no circumstances is it acceptable to offer, give, solicit or receive, directly or indirectly, any form of bribe, kickback or any improper or illegal inducement."[29] Protection of intel-

Corporate Responsibility Criteria

- **Business integrity**—suppliers are required to comply with existing laws and regulations, foster free competition, and avoid conflicts of interest.
- **Fair employment practices**—suppliers are required to pay fair wages, provide safe and healthy workplaces, and use no forced or child labour.
- **Environmental protection**—suppliers may be required to adopt measures to protect the environment.

Monitoring Suppliers' Performance on the Environment: The Case of Alcatel-Lucent

Alcatel-Lucent is an example of a large information technology corporation that not only closely monitors, but also strictly enforces, suppliers' compliance with its CSR policy, which is outlined in the Alcatel-Lucent *Statement of Business Principles*. A mandatory clause, which requires suppliers to comply with Alcatel's CSR principles and apply them to their own business partners, is included in all purchasing contracts. The initial supplier assessment performed by the Alcatel-Lucent purchasing community includes checking the supplier's record on CSR aspects. Alcatel-Lucent also requests all suppliers to provide information on the environmental characteristics of their products or components. Suppliers must ensure that the equipment delivered to Alcatel-Lucent or its customers complies with all restrictions regarding the use of certain substances in products, as well as with other Alcatel-Lucent environmental requirements.

Contracts with any product supplier must include a specific clause containing the following:

1. The supplier is requested to fill in a form on product or component environmental characteristics covering substances in products, energy consumption figures, electromagnetic and noise emissions, and end-of-life information. As a preferred alternative, Alcatel-Lucent requests an eco-declaration for finished products as well.
2. The supplier agrees to meet Alcatel-Lucent supplier requirements on substance restrictions.
3. The scope of the supplier's responsibilities for the end of life of the equipment is defined.
4. Supplier products are requested to be compliant with any key environmental, health, and safety (EHS) regulations.

Alcatel regularly performs evaluations of its suppliers' compliance with its ethical and social standards, including evidence-based questionnaires and on-site audits. To date, over 500 Alcatel suppliers worldwide have been assessed on CSR performance, including 16 on-site audits. By the end of 2008, Alcatel is committed to evaluating the CSR performance of its suppliers, covering 65 per cent of the company's total purchase volume.

Sources: Alcatel-Lucent, "CSR in the Supply Chain"; *Corporate Social Responsibility Report*.

28 Scotiabank, *2007 Corporate Social Responsibility Report*, p. 28.

29 Nortel, *Supplier Code of Conduct*, p. 3.

lectual property is also a growing concern for many multinationals. Today, corporate policy documents devote much more attention to the judicious use of information provided to suppliers than they did a decade ago.

FAIR EMPLOYMENT PRACTICES

MNCs expect SMEs to maintain fair employment practices.

Multinational corporations have a standard set of requirements related to suppliers' employment practices. Suppliers are required to pay fair wages, provide safe and healthy work environments, treat all employees with dignity and respect, and eliminate all forms of discrimination in their workplaces. Many corporate codes of conduct today also include clauses that ban the company's partners from using child or any form of forced labour.

ENVIRONMENTAL PROTECTION

MNCs expect SMEs to be aware of the environmental effects of their business activity.

Environmental issues are rapidly gaining importance as a criterion in supplier selection. At the very least, large firms now expect their value chain partners to be aware of the environmental effects of their business activity and to be willing to collaborate in resolving any issues. (See box "Monitoring Suppliers' Performance on the Environment: The Case of Alcatel-Lucent.") This does not mean, however, that a "green" company automatically becomes a "red-hot" supplier.

The interview data and the study of corporate supplier manuals suggest that while protection of the environment is a growing concern for MNCs' procurement teams, the majority of multinationals are not yet prepared to make environment-conscious practices a requirement for their suppliers. In other words, environment-friendly orientation can rarely be a "deal breaker."

