The lure of "earned preferential treatment"

EPT is viewed as the reward for being a good customer. But what does it mean, and how do you achieve it for lasting results and competitive advantage?

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There has always been something different, something attractive about the phrase "earned preferential treatment" (EPT). It implies that the buyer and their organization is treated differently—like a VIP. It implies perks and benefits not available to others. It implies strongly that the firm is important to the supplier and there exists goodwill and trust between the buyer and the supplier. Yet, a challenge facing most organizations is that of how to win this status.

Many organizations think that you gain this benefit by virtue of better transaction management—paying on time. Other equate EPT with the volume of business—the more that you buy, the more likely you are to gain EPT. The reality is that these views are both right—and both wrong. They are incomplete. They do understand that such a status is a prize that is gained by a process. At the heart of this process is an important issue: "Are you a good customer?" It is the position of this pape that you cannot earn EPT unless you are seen by your suppliers as being a good customer. However, as will discussed at the end of this paper, being a good customer, while important, is not enough by itself.

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Here we will explore the concept of EPT by answering the following questions:

- What is EPT?
- Why is EPT even more important now than in the past?
- What does it mean to be a "good" customer?
- Is being a good customer enough?

EPT: The concept

Like Match.com, supply chains bring together two parties—suppliers and buyers. To date, the focus has been primarily on the buyer's assessment of the effectiveness of the supplier. Largely overlooked has been an exploration of this relationship from the supplier's perspective. This assessment has taken the form of what Joe Sandor, the former chief procurement officer of Sara Lee and a regular contributor to *SCMR*, termed "earned preferential treatment."

EPT means that the buying organization has achieved a special status—one in which it is treated differently. For the supplier, EPT denotes that the buying organization has become a critical customer to the supplier. Yet, EPT is the result of a process (see Figure 1) that brings together being a "good" customer, good supplier relationships and EPT. When a buying organization is seen as a "good" customer, they naturally become more attractive to suppliers—current and potential; Tier 1, Tier 2, Tier 3 and beyond.

FIGURE 1

The process of earning EPT status

Source: Authors

Becoming a preferred customer can be viewed as an example of the law of criticality in action—the recognition that not everything is equally important. This law applies to many aspects of supply chain management: processes, capacity, measures, and customers.

To become viewed as a good, or preferred customer, it's not enough to place orders (especially large orders) and pay your bills on time. It involves aspects such as follows.

- **Supplier treatment.** Are the interactions with the buyer fair, open and honest? Does the buyer treat the supplier as a trusted partner? Does the buyer understand and accommodate possible limitations and constraints faced by the buyer? Such limitations could be both financial and operational.
- **Supplier development.** Does the buyer work with the supplier and help to improve the supplier's ability to improve performance? Does the buyer invest in the supplier, with the goal of helping the supplier to become better?
- **Buyer commitment to the supplier.** Is the buyer willing to work with the supplier over the long-term (through the good and bad times)? Is the buyer willing to help the supplier during downturns, recognizing that suppliers, especially small-to medium-sized enterprises may lack the resources necessary to weather such economic storms?
- **Buyer-supplier communication.** Is there an ongoing flow of information between the buyer and the seller (or is the communication limited only to when orders are placed, or problems encountered)? Is the buyer willing to listen to the supplier? Is the buyer open to suggestions and comments put forth by the supplier?
- **Supplier integration**. Does the buyer work to help integrate the supplier into the buying network by identifying what has to be done to ensure the complete and open transfer and protection of information and data, sensitive or otherwise?

As previously noted, these issues are often overlooked because the primary focus is on buyers and what they are looking for in potentially good suppliers. There is an exception to this view, and it involves the automotive industry.

