

# **Supplier Diversity: A True Value Proposition**

White Paper

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## Introduction

Supplier Diversity in its truest form is “the process which creates fair and equitable engagement for diverse business enterprises to participate in corporate or public agency sourcing and procurement opportunities with the desired state of increasing business while delivering value to the corporations, public agencies, and ultimately the customer.” While the ultimate goal of Supplier Diversity, delivery of value to the customer, we must temper our efforts against the starting premise that “only 65% of companies give Supplier Diversity a medium to high level priority” (The Hackett Group). This starting premise infers the converse fact, “that 35% of the companies give Supplier Diversity a low priority or no priority.” Add the fact that there is an adversarial acceptance within all organizations of Supplier Diversity – this has an overall affect in prioritization and success of the supplier diversity process.

As the facts state above, priority level given to Supplier Diversity reflects itself in several ways: alignment of supplier diversity to the organizational growth strategy; support provided to supplier diversity leaders; organizational accountability for supplier diversity performance; acknowledgement and recognition of contributions supplier diversity affords the organization. Because of these varying levels of priorities we are not realizing the true value Supplier Diversity affords any organization.

## Problem Statement

Supplier Diversity is not being fully recognized and utilized for the purpose which it exists, Strategic Business Support, thereby not fully capturing and achieving its full potential, benefit, and value.

## Real Benefits of Supplier Diversity

Supplier Diversity has been the historical catalyst behind companies including MBEs into their Supply Chain. Through supplier diversity, a critical mass of minority business enterprises has been created. Corporations have taken advantage of this critical mass and have paved avenues for minority businesses to develop and grow. Similarly organizations, through development of this critical mass of minority companies, considered non-traditional, which have been included in their supply chain have realized the value these companies deliver. This non-typical growth and inclusion has netted some very positive results for all stakeholders (Organizations, Agencies, MBEs, Customers, Community). Organizations have realized new income streams as a result of their inclusive behavior. Similarly, minority businesses have emerged, developed, grown, scaled up in size, scaled up in capacity, and scaled up in capabilities resulting in the realization of new income streams. Win –Win! Although we understand the benefits of Supplier Diversity to date - the real benefits are still to come.

Demographics in this country are shifting and will continue to shift. More importantly, this demographic shift has a global impact through a shared relationship between countries. Thus, ethnic minority communities cannot be discounted. The present market is being replaced by a much more diverse population – monetary holdings are shifting thus purchasing power is shifting. It is estimated that the minority population disposable income will grow from \$1.3 trillion today to \$2 trillion in 2015 and \$3 trillion in 2045. Minority purchasing power can reach \$6.1 trillion by the year 2045 (U.S. Small Business Administration, 2007). The workforce will reach the point where it truly reflects parity and accurately reflects our community makeup. Therefore, a new market will be created when we reach a point where the ethnic minority community holds the largest purchasing purse and it is tied to a truly professional

and integrated workforce responsible for sourcing and procuring goods and services. This new market of the future cannot be discounted today (F. Hernandez, personal communication, September 20, 2012).

Supplier Diversity Leaders can attest to the fact that buyers buy from people with whom they share certain characteristics: race; ethnicity; religion; appearance; relationship; etc. And, buyers buy from (Martinez Survey) people whom they like. As demographic changes create a new market these same characteristics will remain in play, the main difference being, buying decisions will now be led by ethnic minority buyers.

In addition to the increase in purchasing power of the ethnic minority community another shift is taking place. The ethnic minority community is becoming a significant political constituency. And, when you combine economic power and political power you gain a significant amount of leverage in the market place.

We understand that supplier diversity has historically enabled inclusion and growth of our diverse business enterprises (DBEs). We must also understand that supplier diversity will continue to be the catalyst of change into the future. Thus, understanding the critical need to build inclusive supply chains, current supplier diversity trends and opportunities to support these trends in a winning manner will reverse the current trend of not realizing the True Value Supplier Diversity contributes to organizations and their stakeholders.

### **Organizational Trends re: Diversity and Supplier Inclusion**

Various trends are occurring in the market place and have been occurring for some time. These trends create a negative effect – perception, preclusion, and ultimately contribute to the erosion of supplier diversity value.