According to the vice-president of an IT corporation, if a company does not practice environmental protection, it will not necessarily lose business. The procurement manager of a mining corporation pointed out that environmental consciousness has been used by some suppliers as "an excuse for raising prices," sometimes by as much as 15 per cent. How common such attitudes are among senior managers is difficult to say, but there is an expectation among certain multinational buyers that environment-friendly technologies should not entail higher prices.[30]

30 The Conference Board of Canada, Interviews with MNCs.

CHAPTER 4

From Adversaries to Allies

Building Long-Term MNC-SME Relationships

Chapter Summary

- Once regarded as adversaries, suppliers are now increasingly seen as business allies.
- Leading MNCs have begun to consolidate their supply bases and prioritize key suppliers, conduct ongoing measurement of supplier performance, practice supplier development, and move toward collaborative models of supplier relationship in order to create more effective relationships with their suppliers.
- While SME suppliers may now find it more difficult to attract the attention of large buyers, those that can bring distinct value to an MNC have a much better chance of forging a long-term partnership.

Only a few decades ago, a typical MNC had dozens of suppliers for each of its product components, turning the management of the supply chain into a cumbersome process. Worse still, interaction with suppliers normally began and ended with the negotiation of the contract. The proliferation of suppliers made them appear powerless in the face of the arm-twisting techniques that many MNCs used to extract price concessions.

Today, much of this has changed drastically. Global competition has forced MNCs to pay serious attention to how they manage relationships with their suppliers. Many companies have adopted a new way of thinking about procurement, introducing supplier relationship management as a distinct area of corporate activity. Once seen as adversaries, suppliers are now increasingly treated as strategic business allies. The leading MNCs have begun to:

- consolidate their supply bases and prioritize key suppliers;
- conduct ongoing measurement of supplier performance;
- practice supplier development; and
- move toward collaborative models of supplier relationship.

Global competition has forced MNCs to pay serious attention to how they manage relationships with their suppliers.

These new developments present many challenges for smaller firms, but they also open up new opportunities for innovation-oriented and flexible SMEs. While SME suppliers may now find it more difficult to attract the attention of large buyers, companies that can bring distinct value to a multinational organization will have a much better chance of forging a long-term partnership than just a decade ago.

GETTING MORE FROM LESS: MNCs AND SUPPLY CHAIN CONSOLIDATION

MNCs build effective relationships with SMEs by maintaining a streamlined value chain that allows them to focus their energies on working with their key suppliers.

As the use of outsourcing expanded from the mid-1980s to the late 1990s, the number of suppliers that MNCs incorporated into their value chains increased. Gradually, many MNCs came to recognize that dealing with too many suppliers could be counterproductive. It raised the administrative costs of doing business. It made assessing and managing supplier performance more difficult. And it exposed the MNC to unnecessary risks, either because of poor delivery by under-performing suppliers or through association with companies that did not measure up to acceptable standards of corporate responsibility.

This prompted a growing number of MNCs to consolidate their supplier base and prioritize key suppliers. (See box "Streamlining the Supply Chain: Supplier Stratification to Optimize the Value Chain.") Under this new model, the supplier base is consolidated and the remaining suppliers are prioritized into three levels: strategic suppliers, core suppliers, and basic suppliers. At each level, suppliers are required to meet a particular set of expectations in return for a corresponding proportion of the procurement spending and integration into the MNC value chain. The result strengthens the supply chain as a whole by reducing the costs of supply chain management, while also enabling the MNC to focus more attention on developing its most important suppliers.[1]

KEEPING A FINGER ON THE PULSE: SUPPLIER PERFORMANCE MEASUREMENT

MNCs build effective relationships with SMEs by continually measuring supplier performance.