The Working Relationship Index (WRI)

One of the features of the automotive supply chain is the Working Relationship Index, or WRI, which went through its 20th iteration in 2020. Initiated by John Henke, a professor at Oakland University in Saginaw, Michigan, the WRI surveyed suppliers to the largest North American automakers, including General Motors, Ford, Chrysler (now FCA US), Toyota, Honda and Nissan. The study sought to identify the factors that influenced these interactions, a factor that Henke referred to as "supplier trust."

It should be noted that this survey is both unique, in that the authors are unaware of a similar survey in another industry, and limited because it only includes Tier 1 suppliers that work directly with the selected automotive OEMs.*

The survey consists of 23 items that suppliers are asked to assess. These 23 items are then categorized into five broad areas: OEM-supplier relationship; OEM communication; OEM help; OEM hindrance; and supplier profit opportunity. Ultimately, these items are reduced to one index or score—the WRI.

Scoring high on this index is coveted by the OEMs. Taking it one step further, the authors of the WRI sought to quantify whether there was a correlation between scoring high in the index and overall operating income compared to the other OEMs in the survey. The answer was an overall improvement of more than $2 billion. In other words, good buyer-supplier relationships are critical strategically, operationally and financially.

Securing EPT is becoming critical now

For many readers, the benefits of EPT are obvious—lower costs, better service, access to innovation and new developments first. Yet, while important, these benefits overlook the most important reason that EPT is important now. EPT is needed because, without it, firms can't hope to achieve the new outcomes with which their supply chains are charged to achieve.

Even prior to the pandemic, supply chain were being asked to operate differently, with a new focus on outcomes such as improved sustainability, better transparency, enhanced cybersecurity or the implementation of digitalization. These outcomes pose some important challenges.

For instance, before they can be realized, each stage of the supply chain must commit to and be involved in the outcome, and each tier must be willing to make the necessary investments. For some outcomes, such as cybersecurity, this may create a potential problem due to two factors: (1) the size of the firm; and (2) the inability to generate a compelling business case.

Suppliers come in all sizes. However, little attention has been paid to suppliers from small- to medium-sized organizations (SMEs), usually defined as suppliers with 500 or fewer employees. Yet, these SMEs are critical to the supply chain because they produce innovative and/or niche products that crucial to their larger OEM customers. More importantly, these firms are often built around certain, hard-to-obtain, but critical skills and capabilities. Because they are small, they are less bureaucratic and more agile, capable of moving quickly to take advantage of new opportunities.

Yet, their size also creates a major problem. Relative to large firms, SMEs are often chronically underfunded with a diminished ability to secure rapid access to additional funding. After all, such firms have lower capitalization; they have lower or non-existent credit ratings than their customers, yet they are heavily dependent on credit for operating income; and, they have fewer financial options. This trait, inherit in almost all SMEs, contributes to the second factor, the inability to generate a compelling business case.

We are currently seeing these two factors playing out around the 889 mandate, a section of the John S. McCain National Defense Authorization Act for Fiscal Year 2019 that prohibits the federal government from directly procuring any equipment, system or service that uses prohibited Chinese technology coming from companies such as Huawei and ZTE.

For many small companies, compliance with the 889 mandate requires a significant investment, one that a small ball bearing manufacturer that serves the DoD estimated at more than $3 million. An investment of this size presents two challenges. First, such firms may have difficulty securing access to the necessary funding. Or, as in the case of the ball bearing manufacturer, they may decide that they simply can't generate a compelling business case and pass on the opportunity.

When these investments are not made, weaknesses in the supply chain emerge. Outcomes such as enhanced supply chain cybersecurity are not achieved. Rather, what occurs is the presence of negative supply chain externalities—where actions taken by one supplier (often acting at a lower tier) create problems and costs that are incurred by the firm, such as a cybersecurity breach.

EPT, and being a good customer, provides a partial solution to this situation, fostering the emergence of goodwill and trust. These conditions encourage suppliers to make the necessary investments.

Insights into being a good customer

At the heart of the survey were the traits that suppliers looked for when evaluating whether a buying organization was a "good" customer. To identify these traits, the research team drew on the following resources.