1. **Reporting is Confidential:** Confidentiality of information is extremely important! This is especially true for publically traded companies. Reporting diverse spend is very limited. This limited reporting results in the inference of results rather than fact based results. The full value of what Supplier Diversity can deliver to any organization cannot be captured if information is inferred.
2. **Reduction in Budgets and Personnel:** Supplier Diversity Budgets have been reduced year-over-year. Similarly, Supplier Diversity FTEs continue to be reduced. Budget range starts at under \$100K. Some organizations have gone as low as .25 FTE in supplier diversity personnel.
3. **Reduction in Supplier Base:** Sourcing and Procurement divisions continue to reduce their supplier base, better known as “Supplier Rationalization.”

### **Recommendations to support Organizational Trends**

Current trends continue to be part of organizational structures. Thus, supplier diversity leaders must make recommendations which embrace organizational change yet insure minority business inclusion, growth, and, development persist.

1. **Reporting is Confidential:** Total diverse spends, total percentages of controllable spend, diverse supplier base are key metrics by which organizations measure supplier diversity success.

Release of confidential information can easily coincide with annual reports to avoid compromising organizational confidentiality. This will protect internal information from being disclosed prematurely. However, to insure organizations capture the full value of their diverse spends, organizations must report their performance. Not reporting results in the self fulfilling inability to realize the full value of Supplier Diversity.

Reporting performance effectively impacts overall organizational performance. Reporting tells the story of how organizations impact growth and development of minority businesses. Reporting tells the story of how effective minority supplier inclusion supports the organization's success. Furthermore, reporting allows for assessment of the "Multiplier Effect" (2002 Washington Input-Output Model). That is, an analysis of the impact minority business growth has on the local economy. For example in the State of Washington, for every 1 Software Publishers & Internet Service job there is an additional 5.887 direct jobs created externally; for every \$1M dollars in labor there is an additional \$1.89M dollars generated externally in labor; and, for every \$1M dollars in direct output into the economy an additional \$670K in direct output is generated (Washington State Office of Financial Management, 2002). Reporting diverse spends plus understanding the multiplier effect puts all organizational spend into perspective: actual dollars contributed to the development and growth of diverse businesses + economic impact to the community = True Value. This level of understanding overall impact comes from reporting diverse spend.

2. Reduction in Budgets and Personnel: Understandably, everyone is doing more with less. However, when supplier diversity resources are cut, organizational ability to outreach is hindered. This results in the self fulfilling inability to realize the full value of supplier diversity. To insure supplier diversity remains within the medium to high level priority at minimum, organizations must budget for success and hire a full-time Supplier Diversity Executive. Budgets have continually been reduced year-over-year as part of cost reduction measures and efficiency percentages. Similarly, supplier diversity personnel continue to be reduced, not replaced, and Supplier Diversity becomes a shared responsibility.

Budget investments must be considered for both short and long-term successes. Like every other business unit, investment of resources (money, personnel, & time) is required to effectively operate. The same principle applies to Supplier Diversity. To effectively identify minority businesses that can meet organizational needs, Supplier Diversity must have a budget that most accurately reflects the activities which the organization deems will have the best recruitment opportunities. And, the budget must have goals attached to measure.

Measurable goals allow for course correction throughout the supplier diversity process – policy, strategy, change management, outreach, advocacy, and delivery. However, to effectively manage the budget and process, organizations must have the right person in the right position to deliver the right results.

The Supplier Diversity Executive must be a position with authority reporting directly to the Chief Procurement Officer. This position must possess the same level of authority as Sourcing and Procurement Executives. Any position subordinate to this will have no authority to create organizational change internally as well as externally. Thus, if organizations wish to maintain their high level priority, improve their mid-level priority, and launch their low-level priority, then

the right budget and empowered Supplier Diversity Executive must be in place. To position the Supplier Diversity Executive in a role of responsibility with no authority is once again moving in the direction of self fulfilling inability to realize the full value of Supplier Diversity.

