UNLEASHING THE INNOVATIVE POWER OF SUPPLIERS

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(Note: More examples and illustrations will be provided in final draft)

1. SUPPLIERS AS A STRATEGIC SOURCE OF COMPETITIVE ADVANTAGE:

   Ask virtually any CEO about their top corporate priorities and invariably growth and innovation are top-of- mind. But few have explored the potentially rich territory of their supply chain to reap innovative rewards. Considering that often 50% or more the corporate budget is expended on suppliers, suppliers represent one of the most impactful means of creating value and competitive advantage. However, because suppliers have traditionally been seen as "vendors," their potential as innovation partners has been overlook, and thus undervalued.

   No longer can companies afford to hold to traditional thinking. Supply management must reckon with the ultimate reality that a company cannot cost-cut its way to long-term prosperity. And worse, in numerous instances, wholesale hacking of suppliers has resulted in a severe diminishment of the supply base, leaving fewer options and alternatives. Further, global competition is forcing companies to recognize that they must double, and even triple their innovation output if they are to remain competitive. More and more, executives are invariably coming to the conclusion that:

   "In a fast moving, rapidly changing world, the most sustainable source of competitive advantage is collaborative innovation."

   Innovation is the most effective strategy for combating competitors with low price structures because it gives rise to a wide range of new options, including new technologies, process improvements, new business models, and access to new market opportunities. In short, innovation from the supply base is a strategic initiative that impacts both revenues and profits.

2. THE BATTLE OF VALUE CHAINS

   As a strategic issue, supply chain innovation should be an Executive Committee issue, faced directly not just by supply management, but by marketing, operations, and finance. Ultimately, any corporation must deal with the fundamental issue of how to deliver value and create competitive advantage in the marketplace. No company is an isolated element, each is part of a value chain, and, in the larger scope, winning the competitive game is more a question of how to create an entire value chain that is more competitive than that of other rivals. This cannot occur if the relationship with both our supplies at the sourcing end of the value chain and the customers at the sales end of the chain is adversarial. A collaborative relationship with primary suppliers and customers is essential if innovation is to flow and flourish.

   Too many of our current business and economic models are founded on the view that commercial enterprise is based on independent stand-alone organizations. A new order of thinking must be established that carefully and critically examines the premises of our currently accepted wisdom and challenges its presumptions.

Based on our study of innovation across business boundaries, we conclude that the best companies have had a deep rethinking about their core business:

a. **Internal versus Inter-Organizational Business Models**: The best companies see their business as part of a more interconnected value chain or network and create a strategic system for creating, aligning, and managing the creation of value. This involves a very intensive rethinking of what value means to their businesses and to their customers, and is clearly communicated into the supply chain.
b. **Strategic Value of Suppliers**: During the last 50 years spending on outside suppliers rose from a paltry 20% of total corporate expenses, to nearly 70% (in some cases more) of expenses. This fundamental shift has made what is now called "supply chain" a major strategic issue that has not been effectively addressed by scholars or businesses. Too many companies still treat suppliers as "vendors," reflecting our old fashioned mentality. The best companies segment their suppliers into at least two categories – strategic suppliers and commodity supplier, the former receiving special attention for the co-generation of innovation streams.
c. **Power of Collaborative Innovation**: As innovation becomes more pivotal in business decisions, and suppliers more critical to the generation of value, the best companies create more effective strategies, architectures, and models, for cooperative creativity than what has been relied upon in the past. The best companies recognize that collaborative innovation is one of the most powerful means of creating new ideas that impact revenues as well as expenses. They recognize that *differentials in thinking* are the primary source of innovation, and this can only come from having a broad series of alliances both internally and externally.
d. **Negotiations & Risk Management**: Current models for cross-corporate negotiations, contract management, and risk management are based on shedding risk, maximizing value for one party while minimizing for the other, and managing relationships tactically/transactionally. These methods have diminished or even negative impact in this millennium's fast moving, inter-connected world when applied to both primary suppliers and customers. .
e. **Revenue Impact of Suppliers**: The flow of innovation from suppliers can have major impacts on revenue as well as cost for the modern enterprises. A strategic review of this impact is essential. The best companies look deep into their supply base for new ideas, products, technologies, services, solutions, and business models that could enlarge their top line. Supply management links with R&D and Marketing to explore these possibilities.
f. **Impact of Critical Drivers of Competitive Advantage**: With the change in the driving forces of competitive advantage, where the traditional drivers based on Size, Positional/Transactional Power, and Financial Clout have been superseded by Speed, Aligned/Collaborative Power, and Innovative Agility, a new model of competitive advantage is essential. (see: Burt/Lynch Model of World Class Supply Management) Supply Chain Management develops greater skills in value management, organizational integration, and strategic alliances.