- An extensive literature review focusing on buyer-supplier relationships, supplier assessment and customer attributes. From this literature review, a number of key constructs and issues were identified and included.
- Discussion with current purchasers and representatives from small- to medium-sized suppliers. During this stage, the authors reached out to contact people who were involved in the buyer-supplier relationship. This pool consisted of people who worked within the government, and those who worked primarily in the private sector. As part of this outreach, one of the research team members solicited input from the Supply Chain Management Alumni of Michigan State University, one of the oldest, largest and best regarded supply chain management programs in the country.
- Discussions from experts in this area—both academic and industry consultants.

From these various sources, the research team identified 21 different attributes, summarized in Table 1.

Launching the survey

Early in the project development, it was agreed that this survey would primarily target SMEs. Second, the survey would not simply target current suppliers, rather, it would take a broader scope by including respondents from three separate groups: (1) those who are currently suppliers to a government agency we identified as GOV; (2) those who were once, but are no longer GOV suppliers; and, (3) those who have never been GOV suppliers. Finally, the survey would broaden the scope to include not only Tier 1 suppliers, similar to WRI studies, but also Tier 2, Tier 3, and Tier 4 suppliers.

We initiated the project on September 17, 2019 and distributed the survey on September 30, 2019. Data collection took place from September 30 to October 25, when the survey was closed at midnight. Over this period, we received 1,151 usable responses, of which 311 came from current GOV suppliers, 148 past GOV suppliers and 692 from non-GOV suppliers. From those responses, we identified several key insights:

TABLE 1

Consumer attractiveness attributes

ATTRIBUTE NAME	ATTRIBUTE DESCRIPTION
TRUST	Mutual trust and respect
PROFIT	Profitability of dealing with the customer
PROBLEMS	Joint problem solving
SIMPLERFP	Simple and complete Request for Quotation/Request for Proposals
TIMELYAWD	Timely awarding of contracts
CLARITY	Clarity of interactions
PREDREVNU	Predictability of revenue flow
CONFLICT	Effective conflict resolution systems
OVERALL	Overall ease of doing business
OPENNESS	Openness to suggestions and improvements from suppliers
EARLYWRN	Early warnings (regarding orders, problems, opportunities)
LTCOMMIT	Long-term commitment to suppliers
FREQCOMM	Frequency of communication (rather than only communication when there is a problem or a bid to be placed)
TRANSPART	Transparency of projects and purchases
PERMEAS	Effective, meaningful performance measures
MISSION	Clear mission and statement
CONSISTMESS	Consistency of messages/measures across levels and organizations
RISK	Risk sharing
INTEROP	Good interoperability (i.e., ability to link processes and share data).
SUPPLIERIMP	Programs for supplier improvement (in response to performance issues)
SUPPLIERDP	Supplier development programs

Source: Authors

What is important to suppliers?

The 21 attributes describing how suppliers viewed their customers were not equally important. Consequently, the first step was to determine what is important to the suppliers. To do so, we asked respondents to evaluate the 21 attributes using a 5-point Likert-scale (1: not important at all to 5: critical/essential). The averages for these ratings are reported in Table 2.

More importantly, this table sorted the 21 attributes in importance, with the most important at the top and the least important at the bottom. The horizontal line found in Table 2 identifies those attributes that were most important (with an average rating at 4.0 or higher) from those that were not as important.

There is one more important feature of Table 2, it involves the third column "Sign." This column reports the results of a simple statistical test—to what extent are the assessments generated by the third respondent groups (i.e., current suppliers, past suppliers and never have been suppliers) the same or different.

