

10 Heartland & Company¹

Teaching Note

Opening Paragraph

On April 19, 2008, Walter A. Walsh, Heartland & Company, supply management manager, met with one of his buyers, Olivia Newcomb, in his Corporate Home Office. They discussed her Heartland & Company cost reduction goals for bearing #B02326620. After the meeting, Mr. Walsh began wondering if changes should be made to the way suppliers were being evaluated, if pricing premiums should be paid to suppliers for performing at a higher level and how business should be allocated among suppliers performing at different levels. These were issues needing further consideration. See Table 1 to review the supplier evaluations for New England Works and Midwest Bearings.

Immediate Issues

- Allocating business between two suppliers.
- Evaluating the supplier evaluation system.
- Managing conflicting goals of long-term supplier relationships and annual cost reductions.
- Consider pricing premiums for a higher-rated supplier.

Basic Issues

- Developing an understanding of supplier performance evaluations.
- Developing an understanding of conflicts in supplier evaluation programs.
- Understanding the challenges of deciding whether to grant price premiums to highly rated suppliers.

Teaching Objectives

- Develop a working knowledge of issues in the development of a supplier rating system.

1. Michael A. McGinnis, The Pennsylvania State University, New Kensington Campus, New Kensington, Pennsylvania (mam47@psu.edu). This case was prepared solely to provide material for classroom discussion. The author does not intend to illustrate either effective or ineffective handling of a managerial situation. The author has disguised some names and other identifying information to protect confidentiality. The views presented here are those of the case author. Copyright © 2009 by *Operations and Supply Chain Management: An International Journal* and the author.

- Develop an understanding of the interrelationship between supplier performance and pricing decisions.
- Develop an understanding of the challenges of managing conflicting organizational objectives.

Discussion Questions

This case can be taught using five different approaches. One approach would focus on the merits of the current evaluation system. Here, emphasis would be on questions one, two and three. A second approach, using questions four and five, would be to focus on the issue of negotiating differential prices (premiums or penalties) based on supplier performance. A third approach would be to address whether to single source part #B02326620 or divide the business between two suppliers. This approach, which focuses on questions six and seven, provides an opportunity to explore the advantages and disadvantages of single sourcing versus sourcing from two or more suppliers.

Fourth, the discussion of this case could examine the challenges of simultaneously managing two conflicting, but not mutually exclusive, organizational priorities. Here emphasis would be on question eight. This puts the student in the role of a manager who must provide guidance to someone who may be less experienced. Finally, this case can also be taught using a blend of the above approaches to examine the challenges of making a single sourcing decision within the context of organizational realities. In these teaching scenarios, student responses may vary substantially.

The following answers should not be considered as definitive; rather they provide examples of what the instructor might expect. These answers also provide material that can be used for supplemental lectures at the end of the case.

Discussion Questions

- 1. What are the advantages of basing a supplier's overall evaluation on its lowest performance on one of the five dimensions (Quality, Delivery, Cost Management, Technical Support and Wavelength)? What are the disadvantages? Overall, do you think that basing a supplier's overall evaluation on its lowest performance on one dimension is a good idea or not? Why or why not?**

In the organization on which this case is based, overall supplier evaluations were based on the lowest score on the five dimensions. A possible advantage of this approach is that a supplier must do well on all dimensions in order to receive a favorable overall evaluation. A possible disadvantage is that a supplier may “game” the evaluation system and not improve above its lowest dimension.

- 2. Develop importance weights for the five supplier rating dimensions shown in Table 1. Should these weights be equal? Briefly explain the basis for these weights.**

This question should lead to a wide range of viewpoints among the students. Apparently, Quality is paramount since both suppliers are at the Partner Level. The other dimensions (Delivery, Cost Management, Technical Support and Wavelength) can be points of contention among the students. For example, Delivery and Technical Support appear to be less critical since Midwest Bearings is rated “Approved” on

these dimensions. In the case of New England Works, a lower rating in Cost Management appears to be offset by higher performance in Delivery, Technical Support and Wavelength.

The current system appears to be categorical. However, since the suppliers' overall evaluation is determined by its lowest rating on any dimension, some students might argue that weighting appears to be situational by placing the most emphasis on the lowest-rated dimension.

If all five dimensions are weighted equally, then Quality, Delivery, Cost Management, Technical Support and Wavelength could each have a value of, for example, 20 points. This would result in a maximum score of 100. If, for example, the weight of Quality is increased to 40 points, then a total of 20 points would have to be deducted from the other four dimensions. This challenge often leads to some spirited discussions among students.

3. Develop a weighted-point system for evaluating Heartland & Company bearings suppliers. Please keep in mind that (a) the sum of these five weighted dimensions must add to 100 points, and (b) Heartland & Company has the current goals of developing long-term relationships with suppliers and generating cost reductions.

This question continues the discussions from questions 1 and 2, forcing the students to actually face decisions about priorities. To develop a weighted-point plan, students would need to assign values to "Supplier Performance Rating Scale." For example, "Partner" = 1.0, "Key" = 0.9, "Approved" = 0.8 and "Conditional" = 0.7, with any lower assessment = 0.0. Assuming all five values are weighted equally, a comparison of New England Works and Midwest Bearings would now appear as follows.

DIMENSION	NEW ENGLAND WORKS	MIDWEST BEARINGS
Quality	1.0 × 20	1.0 × 20
Delivery	1.0 × 20	0.8 × 20
Cost Management	0.9 × 20	1.0 × 20
Technical Support	1.0 × 20	0.8 × 20
Wavelength	1.0 × 20	0.9 × 20
Overall	98	90

A modification of the weighted-point system would be to place constraints on total and individual scores. For example, a supplier would be required to have a minimum overall score of 85 with a maximum of one dimension rated as low as "Conditional."