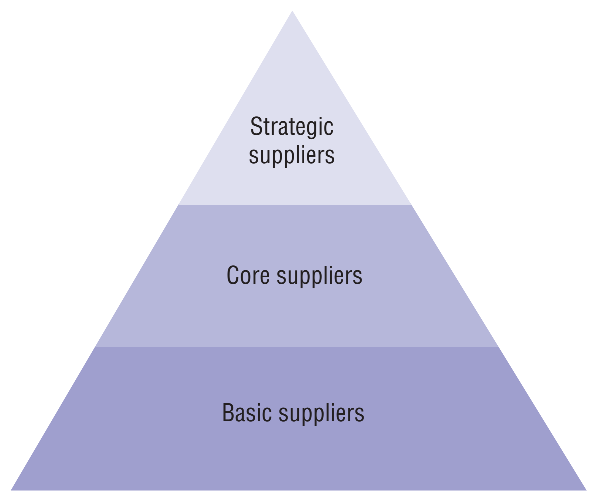
To ensure the continuing fit between the company's needs and supplier performance, most large corporations conduct regular evaluations of their suppliers.

1 Prokopets and Tabibzadeh, *Supplier Relationship Management*; The Conference Board of Canada, Interviews with MNCs.

Streamlining the Supply Chain: Supplier Stratification to Optimize the Value Chain

In a stratified system of supplier relationship management, suppliers are typically tiered into three basic levels: strategic suppliers, core suppliers, and basic suppliers. Each level of supplier has a given set of expectations and receives a corresponding proportion of the MNC's procurement expenditure and attention. Suppliers that perform well have the opportunity to move up a level, while those that under-perform may be demoted or removed from the value chain altogether.

A Stratified System of Supplier Relationships



Source: Prokopets and Tabibzadeh, Supplier Relationship Management.

Strategic suppliers are the most important suppliers. They provide a large volume of key goods or services and often manage other, lower-tier suppliers. Suppliers at this level are expected to be closely aligned with the lead MNC's operational systems and business strategy. They are also expected to provide innovation in product development, assistance in accessing new markets, and continuous improvement in quality and productivity, in addition to meeting the criteria for the other two levels of suppliers.

Core suppliers are mid-level suppliers. They provide important goods and services and sometimes manage other, lower-tier suppliers. They are expected to have geographic reach and be responsive to changes in product quantities and specifications, in addition to meeting the criteria for the basic suppliers.

Basic suppliers are the lowest tier of suppliers. They provide the most basic goods and services and are expected to provide quality, value, and a timely delivery.

Sources: Prokopets and Tabibzadeh, *Supplier Relationship Management;* The Conference Board of Canada, Interviews with MNCs; The Conference Board of Canada.

Such evaluations allow MNCs to monitor the "health" of their value chains, identify areas for improvement, and take corrective action if necessary. In addition, the results of these evaluations play a key role in determining suppliers' potential as preferred or strategic partners.

Today, many MNCs have implemented formalized evaluation systems, where all supplier companies are assessed against a set of uniform metrics and receive scores based on their performance. (See box "Supplier Evaluation in the Pharmaceutical Industry: The Case of Bayer.") Similar to supplier selection (see Chapter 2), buyers do not differentiate between large- and small-size suppliers and use the same criteria to evaluate performance. The specific criteria may vary, but product quality, delivery, service, and price are standard elements in all supplier evaluations.

Although many recent studies point to the decreasing importance of price in selecting and retaining suppliers, our research shows that corporate procurement officers continue to view product cost as a key driver of successful buyer-vendor relationships. A number of interviewees emphasized ability to offer cost reduction programs as a core expectation of suppliers looking to enter into a long-term partnership.

Supplier responsiveness is another characteristic that is highly valued in the procurement community. Companies that quickly respond to changing customer needs—be it sudden increases in demand or alterations in product design—are more likely to receive high scores and become candidates for long-term alliances.[2] Suppliers in the "core" and "strategic" categories are also expected to demonstrate innovation capabilities.

The frequency of supplier evaluations varies from company to company, but the majority of large MNCs conduct evaluations of supplier performance at least once a year. Some companies—especially those with shorter product life cycles—evaluate their suppliers every month or even more often.