Addressing the issue of innovation means creating a much clearer understanding of the nature of innovation than the old adage that *invention is a flower, and innovation is a weed."* Fundamentally there are six types of innovation, each having its own powerful and intrinsic value. The six variants each have a vital role to play in the supply base (and companies must be aware of their different strategic impacts in creating competitive advantage):

i. Technology Invention (e.g. patentable)
ii. Product Improvement/Design
iii. Systems Solutions/Integration
iv. Process Improvement
v. New Business Models
vi. Market Extensions

What makes this six-dimensional model of innovation attractive is that it empowers non-technical people to engage fully in all but one of the type of innovation.

3. WHY & HOW THE VALUE NETWORK BEATS THE COMPETITION

When Collaborative Innovation Networks are pitted head-to-head with Legacy Supply Chain Models, the value networks win time after time. It is important to understand why. Our research and operational experience has shown there are a number of reasons, the most important of which is collaboration. A cooperative system enables strategic alignment, flow of innovation, mutual interest, and speed of decision-making. These factors eliminate or reduce non-value added friction costs in the business system, thus enabling greater profitability, long-term planning and investment horizons, integration among network entities, and better flow of useful information within the network.

Our research and hands-on implementation experience gives us a rich insight on how these value networks actually operate. Some of the examples of Value Network power include IBM Global Services & Software Solutions, P&G, Cisco Systems, and many others. In our analysis, we will also be including other examples, such as Toyota, Harley Davidson, and the Rolls Royce Starfish supplier network.

Strong, visionary leadership is required in such a situation, as well as the ability to interact at the senior levels of the members of the value network. But good intentions and eloquent words are insufficient. A powerful system based on best practices in alliance and innovation architectures, along with powerful championing skills will be required to make the mind-set shift, the culture shift, the strategic shift, and the operational systems shift together.

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APPENDICES

APPENDIX A. PIVOTAL ROLE OF INNOVATION

As the nature of business has changed, *innovation* has emerged as the pivotal leverage point for organizations to adapt to the new business order. Innovation plays a major role because it becomes the centerpiece and rallying point for a number of core issues:

- Strategic thinking regarding the role of suppliers in the creation of core value
- Engaging people and teams across the value chain in using differentials in thinking to generate innovation
- Developing more powerful innovation architectures
- Focusing on Best Practices in Innovation
- Building Strategic Relationships with key suppliers to produce the "Synergy of Compatible Differences"
- New leadership roles that connect companies, teams, people, and innovation systems
- New evolutionary economic model that can harness the value of collaborative innovation
- New Tools and Metrics that link to the new strategies

APPENDIX B. IMPEDIMENTS AND FALLACIES IN CURRENT THINKING AND MODELS

As a result of the empirical evidence gathered from our groundbreaking research, we have also identified a number of fallacies in commonly accepted thinking about business systems, negotiations theory, relationships, and flow of knowledge, innovation, and information. Among those fallacies and commonly accepted ideas we wish to dispel are:

- Myth #1 – Because Buyer and Seller have differing assessments in how value is gauged in the transaction, in practice they have objectively conflicting interests.
- Myth #3 – Power is the primary basis for relative strength of the buyer-supplier relationship.
- Myth #4 – In a world of Scarcity, Win-Lose negotiations is the best approach
- Myth #5 – Win-Win is too fuzzy, it's basically anything you are happy with.
- Myth #6 – It's not in the interests of Buyer & Seller to Maximize their benefit
- Myth #7 – Exchange is at the heart of all human existence

In place of these myths, based upon our research and empirical evidence, we propose a more empowering set of principles.

APPENDIX C. HOW TO MOVE FROM SUPPLY CHAINS TO VALUE NETWORKS

Making the shift from stand-alone businesses operating with suppliers in a tactical-transactional mode into a value network is a massive paradigm shift requiring a change in strategies, management capabilities, structure, metrics, and culture. This is not a shift for the timid or leaders without experience in the field.

As the Burt/Lynch Model of World Class Supply Management indicates, the priorities, processes, and practices are dramatically different at opposing ends of the spectrum. Organizations without world class alliances are severely disadvantaged in making such a shift.