TABLE 2

Consumer attractiveness attributes evaluated by suppliers

(Mean values)

	IMPORTANCE	SIGN
Mutual trust and respect	4.52	++
Profitability	4.29	
Joint problem solving	4.25	++
Simple and complete RFQ	4.24	
Timely awarding of contracts	4.18	
Clarity of interactions	4.18	++
Predictability of revenue flow	4.18	
Effective conflict resolution systems	4.13	++
Overall ease of doing business	4.09	
Openness to suggestions and improvements	4.08	++
Early warning	4.05	++
Long-term commitment to suppliers	4.04	
Frequency of communications	4.01	++
Transparency of projects and purchases	3.98	++
Effective, meaningful performance measures	3.97	
Clear mission and statement	3.93	
Consistency of messages/measures	3.93	++
Risk sharing	3.80	+
Interoperability	3.79	++
Programs for supplier improvement (performance)	3.77	++
Supplier development programs	3.38	++

Note: For SIGN (significance), ++ denotes that the differences between the groups is significant at the 0.05 level; + denotes that the differences are significant at the 0.10 level.

Source: Authors

From Table 2, we drew the following conclusions.

- The respondents consider all attributes important. It is interesting to note that not one of the attributes was rated at 3.0 or less. Suppliers are apparently very demanding of what they want from customers in today's supply chain.
- ***Suppliers who deal with the private sector only have higher expectations relative to those who currently worked with GOV or those who have worked with GOV in the past.*** We can see from Table 2 that, out of 21 attributes, significant differences were observed for 13 attributes. For each of these 13, the ratings generated by those who had never worked with GOV were consistently higher than those observed for the other two groups.

This data paints a picture of suppliers who are generally more demanding. They want more; they have been exposed to best practices in other industries and they use these experiences to shape their expectations of what they want from a customer.

Can we simplify the 21 attributes?

Before leaving the quantitative analysis, let's discuss a major problem: Dealing with 21 different attributes is complex, so can we simplify the 21 attributes? To address that issue, we used exploratory factor analysis to determine if there were hidden factors present in the 21 attributes. The results are summarized in Table 3.

TABLE 3

Supplier base management four pillars of success extracted factors

RELATIONSHIP MANAGEMENT	COMMUNICATION FLOW	SUPPLIER COMMITMENT	TRANSACTION MANAGEMENT
• Problem solving	• Performance measurement	• Supplier development	• Timely awarding of contracts
• Conflict resolution	• Consistency of message	• Long-term commitment	• Simple RFP
• Clarity of objectives	• Transparency	• Interoperability	• Predictable revenue
• Mutual trust and respect	• Frequency of communication	• Supplier development (problem driven)	• Overall ease of doing business
• Mission	• Early warning		• Profitability
• Openness			
• Risk sharing			

Source: Authors

What this analysis tells us is that purchasing professionals should focus on four pillars if they want to be viewed as a "good" customer.

1. Improve the relationship management process. This is the ongoing process by which the government and its suppliers work with each other. This pillar recognizes that cooperation is necessary to deal with problems as they occur and to facilitate the generation and flow of ideas and suggestions between the government and its suppliers.

Suppliers are often intelligent and well-versed in their areas of expertise. They can identify potential problems at early stages of design—the best and most cost-effective place to introduce such suggestions. Yet, such relationships do not occur in a vacuum; for instance, they don't occur when there is a strict "I am the buyer and I tell you what to do" environment. Rather, cooperative and effective relationships occur when there is mutual respect and trust; such relationships occur when there is openness and a willingness to consider new and different ideas.

2 Improve communication flows. Communication is an on-going affair; it is not limited to the announcement of a bid or when there is a problem. We recognize that it takes time for the supply chain and its elements to react or change. That is why early warning is so important. Communication deals not only with complaints and problems; it also deals with recognition of jobs well done. To draw on a useful analogy, in marriage, the top reason for couples breaking up is poor communication. A buyer-supplier relationship can be regarded as a form of marriage.

3. Increase the level of supplier commitment. Suppliers want to know that they are important to the buyer. One way that the buyer can communicate this importance as well as the implied worth of the supplier is through supplier commitments.