Different categories of suppliers may be evaluated at different intervals. A large retail corporation interviewed for this project conducts quarterly evaluations of strategic suppliers and annual evaluations of other suppliers. Nortel follows a similar approach, holding quarterly business reviews with strategic suppliers and biannual reviews with core suppliers. The company also organizes technology roundtables with strategic suppliers, where technology roadmaps are shared.[3] A few companies, such as Honda, even monitor the performance of their second- and third-tier suppliers.

Supplier self-evaluation through the use of scorecards is becoming an increasingly popular practice among large MNCs. It allows suppliers to benchmark themselves against their peers and identify areas that require attention.[4] An early adopter of scorecards, Wal-Mart

Supplier Evaluation in the Pharmaceutical Industry: The Case of Bayer

Bayer's Supplier Relationship Management (SUPREME) model aims at concentrating procurement volume on the best suppliers through a global and standardized approach. Supplier evaluation is one of three components of SUPREME, which also includes supplier selection and supplier optimization.

Bayer evaluates its suppliers along four dimensions: procurement, quality, logistics, and technology. For each of these dimensions there are five clusters:

- business safety and environment;
- current performance;
- systems to sustain performance;
- future requirements; and
- cooperation, service, and support.

Each supplier receives a score using a zero to 100 point scale and, depending on the point total, is placed in one of the four categories:

- Supreme: suppliers scoring above 90 points are preferred partners for strategic relationships.
- Standard: suppliers scoring 70 to 90 points fulfill Bayer's standard requirements.
- Poor: supplier scoring 50 to 70 points require special attention in supplier optimization.
- Desourced: suppliers scoring below 50 points are not considered for long-term relationships and/or large purchasing volume and are desourced as early as possible.

Source: Bayer, SUPREME.

2 On the importance of responsiveness in supplier evaluations, see also Kannan and Tan, "Supplier Selection," pp. 14–15.

3 Carbone, "The Changing Face of Nortel."

4 A 2002 study of evaluation methods used by U.S. firms found that approximately 60 per cent of the surveyed companies evaluated their suppliers; over 21 per cent practiced supplier self-evaluations; and the rest used a combination of the two approaches. See Simpson et al., "Measuring the Performance of Suppliers," pp. 29–41.

now uses them to assess suppliers' performance in a number of areas, including environmental practices. In February 2007, the company launched a packaging scorecard with the goal of helping its suppliers to reduce packaging and conserve natural resources. The scorecard is a measurement tool that allows suppliers to evaluate themselves in relation to other suppliers on carbon dioxide emissions, product-to-packaging ratios, recycled content usage, and six other indicators. Suppliers receive an overall score relative to other suppliers, as well as relative scores in each category. More recently, Wal-Mart also introduced scorecards to assess the environmental sustainability of its electronic and textile products.[5]

Too often supplier development efforts begin and end with a discussion of the most recent evaluation metrics; while supplier development must start with fixing non-systemic problems, it does not need to end there.

In the era of global outsourcing, it is not surprising that some MNCs are choosing to hire third-party agencies to monitor supplier performance rather than perform evaluations in-house. In The Conference Board, Inc. 2006 study of supplier management practices utilized by large companies, all seven surveyed firms used independent third parties to evaluate their suppliers. Four of these third parties were not-for-profit organizations; three were for-profit. To audit its suppliers on workplace standards, Coca-Cola, for instance, retained firms with experience in the apparel and footwear industry, which faced supply chain controversies earlier than the food and beverage industry. To audit its global network of meat, poultry, and seafood suppliers, McDonald's retained Conservation International, a not-for-profit organization that seeks to protect global biodiversity.[6]

While measuring supplier performance is a necessary element in optimizing supply chain effectiveness, it provides only the diagnosis, not the solutions. Realizing the full potential of supplier relationships requires close collaboration between suppliers and the purchasing organization, aimed at helping suppliers develop their capabilities.

GROWING TOGETHER: MNCs AND SUPPLIER DEVELOPMENT

MNCs build effective relationships with SMEs by promoting supplier development.