Any executive wishing to makes such a shift will need to know the inter-related complexity of managing multiple shifts simultaneously, including:

1. **Integration**
   - Commercial Integration of Multiple Products & Services
   - Technical Integration of numerous systems, such as hardware, software, networks, voice, & data
   - Cross business unit collaboration and alignment typically required to provide the integrated solutions
2. **Value Proposition**
   - Must demonstrate Substantial/Quantum improvement over competitive alternatives
   - Measured by Customer's Metrics, not vendor's performance
3. **Customer Base**
   - Large enough to justify customization, integration, and alliance coordination costs.
4. **Engineering & Sales Forces**
   - Strategic integration of technologies, processes & sales forces
   - Often requires intimate knowledge of vertical market needs
   - Different sales cycles and different metrics
   - Cross-Function Integration across disparate businesses
5. **Pricing**
   - Not based on Component Cost
   - Based on Total Value to the Customer or Total Cost of Ownership
   - Customized Solutions require unique pricing
6. **Implementation**
   - Alliances required to provide basic elements of the product-service solution
   - Careful Control of Roll Out to ensure successful delivery of products, services, and solutions
   - Voice of the Customer and Voice of the Supplier to be heard across the network
   - Multiple forms of communications and information flow across the network

APPENDIX D. SUSTAINING INNOVATION IN A VALUE NETWORK

Value networks are complex integrated adaptive systems, and therefore are not easily managed without a disciplined, rigorous architecture based on clearly defined and tested best practices. For those companies that have taken the time to put such systems in place, the results have been quite rewarding. However, on the opposite side, organizations that have used the "intuitive" approach held in the minds of but a few key managers, have had unenduring, ephemeral results. For

example, Motorola has, at times used the intuitive approach to supplier value networks, without sustainability as other managers were unable to grasp the strategic or operational principles. However Cisco Systems has taken a more systematic approach to its supplier networks, and shown stronger sustainability.

The "connective tissue" of the network that links the network together is a critical element to the success of the network. One school of thought has promoted the "information system" as the core binding tissue. While this is important, it is but one small element of the systematic set of linkages that are necessary.

Another school of thought has believed that social network architecture should be effective as the connective tissue, but this has proven to be a blind alley. However, strategic alliance architecture, with its three dimensional framework focusing on strategic fit, chemistry/culture fit, and operational fit has proven to be a highly effective underpinning for the connective design of the network.

APPENDIX E. UNLEASHING THE ECONOMICS OF ABUNDANCE

The power of the value networks and their ability to capitalize on the acceleration of flows of innovation, speed, and integration has increased the visibility of what, in effect, has become an understanding that there are two parallel economic systems interacting in the network. One system is the traditional "Economics of Exp***e***ndables" which work under the well-versed rules of economic engagement. The other system, just as powerful, less visible and more virtual, is based on the "Economics of Exp***a***ndables."

Our analysis demonstrates the new economic systems and how companies can effectively capitalize on "Exp***a***ndables" in their day-to-day business interactions, using the co-creation power of innovation to produce synergies across the network. However, such "exp***a***ndables" are difficult to unleash in a transactional world. New principles, architectures, skill sets, mind sets, and metrics are essential when companies make the shift from transactional buy-sell arrangements to value network relationships.

APPENDIX F. BASIC ARCHITECTURE FOR SUPPLY CHAIN INNOVATION

The fundamental architectural framework for any practitioner seeking to create an innovation-driven value network will be to start with six essential elements:

1. **Strategic Imperative**
   - Establishing a Strategic Imperative for Innovation in the Competitive Environment
   - Policies & Programs to Launch an Innovation Program
   - Using Innovation Stratagems to beat the competition
   - Develop a Strategic Innovation Portfolio Management System
   - Innovation on the Edge: Using Alliances as Engines of Innovation
   - Keeping Innovation Alive after an Acquisition
2. **Leadership & Relationships**
   - Innovation is a Senior Exec's Responsibility to transform into a top priority and program

- Senior Leadership must develop new thinking & new architecture
- Vision without Execution is Hallucination
- Without effective leadership leading the charge failure is inevitable
- Innovation Leaders must be highly focused and capable:
  - Strategize
  - Organize
  - Nurture the Transformation
- Innovation is Another Form of Change
  - Change Creates Conflicts
  - Power Bases Disrupted
  - Organizational Norms Reconfigured
  - Core Processes Replaced
  - Organizations must Designate & Empower "Innovation Champions" to Drive the Shifts

