OEMs: DISCOVER THE HIDDEN COSTS AND RISKS IN YOUR COMPLEX SUPPLIER NETWORK

Are your customers willing to pay for the cost of complexity in your supplier network?

By Mike Huiras, VP Sales & Marketing

I think we both know the answer to that question.

With price competition and cost pressures squeezing the profitability of medical devices, supplier networks are the latest target for cost reductions — and rightfully so. Complex supplier networks add costs, without adding value.

Medical device outsourcing is projected to continue to grow at an expected 11% compound annual growth rate, according to Technavio, a market research firm. Forward-thinking OEMs are simplifying their procurement model by reducing the number of suppliers and establishing strategic, instead of tactical, supplier relationships.

Intuitively, this makes sense.

However, consolidating suppliers is a monumental undertaking. How do you select a strategic partner? What are the risks of consolidating and how can you avoid them?

HOW DID SUPPLIER NETWORKS GET SO COMPLICATED?

Historically, the absence of a procurement strategy led to the growth of complicated networks of suppliers.

For years, the added costs of managing complex networks of suppliers were either accepted or ignored. Those added costs include: transactional costs and headcount needed to manage the relationships, quality and contracts, not purchasing at scale, and the cost of carrying additional inventory.

However, the industry evolved in ways that magnified the impact of complicated supplier networks:

- New regulations made OEMs responsible for the quality of their suppliers.
- Cost and price pressures increased from payers, customers, and competition.
- Regulatory complexity increased, including reporting and monitoring.
- OEM mergers and acquisitions forced the blending of already complex supplier networks.
- Level of concern over design control and the contract manufacturer's quality management system increased.

WHY CONSOLIDATE? WHY NOW?

As OEMs face cost and price pressures from multiple fronts (including competition, globalization, entry into lower cost markets, and insurance reimbursement changes), supplier costs are being scrutinized and the value of strategic partnerships in sustaining growth is gaining industrywide attention.

Reducing the number of suppliers to focus on a few strategic partnerships in this new industry climate offers multiple benefits:

- Reduced costs including lower transaction costs, ability to purchase at scale, reduced inventory, and reduced working capital.
- Reduced time and staff to manage suppliers including time and resources spent auditing, visiting sites and, managing relationships.
- Added value of strategic partners including improved planning, long range planning, continual management of costs, product development expertise, motivation for innovation, and willingness for capital investment.

However, simplifying in a highly regulated environment is anything but simple! Success is not guaranteed. The full benefits of consolidating a supplier base may not be realized if the supplier is not motivated to invest, is not capable of scaling up, is not financially capable of following through on investments, or if the transition and integration are not managed properly. How do you avoid the pitfalls of consolidation?

IDENTIFY WHAT YOU NEED FROM A STRATEGIC PARTNER

The model of using fewer strategic partners relies on selecting a partner(s) with complementary competencies working toward common goals for mutual benefit. In this arrangement, OEMs are able to focus on their core strengths of research and development, design, marketing, and sales, and allow their contract manufacturer to focus on production, quality, and outbound logistics.

The relationship is strategic enough for executives from the OEM and partner to meet regularly to create closer alignment for the future. As an example, they may discuss a new project that will be transferred in the near future. With advance planning, the partner can determine the most cost effective way to invest in the equipment, choose the best location for manufacture, the best technology for the process, and the human resources and skills necessary.

OEMs need suppliers that can offer this higher level of partnership. The partner doesn't just provide the service, they come up with creative solutions on the business side, whether that's investing in new technology, different manufacturing locations, or committing to process and quality improvements. Ultimately, both organizations are strengthened by the commitment of the partnership.

From a manufacturing perspective, OEMs need contract manufacturers that can both support new product introductions and deliver ongoing manufacturing projects on time. The contract manufacturer owns the manufacturing expertise and the manufacturing investment, and must be able to respond to industry trends to change and grow in response to their partner's needs.

WHAT DIFFERENTIATES A STRATEGIC PARTNER?

- How well do they understand their costs and cost drivers?
- How do they manage their quality and regulatory strategy? Is this system robust for scale-up?
- Do they have the technical capabilities to support a new opportunity?
- Do they have successful experiences in helping partners develop new products at speed?
- Do they have experience with innovation?

New product development is a competency which many OEMs are increasingly looking to outsource (or share) as a partnership. Yet many contract manufacturers cannot adequately manage the process of getting a new product to market. A best practice in this area is to appoint dedicated cross-functional teams to development projects. This project management approach drives accountability and visibility for both the partner and customer.

In some cases, a customer will have a need for a strategic partner with proprietary or specialized manufacturing capabilities that are difficult and costly to replicate.

From an operations standpoint, Lean Six Sigma must be a priority for a strategic partner. When OEMs commit a large share of their business to a strategic partner, they become more dependent on that partner. The partner must manage their operations to constantly look for new ways to drive out costs, to deliver on time, and to deliver a quality product, all of which benefit the OEM.

3 TIPS FOR REDUCING SUPPLIER CONSOLIDATION RISK

1. Have a thorough diligence process before evaluating any supplier partner.

The successful candidate must have an appetite for investment, ability to scale human resources, and the technical abilities to meet the challenges of consolidation. On the technical side, starting up new equipment and analyzing process capability will require the right team in place and may require an investment in tooling and a dedicated project team.

2. Don't underestimate the importance of good financial standing when vetting contract manufacturers.

Consolidation requires a financial

commitment from the partner. New equipment and talent require investment. If a partner cannot financially afford the investment in these expenses, either your supply will be interrupted or the OEM will have to step in to make the financial investment that was expected of the partner. Either way, fingers will likely be pointed at whoever did not uncover the financial risk during the vetting process.

3. Supplier consolidation experience counts.

Ask your suppliers what they have learned in their consolidation experiences. What are their processes for transitioning and integration? For OEMs, significant effort must be invested to make sure the transition is efficient. OEMs will need to commit resources, especially in the areas of quality and engineering. Many of the transition decisions cannot be made by the supplier alone. It takes great effort on the front end of the consolidation by the OEM to reap the benefits on the back end.

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ABOUT THE AUTHOR

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Mike recently joined Flexan as the Vice President of Sales and Marketing. Mike began his career with Helen Curtis as a sales representative for the consumer products division. He then joined Abbott in the Diagnostic and Molecular Diagnostics divisions, where he spent twenty-three years in several sales and marketing management roles of increasing responsibility in global product development, new ventures and international commercial operations. Most recently, Mike served as the Senior Director of Global Marketing for Abbott Molecular business which focused on rapid and broad detection of pathogens responsible for infections of critically ill patients. He holds a Bachelor of Business Administration from Loyola University of Chicago.

ABOUT FMI

FMI is positioned to offer a comprehensive end-to-end solution for your medical device outsourcing needs from our years of *Proven Partnership* with our customers. We support our customers in all aspects of the product development process, including tooling design, prototyping, and process development. We work with our customers to speed products to market through our rapid development program, while maintaining the highest quality.

Since 1989, we have been supplying micro-precision molded components to leading medical device manufacturers and helping them expand their global market reach. We understand the intricacies of FDA requirements and global manufacturing standards and we aim to exceed them with our proven partnership in contract manufacturing solutions.

FMI Medical is a privately held company, owned by Flexan LLC, founded in 1946, with more than 600 employees worldwide. We have manufacturing locations in Lincolnshire (IL), Elk Grove Village (IL), Salt Lake City, Suzhou (China), and Chicago.

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