Supplier development is an activity that a purchasing organization undertakes to improve suppliers' performance or capabilities. Depending on the purchaser's needs and areas that require improvement, it may take a number of forms, including:

- helping suppliers redesign their corporate strategies to achieve a closer fit with the corporate strategy of the buyer company;
- increasing suppliers' value-creating capabilities through reducing product costs, time to market, quality, or environmental performance; and
- assisting suppliers to expand their markets or design new products.

These goals can be reached through a variety of techniques such as personnel training and exchange, intellectual capital sharing, joint investment in new capabilities, systems integration, and multi-supplier collaboration. As research data suggest, many MNCs expect their suppliers to demonstrate continuous improvement on cost and service levels, but few of them have formal supplier development programs in place. Too often supplier development efforts begin and end with a discussion of the most recent evaluation metrics. While supplier development must certainly start with fixing non-systemic problems identified during performance reviews, it does not need to end there.

Among the MNCs that have long been on the cutting edge of supplier development are Toyota and Honda, Japan's automaker giants that also operate extensively in the North American market. While both companies set extremely high standards, they also help their suppliers improve to meet those requirements. For instance,

5 Wal-Mart Stores, Inc., *Wal-Mart Announces Initial Results; Wal-Mart Announces Goal; Wal-Mart Stores, Inc., Offering Environmentally Friendly Textile Options.*

6 Shireman, *Toward a Framework for Supply Chain Leadership*, p. 7.

the two automakers invest heavily in developing the design capabilities of their first-tier suppliers. Both companies have created guest engineer programs, which bring engineers from first-tier supplier companies to work at Toyota or Honda facilities for up to three years. Honda also sends its engineers to the U.S., where they lead *kaizen* (continuous improvement) events at supplier facilities. While other automakers spend from one day to one week per year on supplier development, Honda commits 13 weeks to its development program. As a result, Honda's Best Practices program has increased suppliers' productivity by about 50 per cent, improved quality by 30 per cent, and reduced costs by 7 per cent.[7]

Supplier development can be challenging for both parties, as it requires them to commit financial and personnel resources to an activity that is fraught with risk and offers no guarantee of success. Even more importantly, it calls for organizational structures that facilitate continuous learning and encourage greater intimacy and trust between value chain partners. The management of the purchasing company must be convinced that investing in the development of supplier capabilities is strategically and financially justified. In turn, suppliers need to feel confident that accepting advice and training from the buyer will benefit their organizations. To cultivate an atmosphere of trust, MNCs must learn to separate supplier relationships from the market pressures that usually dominate contract negotiations, and start building an organizational culture that favours long-term commitment over short-term financial gain.

THE COLLABORATIVE TURN: TOWARD A NEW MODEL OF SUPPLIER RELATIONSHIP

MNCs build effective relationships with SMEs by enhancing the role of supply chain professionals in the organizational hierarchy and moving from traditional, adversarial methods of procurement to more collaborative models of supplier relationship management.

What, then, is the general direction in which value chain relationships have recently been evolving? The experiences of the leading companies definitely point to what may be described as a "collaborative turn" in managing procurement and supply within large organizations. More and more MNCs are abandoning the old "adversarial" approach to suppliers—which focused on short-term gains at the expense of strategic advantages—and adopting the collaborative model of supplier relationships. Little known just a decade ago, supplier relationship management has become the slogan of the day in many multinational corporations.

The fact that the phrase "supplier *relationship* management" (SRM) is now commonly used, along with the more traditional phrase "supply *chain* management" (SCM), is in itself suggestive. The term "relationship" highlights this increased emphasis on managing the relationships among the members of the supply chain, in addition to managing the mechanics of supply chain operations. While the main objective of SCM is to ensure the smooth delivery of required goods, the new model focuses on building strategic multi-partner alliances based on shared goals and long-term mutual benefits.

