Supplier Evaluation and Selection

Chapter 7
Chapter Overview

- One of the most important processes performed in organizations today is the evaluation, selection and continuous measurement of suppliers.

- Enlightened purchasers commit major resources to this process.
Chapter Overview

- This chapter provides an overview of the evaluation and selection process.

- Critical issues in supplier selection are discussed.
Chapter Overview

- A sound supplier selection decision today can reduce or prevent a host of problems tomorrow.
The Sourcing Process

Supplier Evaluation and Selection

What criteria and methods will we use to evaluate and select suppliers?

Supplier Management

What must we do to manage suppliers effectively and efficiently?

Supplier Development

What efforts should we put forth to improve supplier performance?
Supplier Evaluation and Selection Process

1. Recognize the need or supplier selection

2. Identify key sourcing requirements

3. Determine sourcing strategy

4. Identify potential supply sources
Supplier Evaluation and Selection Process

5. Limit suppliers in the pool

6. Determine method of supplier evaluation and selection

7. Select supplier and reach agreement
Supplier Evaluation and Selection Process

Steps in selection Process

1. Recognize need for supplier selection.

Discussion Question: How or when do we know that a need exists to evaluate and select a supplier?
Supplier Evaluation and Selection Process

Steps in selection Process

2. Identify key sourcing requirements.
   (What are you looking for in a supplier?)

- Quality
- Cost
- Delivery Performance
- Technological Capabilities
Supplier Evaluation and Selection Process

Steps in selection Process

3. Determining sourcing strategy.
   (The sourcing will differ from requirement to requirement.)

   • Single source vs. multiple sources.
   • Short-term vs. long-term contracts.
   • Domestic vs. foreign supplier.
Supplier Evaluation and Selection Process

Steps in selection Process

4. Identify potential supply sources.

(Intensity of search differs from requirement to requirement based on capability of current supplier and strategic importance of the requirement.)
## Supplier Evaluation and Selection Process

### Guidelines for Intensity of Search

<table>
<thead>
<tr>
<th>Strategic Importance</th>
<th>Capability</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH</td>
<td>HIGH</td>
</tr>
<tr>
<td>Hi capability/Hi strategic importance</td>
<td>Hi capability/Lo strategic importance</td>
</tr>
<tr>
<td>MINOR to MODERATE INFORMATION SEARCH</td>
<td>MINOR INFORMATION SEARCH</td>
</tr>
<tr>
<td>Lo capability/Hi strategic importance</td>
<td>Lo capability/Lo strategic importance</td>
</tr>
<tr>
<td>MAJOR INFORMATION SEARCH</td>
<td>MINOR to MODERATE INFORMATION SEARCH</td>
</tr>
</tbody>
</table>
Supplier Evaluation and Selection Process

Steps in selection Process

4. Identify potential supply sources (cont’d.)

**Discussion Question:** What are the various sources of information available when identifying supplier candidates?
Supplier Evaluation and Selection Process

Steps in selection Process

5. Limit suppliers in selection pool.

– Purchasers often perform a first cut or preliminary evaluation of potential suppliers to narrow the list

– Time and resources prohibit in-depth evaluation of all suppliers
Supplier Evaluation and Selection Process

Steps in selection Process

5. Limit suppliers in selection pool.
   – Methods to reduce suppliers in the pool--

• Financial risk analysis (discussed later)
• Evaluation of previous performance
• Evaluation of supplier provided information
• What kind of information should we ask suppliers to provide?
Supplier Evaluation and Selection Process

Steps in selection Process

6. Determine Method of Supplier Evaluation and Selection. (Once the pool is reduced you must decide how to evaluate remaining suppliers.)

- Review supplier provided information:
  - RFP’s
  - Detailed cost breakdown information.
Supplier Evaluation and Selection Process

Steps in selection Process

6. Determine Method of Supplier Evaluation and Selection (cont’d).

- Supplier visits
- Use of Preferred suppliers
- External or Third-party information
Supplier Evaluation and Selection Process

Steps in selection Process

6. Determine Method of Supplier Evaluation and Selection (cont’d).

• Cross-functional teams often evaluate suppliers directly through on-site visits
Supplier Evaluation and Selection

• Step 6: Determine method of supplier evaluation (cont’d)

  – Possible areas to evaluate during a supplier visit--
    • Cost structure
    • Delivery performance
    • Quality systems and performance
    • Management capability
Supplier Evaluation and Selection

• Step 6: Determine method of supplier evaluation (cont’d)

  – Possible areas to evaluate during a supplier visit--
    • Workforce capability
    • Supplier agility and flexibility
    • Supplier’s supply chain management capabilities
Supplier Evaluation and Selection

• Step 6: Determine method of supplier evaluation (cont’d)

  – Possible areas to evaluate during a supplier visit (cont’d):
    • Process and technological capability
    • Environmental compliance
    • Financial capability and stability
    • Information systems capability
Supplier Evaluation and Selection