This involves formal systems for developing and evaluating suppliers. These systems help the supplier understand what the requirements are to do a good job for the customer. In many cases, especially when dealing with small- to medium-sized enterprises (which are often informally run), buyers can help suppliers improve control over their processes by introducing them to such tools as process flow analysis, capacity management and lean tools. They can also help the supplier understand how to submit bids and how to bill. They also help the speed and ease with which the systems and processes of the suppliers and those of the government can be interfaced. As a customer, buyers must not only be willing to buy from its suppliers; it must be prepared to share them so that they are better suppliers.

4. Do a better job of managing the transaction or the buy. This final element is the most straightforward. It deals with revenues and costs. Because many suppliers working with GOV are SMEs, one challenge is that they lack the financial resources of large suppliers. Consequently, effective transaction management is very important to these suppliers.

This analysis also tells us which attributes contribute to which specific pillar. Each pillar can be viewed as the result not of activities, but of processes. As Joseph Juran, one of the fathers of Total Quality Management once remarked: If you don't like the outcome(s), change the process(es). This statement is now referred to as "process thinking."

The takeaway is that any government agency, or private sector business, must evaluate the processes that are responsible for each pillar, identify the weaknesses and deficiencies present in each and improve these processes by attacking and eliminating these deficiencies.

While this is a major undertaking, the good news is that the tools, procedures and systems needed to achieve these improvements are present—they are found in most Total Quality Management systems.

One other takeaway: While the survey focused on government suppliers, we believe the insights are applicable to buyer-supplier relationships in other industries.

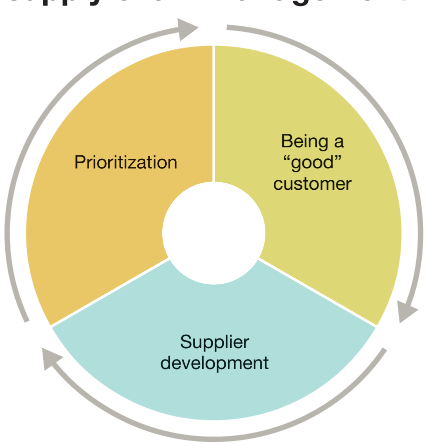
Is being a good customer enough?

In a word: No. To help managers achieve the objectives described in the preceding section, being a good customer has to be complemented by two other activities: prioritization and supplier development (see Figure 2).

These activities are too important to be discussed in a sentence (expect to see an article about them in upcoming issues of *SCMR*). Taken together, earned preferential treatment, prioritization and supplier development form the foundation on which modern strategic supply chain management is built.

FIGURE 2

The foundations of modern strategic supply chain management



Source: Authors

About our research

Our study was initiated by a U.S. Federal agency that we refer to as GOV. Our research targeted primarily small- to medium-sized suppliers (SMEs), defined for our purposes as suppliers employing 500 or fewer employees. Completed over a three-month period, the study helped the researchers better understand the relationship between EPT and being a good customer. More importantly, it helped the team understand that being a good customer is not enough.

EPT at critical supply chain stages

EPT is an important component of every well-run supply chain. However, it is earned not by large volume purchases or by paying on time. Rather, it is earned by being a good customer. When you are a good customer, you build good supplier relationships. With EPT and good supplier relationships, you position your company to build a strategic supply chain.

However, EPT and good supplier relationships are only part of the answer. To be truly effective, these have to be paired with prioritization and supplier development. As our research demonstrates, EPT is what you get when you are a good customer to all tiers of the supply chain, and not simply Tier 1.

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To read more about the Working Relationship Index, see Lost Supplier Trust, Lost Profits (scmr.com/article/lost_supplier_trust_lost_profits) from the May 2014 issue of SCMR, *and How They Did It: Supplier Trust at GM (scmr.com/article/how_they_did_it_supplier_trust_at_general_motors) from the May 2017 issue.*