In today's tough economic climate, there may be a temptation for some MNCs to retreat back to the adversarial approach to SRM in the hopes of obtaining immediate cost reductions. But this would be a mistake. Intelligent cost reduction that maintains (or indeed improves) the quality of the organization's product while maintaining the sustainability of the supply chain is the primary goal of a properly managed collaborative approach to SRM. The difference is that the collaborative approach seeks to achieve these goals, and does so more effectively over the long term, through cooperation rather than confrontation with suppliers.[8]

According to a 2005 survey of 229 senior procurement executives from Europe and the U.S., SRM activities resulted in an average annual savings of 1 per cent of their companies' total annual procurement spending, and SRM leaders were able to attain an average annual savings of 3 per cent.[9] This is why MNCs that pioneered

7 Liker and Choi, "Building Deep Supplier Relationships," p. 113.

8 The Conference Board of Canada, Interviews with MNCs; Romala at al., "Supplier Relationship Management;" Prokopets and Tabibzadeh, *Supplier Relationship Management;* Liker and Choi, "Building Deep Supplier Relationships."

9 Accenture, *Designed to Differentiate,* p. 4

the collaborative SRM model, such as Toyota and Honda, have long stopped viewing their suppliers as mere links in a "chain" with goals diametrically opposed to their own. Instead, they see supplier companies as "semi-insiders" that are not only expected to share the same values and objectives as those of the customer, but are also entitled to take advantage of its expertise and know-how.[10]

Rethinking traditional supply management frameworks may be a difficult step for MNCs. It calls for a greater degree of transparency and integration across the supply chain than many multinationals are currently willing or able to offer. It requires the ability to put long-term goals above immediate gains and the willingness to take reasonable risks on new suppliers (including small and medium-sized companies). It also demands the vision to recognize procurement as a strategic business imperative. (See box "A Profession in Transition: The Evolving Role of Supply Chain Management—Implications for Organizational Effectiveness.") Those MNCs that are able to make this transition will be rewarded with more harmonious and ultimately more profitable relationships with their suppliers and, consequently, with an improved competitive position in the global market.

A Profession in Transition: The Evolving Role of Supply Chain Management—Implications for Organizational Effectiveness

Supply chain management has undergone a dramatic transformation in the past four decades. Once regarded as buyers of office supplies and cleaning services, supply chain managers are now more likely to be called upon to resolve problems in logistics and relationships with key suppliers. Increasingly, many are also moving into senior positions and are involved in forming (or influencing) overall corporate strategies. This change in function has required a new set of skills, knowledge, and abilities. To this end, the Purchasing Manager's Association of Canada has recently retooled its course offerings to "shift the focus from purchasing to strategic supply chain management to meet the evolving needs of the marketplace."

Still, there is evidence that the position of many supply chain managers has yet to catch up with the strategic importance of their role in many organizations. In a recent global survey of procurement officers by the U.K.-based Chartered Institute of Purchasing and Supply, 80 per cent of the respondents said that their profession was "highly" or "well" regarded, but that it is still seen as largely "operational" in nature. Not surprisingly, 40 per cent of the respondents also said that the need to raise the profile of the purchasing and supply function was the single biggest challenge facing their profession.

Top-performing organizations have recognized the importance of the supply chain function. According to a 2007 study by Accenture, organizations that had achieved "master" procurement status provided senior supply chain managers with boardroom awareness and a clear mandate from top management to shape and manage purchasing policies and practices across the organization. As a result, these organizations saved 10 times as much as it cost them to operate their procurement function and enjoyed productivity levels 30 per cent higher than other organizations. And there is more to it than simply cost savings. Supply chain managers in "master" procurement organizations are also much better positioned to make use of their knowledge to anticipate trends, inform strategic corporate decisions, and create and maintain effective relationships with key suppliers. As the global risks to supply chain competitiveness and sustainability intensify, these benefits are becoming more important than ever for MNCs and their supply chain partners.[1]

Sources: Accenture; The Chartered Institute of Purchasing and Supply; The Conference Board of Canada.