4. Make a case for paying a price premium that favors a higher overall rated supplier, such as New England Works. Make a case for not granting a price premium for a higher-rated supplier. Which would *you* recommend? Why?

One point of view is that Midwest usually quotes prices that are about 2 percent lower than New England. On a total of U.S. \$8.5 million annual sales to Heartland & Company, this would amount to about U.S. \$170,000. New England's savings contribution of U.S. \$500,000 to U.S. \$1 million/year translates into 2.5 percent to 5.0 percent based on 2007 purchases of U.S. \$20 million. A debating point here may be whether the savings due to efficiency gains resulting from New England's technical support would continue if Part #B02326620 is sourced from Midwest. Student comments when I taught this case ranged from 0 to 5 percent with a median of 3 percent. Several students recommended that adjusting the percentages of business awarded to New England and Midwest be based on supplier evaluations.

Another point of view is that Heartland & Company can “have its cake and eat it too” by sourcing from Midwest Bearing but continuing to buy a reasonable amount of bearings from New England Works. The alternate point of view is that Heartland & Company should reward New England’s commitment to technical support by paying a small premium. What students eventually recommend will depend on the priorities of immediate price concessions versus long-term efficiency gains. A factor that the instructor might want to suggest is that the buyer’s decision may depend on the Heartland’s reward system. Is Ms. Newcomb’s performance based on long-term efficiency gains, or is it based solely on price?

- 5. Assume that Heartland & Company is considering paying a price premium to the more highly rated supplier (New England Works) in this year’s buy of part #B02326620. If the only two suppliers quoting on this part are New England Works and Midwest Bearings, what percentage premium (over the lower price) would you recommend? Justify your response.**

It depends. If the reward system recognizes annual cost reductions, then Ms. Newcomb will probably opt for the lower prices of Midwest. However, if group incentives are used, then contributions to Heartland’s efficiency gains might favor New England. A major challenge here is the ability to measure price versus the difficulty of measuring (and internally selling the merits of) long-term cost savings resulting from a supplier’s technical support. In this specific case Mr. Walsh’s discussion with Ms. Newcomb focused on “cost reduction goals.” It was not clear whether “cost reduction goals” meant (a) reductions in bearing unit costs, (b) reductions in total cost of acquisition, (c) reductions in overall costs resulting from better coordination of delivery, (d) reduction in overall costs resulting from supplier technical support, or (e) a combination of these techniques.

- 6. Should Heartland & Company single source with New England or with Midwest? Or should they divide the business between the two? Briefly explain your rationale.**

This question provides an opportunity to discuss the advantages of single sourcing versus awarding the business to more than one supplier. On the one hand, awarding the business to one supplier provides opportunities for leverage on quality, delivery, pricing, technical support and overall cooperation. On the other hand, using multiple sources reduces the risk of crisis due to supply interruptions and enables the buyer to compare supplier performance more directly. Again, students should be able to think through the alternatives, weigh the advantages and disadvantages of each and make a defensible recommendation. Currently, the fashion is to prefer single sourcing. However, this approach may not be optimal if the supply environment is uncertain. Some students will argue 100 percent New England Works based on their higher performance, especially on technical service. Others will argue 100 percent Midwest Bearings based on lower price.

- 7. Assume that Heartland & Company has decided to divide the purchase of part #02326620 between New England Works and Midwest Bearings. What percentage would you recommend be bought from each? Briefly explain your rationale.**

Some students may argue for a 50-50 split in order to recognize both suppliers’ strengths. Other students may argue for some other percentage split based on their emphasis on New England Works’ or Midwest Bearings’ strengths. Some students stated that the percentage of business awarded between the two suppliers should be based on supplier evaluations. At the time of this case, the combined spend with

New England Works and Midwest Bearings was divided about 70 percent to the former and 30 percent to the latter. The basis of these percentages is unknown. The mix favored by students when I taught this case ranged from 65 percent New England/35 percent Midwest to 80 percent/20 percent, with the majority of responses in the 70–75 percent/30–25 percent range.

- 8. Heartland & Company (a) places a high priority on developing long-term relationships with suppliers that meet its goals and (b) pursues an aggressive program of annual cost reduction. If you were Mr. Walsh, what guidance would you give to Olivia regarding how these goals should be treated? Briefly explain your rationale for the guidance you gave.**

This question presents a challenge faced in many real-life situations. Two or more goals are often not neatly aligned nor necessarily in conflict. While student perspectives will vary, two considerations will probably shape Mr. Walsh's advice to Ms. Newcomb. The first consideration will be the current emphasis on partnerships within the organization. If partnerships are considered important, then I would advise Ms. Newcomb to look at the big picture and emphasize her decision's implications for the long term. This is especially important if developing and/or maintaining long-term supplier relationships are an important part of Ms. Newcomb's performance review. Conversely, if annual cost reductions are a major priority, then she should focus on price.

In either scenario, I would coach Ms. Newcomb to continually emphasize to New England Works that price is a continuing problem that should be addressed. At the same time, she should encourage Midwest Bearings to improve delivery, technical support and overall responsiveness. Based on Mr. Walsh's discussion with Ms. Newcomb it sounds like cost reduction is a higher priority this year than long-term relationship nurturing.

When I taught this course, many students suggested that the mix be adjusted according to the Heartland & Company "theme of the year." When emphasis is on price, allocate a greater percentage of business to Midwest Bearings, and when the emphasis is on long-term relationships, allocate a greater percentage of business to New England Works.