3. Legal & Contractual

- The Value of IP is short-lived in a fast-moving world, and therefore its renewal and regeneration and future new royalty streams are just as important as its protection of current IP & royalty streams:
  - IP is often generated by Multiple Parties, often in Alliance with each other
  - IP is a Continually Renewing set of ideas that need to be Regenerating, therefore IP must be proliferated & shared in order for it to Expand
  - To retain Competitive Advantage, the Co-Generation of new IP among alliance partners is critical, and the establishment of a Regenerative System of Continually Improving IP is more important than being stuck with an old, dysfunctional IP that is outdated soon after it is created.
  - Ensure Getting Right Agreement in place will Never Delay Joint Projects
  - Ensure Contracts are Flexible enough to change quickly with the rate of change in the strategic environment
  - Build Innovation Relationships between parties that ensure continuous streams of innovation from the system of relationships

4. Organizational Design, Structure, & Culture

- Most organizations were designed for functional efficiency, not innovation. This creates a number of natural barriers to innovation. Three major organizational areas must be addressed:

  1. STRUCTURE & INTEGRATION
  - Shifting the Organization to Handle a Fast Moving Innovative World
    - Managing Ambiguity & Uncertainty
  - Internal Organizational Connectivity
    - Cross Functional Teams
    - Linking Innovation to Functional Units
    - Cross Business Unit Integration
    - Managing Innovation at Every Point in the Value Chain
  - External Organizational Connectivity
    - Alliances Relationships
    - Business Process Outsourcing Relationships
    - (IT, HR, Manufacturing)
    - Linking Solutions Providers or Systems Integrators or Compatible Suppliers
    - Build network nodes where talents & ideas are aggregated

  2. ATTITUDES, BELIEFS & CULTURE
  - Culture of Collaborative Innovation
    - (The Number One influence on successful innovation)
    - Values – Interpersonal & Discovery
    - Behaviors & Rewards
    - Prevention of non-synergistic Actions

        - Managing Knowledge & Learning
        - Prevention of the Ill Effects of "Not Invented Here" and the "Politics of Innovation"
        - Impact of Culture and Trust on Network Innovation
    3. NETWORK DEVELOPMENT & CAPABILITY BUILDING
    - Developing the skills, abilities, and infrastructures throughout the network to improve individual, team, and cross-functional capability to perform at world-class standards

5. Performance Processes

- A comprehensive and systematic approach must be taken to ensure processes and practices are up to the task of producing valuable streams of innovation. A number of issues must be addressed, including:
    - Innovation Triggers
    - Innovation Blockages
    - Innovation Generation Processes
    - Filling the Pipeline with Innovation
    - Triaging Innovation & Integrating Innovation
    - Managing Cooperation & Co-Creation
    - Fast Time Processes
    - Managing Breakdowns
    - Legal Processes for Joint Collaboration
    - Combating "Not Invented Here"
    - Integrators & Integration
        - Eclectic Resourcing
        - Cross Breeding
        - Non-linear Thinkers
        - Synthesis & Genesis
    - Mechanisms
        - Connecting to the Customer
        - Linking the Value Chain
        - Breakthrough Thinking
        - Continuous Improvement Initiatives
        - Cross Training, Co-Location, Secondment
        - Cross-Functional Teaming
        - Breakthrough "Tiger Teams" and "Skunk Works"

6. Economics & Metrics & Reward Systems

It's abundantly true that "if you can't measure it, you can't manage it." So also is it true that without metrics you can't sustain it, reward it, or nurture it. Metrics focus on identifying where value is created, lost, destroyed, or opportunities are overlooked, while avoiding the creation of "metrics spaghetti" where so many metrics are intertwined that everyone is spending all their time measuring, and no one is creating. Once metrics are clearly aligned with strategy, then rewards must be aligned to ensure a symbiotic effect between strategic objectives, metrics, and rewards within the network. In the end, the right metrics don't just measure innovation, they actually drive innovation and ensure that the network doesn't just innovate for innovation's sake, but creates useable, sustainable, and valuable innovation. This involves:

- Basic benchmarking:
    - What is the Current Baseline?
    - What are the Key Metrics?
    - Is each member of the network "Best In Class"?
    - How far behind is the network?
    - What does it cost to be less than best?
- What is the Total Cost of Ownership across the network?
- What are the critical "Leading Indicators" of innovation and competitive advantage?
- What are the Key Risk Factors?

- What is the Right Success-Failure Proportion?
- How well are the rewards systems aligned with the strategic objectives and metrics?
- Are the Risk-Reward relationships properly allocated across the network to produce the results required to be innovative?

Is the network measuring and rewarding “synergy?”