1 Accenture, *High Performance*, pp. 4–5, 10–17, 21–22.

10 Liker and Choi, "Building Deep Supplier Relationships."

CHAPTER 5

Conclusion and Call to Action

> **Chapter Summary**
>
> - Partnering with SMEs can help MNCs build a strong position in the market by providing them with opportunities to reduce costs, innovate more effectively, and adapt quickly.
> - MNCs look at product attributes, company attributes, and corporate responsibility criteria when determining supplier selection.
> - To make a successful connection with an MNC, SMEs need to understand these criteria and market their products, company, and social and ethical standards accordingly.

CONCLUSION

In an era of heightening global competition, many large companies are looking for new ways to improve their competitive advantage. Partnering with SMEs opens up new opportunities for MNCs in their quest to build a strong position in the market. It can help MNCs improve productivity, innovation, and adaptability, as well as enhance their reputation, diminish their risks, and expand their access to untapped markets and talent.

Most MNCs do not distinguish between large, medium, and small suppliers. Rather than looking at size, MNCs prefer to assess value. Exactly what value means to them will differ in each instance of supplier selection, depending on product, industry, and firm strategy. But the basics of supplier assessment remain the same across the board: MNCs look at product and company attributes and corporate responsibility criteria when determining which supplier is selected. (See box "Checklist of What MNCs Look For in Their SME Suppliers.")

To make a successful connection with an MNC, SMEs need to understand these criteria and market their products, company, and social and ethical standards accordingly. The first step for SMEs, however, should be to understand their own strengths, limitations, and desires. This will allow them to identify their niche in the market, find the right MNC partners, and make the best pitch for forming a collaborative relationship.

The basics of supplier assessment remain the same across the board: MNCs look at product and company attributes and corporate responsibility criteria.

Working within the appropriate niche is especially important for SMEs in the current era of MNC supplier consolidation. Increasingly, MNCs are moving toward streamlining their supply chains to reduce administrative costs and to focus their energies on developing long-term relationships with only the "best of the best" suppliers. The research for this report suggests that this process need not exclude small suppliers, but it does mean that each SME must work to its particular strengths in order to give itself the greatest chance for success.

Checklist of What MNCs Look For in Their SME Suppliers

The following checklist can be used by SMEs to review whether or not they have met MNC product, company, and corporate responsibility criteria. If not met, a plan to meet these criteria can be developed.

Criteria		Met	Not met	Plan to achieve
Product attributes	Quality	☐	☐	☐
	Price	☐	☐	☐
	Delivery	☐	☐	☐
Company attributes	Financial stability	☐	☐	☐
	Compliance with standards and certifications	☐	☐	☐
	Production capacity	☐	☐	☐
	Flexibility	☐	☐	☐
	Geographic location	☐	☐	☐
	Electronic capability	☐	☐	☐
	Market niche	☐	☐	☐
Corporate responsibility criteria	Business integrity	☐	☐	☐
	Fair employment practices	☐	☐	☐
	Environmental protection	☐	☐	☐

Source: The Conference Board of Canada.

For SMEs, the upside of supplier consolidation is that it has been accompanied by the evolution of more collaborative forms of supplier relationships. Mature supply chain organizations have concluded that adversarial, transaction-based arrangements with suppliers are no longer viable in an environment where their own survival and prosperity is so intimately linked with those of their value chain partners. In this environment, it makes much more sense to invest in developing strong, long-term relationships with key suppliers. Only in this way can each link in the value chain be accurately assessed and strengthened on an ongoing basis.

SMEs thus stand to benefit from entering into these relationships as well. Partnering with an MNC not only provides opportunities for revenue growth and accessing wider markets, but can also offer SMEs significant prospects for accessing the expertise and experience of their MNC partners. When these things happen, the development of a more competitive, innovative, and growth-oriented MNC-SME value chain often follows—ultimately, for the good of all partners involved and the Canadian economy as a whole.

CALL TO ACTION

MNCs, SMEs, and governments all have a role to play in promoting the development of effective MNC-SME value chain connections.