• Step 6: Determine method of supplier evaluation (cont’d)

  – Possible areas to evaluate during a supplier visit (cont’d)
    • Production scheduling and control systems
    • Longer-term relationship potential
    • Capacity
    • Other?
Supplier Evaluation and Selection Process

Steps in selection Process

7. Select supplier and reach agreement

• Competitive Bid
• Negotiations
• Weighted factor approach
Key Supplier Evaluation Criteria

Various Performance Categories Considered During Supplier Evaluation and Selection

• Criteria most evaluations rate suppliers:
  • Cost/price
  • Quality
  • Delivery

• Is this effective criteria? Why or Why not?
Key Supplier Evaluation Criteria

*Various Performance Categories Considered During Supplier Evaluation and Selection*

- Other criteria that should be considered when evaluating suppliers:
  - Management Capability
  - Employee Capabilities
Key Supplier Evaluation Criteria

Various Performance Categories Considered During Supplier Evaluation and Selection

- Other criteria that should be considered when evaluating suppliers:
  - Supplier’s Cost Structure
  - Total Quality Performance, Systems, and Philosophy
Key Supplier Evaluation Criteria

Various Performance Categories Considered During Supplier Evaluation and Selection

- Other criteria that should be considered when evaluating suppliers (cont’d):
  - Process and Technological Capability
  - Environmental Regulation Compliance
  - Financial Stability
  - Production Scheduling and Control Systems
Financial Ratio Analysis

**Supplier Financial Analysis**

**Do it when?**
- For new suppliers
- For purchase requirements involving significant dollars
- For critical items
- When pursuing longer-term agreements

**Why do it?**
- To manage business risk
- To eliminate marginal suppliers early in the evaluation process
Financial Ratio Analysis

Sources of Supplier Financial Information

- Company-published annual reports
- Company-supplied 10-K and 10-Q reports
- Dun and Bradstreet reports
- TRW credit reports
- Trade and business journals
- Supplier provided data
Financial Ratio Analysis

Liquidity Ratios

- How capable is the supplier of meeting short-term cash needs?
  - Current ratio
  - Quick ratio

Leverage Ratios

- Is the supplier over-leveraged and capable of paying long-term obligations?
  - Debt to assets
  - Time interest earned
  - Fixed charge coverage
Financial Ratio Analysis

Activity Ratios

- How effectively is the supplier managing assets?
  - Inventory turnover
  - Average collection period
  - Return on net assets

Profitability Ratios

- How profitable is the supplier? What rate of return is the supplier earning?
  - Gross and net profit margin
  - Return on equity
  - Return on investment
Key Supplier Evaluation Criteria

Various Performance Categories Considered During Supplier Evaluation and Selection

• Other criteria that should be considered when evaluating suppliers (cont’d):

  • E-commerce Capabilities
  • Supplier’s Sourcing Strategies, Policies, and Techniques
  • Long-Term Relationship Potential
Supplier Evaluation and Selection

- Straightforward: Easy to calculate
- Reliable: Measures are well understood by evaluators
- Comprehensive: Considers important categories or criteria
- Flexible: Can be used with different purchase categories
- Objective: Uses a quantitative scoring system

Effective Supplier Assessment Survey or Audit
How to Develop a Tool for Supplier Evaluations

STEP 1  Identify key supplier evaluation categories

STEP 2  Weight each evaluation category

STEP 3  Identify and weigh subcategories

STEP 4  Define scoring system for categories & subcategories

DEVELOP THE SURVEY
How to Develop a Tool for Supplier Evaluations

**STEP 5**
Evaluate supplier directly

**STEP 6**
Review results and make selection decision.

**STEP 7**
Review supplier performance continuously

*Purchasing and Supply Chain Management, 3e Monczka/Trent/Handfield
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Critical Supplier Selection Issues

Issues to consider:

- Size Relationship
  - Not big enough to make an impact

- Use of International Suppliers
  - JIT may be an issue
Critical Supplier Selection Issues

Issues to consider:

- Competitors as Suppliers
  - Limits information shared and relationships formed.
Critical Supplier Selection Issues

Issues to consider:

- Countertrade Requirements
  - Boeing purchases portion of requirements in markets where it hopes to do business or where it must satisfy countertrade requirements of international government
Reducing Time Required to Select and Evaluate Suppliers

From 1980’s to 2003, product development time for the automobile industry has changed from 60 months to 24 months with the new goal being 18 months!

Processes supporting this development time, such as supplier selection, must also be shortened.
Supplier Evaluation and Selection Conclusions

• Supplier evaluation and selection is one of the most important processes performed by firms today
• Companies should develop standard tools to support the assessment
• Successful selection can prevent later supplier-related problems
• Teams are often used to evaluate and select suppliers