WHAT MNCs CAN DO

- **Make a sustained effort to connect with SME suppliers.** Forging value chain relationships with SME suppliers can be an important source of improved performance and increased profits for MNCs. To harness these opportunities, large business organizations need to raise their awareness of the economic and social benefits of MNC-SME collaboration, as well as their knowledge of other companies' best practices. They should also dedicate more financial and personnel resources to the task of identifying and connecting with SME suppliers.
- **Invest resources in supplier development activities.** MNCs need a strong commitment to working with their suppliers on developing their value-creating capabilities and solving problems identified during performance reviews. This involves creating a new organizational culture based on greater trust and intimacy between value chain partners.
- **Implement collaborative models of supplier relationship management.** MNCs should abandon the old transaction-based techniques of supplier management in favour of collaborative models, which put strategic partnership and long-term objectives above short-term gains and immediate market pressures.
- **Introduce supplier diversity programs.** Supplier diversity is a greatly underutilized source of value for MNCs operating in Canada. Introducing supplier diversity programs that target minority-owned businesses can provide MNCs with new ways of reducing costs and improving performance.
- **Participate in SME product development teams.** MNCs have global market knowledge and expertise in technology and operations management that can assist SME product development teams in creating innovative products and services.

WHAT SMEs CAN DO

- **Ensure product and company characteristics meet MNCs' selection criteria.** MNCs look for the best possible combination of product and company attributes in their suppliers. As it is often difficult to achieve the same degree of excellence on all the attributes, SME suppliers may wish to identify the areas that they consider most important and focus on improving their performance in these areas.
- **Identify key capabilities and work on improving them.** SMEs that occupy a specific market niche have the best chances of entering MNCs' value chains. To increase their attractiveness to large buyers, SMEs need to know what they do best and focus on developing these capabilities.
- **Improve performance on corporate social responsibility (CSR)**. Suppliers' performance on CSR will be an increasingly important factor in supplier selection decisions. To increase their chances of partnering with MNCs, SMEs need to ensure that their policies on business integrity, employment practices, and environmental protection conform to those of their prospective partners.
- **Consider opportunities to collaborate with other SMEs.** Although SME suppliers may not have the capabilities and resources to land large-scale contracts with MNCs on their own, there are opportunities for them to link into the global value chains of MNCs by working with other SMEs. This can be achieved either by becoming a supplier to a higher-tier SME supplier or by joining together with other SMEs to form a consortia for bidding on MNC contracts.

Large business organizations need to raise their awareness of the economic and social benefits of MNC-SME collaboration and their knowledge of other companies' best practices.

WHAT GOVERNMENTS CAN DO

- **Provide research on the benefits of MNC-SME linkages.** Although this study outlines a macro-framework for forging effective MNC-SME value chain connections, more research is needed at the sector-specific level of analysis. As discussed in Chapter 2 of this report, different value chains, industries, and products lead to different expectations and relationships. This micro-research will provide a clearer picture of the opportunities and challenges for MNCs and SMEs in each sector, as well as the expectations, methods of connection, and best practices in these areas.
- **Promote connections between MNCs and SMEs by organizing forums, conferences, trade shows, and other activities.** Making a successful connection with the right partner is one of the greatest hurdles faced by

MNCs and SMEs alike. Not only are many MNCs inundated with requests for partnership arrangements, they are also faced with a sea of possibilities in supplier selection. Not incidentally, even the best of SMEs find it difficult to get the attention of busy MNC procurement executives and managers. This makes the process of linking the best partners together difficult at times, resulting in missed opportunities and lower economic growth. Governments can facilitate these connections by creating the opportunities for leading MNCs and SMEs to come together in forums, conferences, trade shows, and other activities to improve Canada's competitive position by promoting strong MNC-SME value chain connections.

- **Assist SMEs in navigating the complexities of the MNC procurement process.** The processes involved in forming a partnership with a large MNC can be a daunting one for SMEs. Cross-border regulations, bureaucratic red tape, concerns over intellectual property, and a host of other barriers can make the costs of even investigating such a relationship appear to be too large for a small company. Governments can assist in this area by providing information, expert advice, and connections with the right contacts within MNCs and international markets to help defray these costs.

APPENDIX A

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