Positioning the Supplier Diversity Executive in an empowered role with authority will facilitate ROI delivery. In fact, "Leading procurement organizations that have a slightly higher adoption rate of Supplier Diversity programs than typical companies, yet are able to generate 133% greater return on the cost of procurement operations than average performers driving an additional \$3.6 million to their bottom line for every \$1 million in procurement operations costs" (The Hackett Group). Similarly, just as Supplier Diversity is measured by diverse spend, percentage of controllable spend, and diverse supplier base, Supplier Diversity ROI can be measured if you have the executive and budget in place to succeed.

Like any other Return on Investment (ROI) Supplier Diversity ROI should clearly state the desired outcome. ROI in Supplier Diversity can be calculated like any other ROI calculation. Across all industries there is a typical ROI calculation formula:

$$\text{ROI} = \frac{(\text{Gain from Investment} - \text{Cost of Investment})}{\text{Cost of Investment}}$$

However, in Supplier Diversity there are specific elements that must be measured requiring an additional step in the process.

Supplier Diversity ROI Model 1:

Step One: Set annual diverse spend goals:

Goal 1: Define top line diverse spend goal

Goal 2: Define bottom line diverse spend savings (Inherent in this goal is the need for all sourcing and procurement executives to fully understand the value of their activities)

Objective 1: Sourcing and Procurement executives know each activities value – spend and savings. This information must be part of the Supplier Diversity Value.

Objective 2: Measurement must include both diverse spend savings and non-diverse spend savings captured due to fair and equitable competition within the Supply Chain. In each instance savings is captured as a result of minority business inclusion in the process.

Step Two: Normal ROI Measurement and Calculation

$$\text{ROI} = \frac{(\text{Diverse Spend Savings} - \text{Supplier Diversity Investment})}{\text{Supplier Diversity Investment}}$$

Diverse Spend Savings Defined: Annual Savings delivered by diverse firms or non diverse firms competing for the same business

Supplier Diversity Investment Defined: Supplier Diversity Personnel + Supplier Diversity Budget + Additional Resources\*

\*Additional Resources does not include sourcing and procurement executives performing their normal course of work (must not double count for performing their tasks).

Use of Model 1 shows how Supplier Diversity performance efficiently delivers bottom line value.

Supplier Diversity ROI Model 2:

There is a second method to measure Supplier Diversity ROI value. That is:  
Step One: Measure total annual diverse spend performance.

Step Two: Use normal ROI measurement and calculation

$$\text{ROI} = \frac{(\text{Actual Diverse Spend} - \text{Supplier Diversity Investment})}{\text{Supplier Diversity Investment}}$$

Use of Model 2 shows overall percentage of diverse spend dollars compared to investment dollars. This is indicative of the operational efficiency within which the Supplier Diversity process operates.

The true value of Supplier Diversity can be monetized by using either ROI Model 1 or 2. In each instance we will be able to measure the quantitative value (efficiency percentage) of Supplier Diversity. Whether an organization chooses to use Model 1 or Model 2 the value Supplier Diversity delivers to any organization can be measured in dollars and percentages/operational efficiencies.

Organization must also institute a management by fact/in-process check system such as a KPI (Key Process Indicator) model to support ROI measurement. This will insure all aspects of an organizations supplier diversity process are being monitored. Following the KPI process will allow any organization to understand the contributing value Supplier Diversity delivers every step within the supply chain process, budget process, outreach process, inclusion process, internal business unit performance process, all the way to individual performance process. This management by fact/in-process model supports effective capture of ROI and the True Value of Supplier Diversity.

Savings and contributions which Supplier Diversity Executive drive should contribute to fund the budget and appropriately staff the department, i.e., reinvest in the department, in order to capture and grow the true Supplier Diversity value. All departmental activities should contribute to self funding Supplier Diversity. All other departments are expected to contribute to profitability through increased revenues or cost savings. Their expectation and performance drives funding. Supplier Diversity department should be held to the same standard, empower Supplier Diversity leaders, build an effective budget, staff appropriately, and hold them accountable.

By critically analyzing the previous trends we see where value can be extrapolated and Supplier Diversity becomes critical to the organizations success. There is a third trend which on its face may seem detrimental but upon critical review it too contributes to the value of Supplier Diversity.

3. Reduction in Supplier Base: Typical Supplier Diversity measurements are as follows: dollars spent with diverse suppliers; diverse spend percentage of controllable spends; and diverse supplier base compared to the overall supplier base. Every industry has certain benchmarks which allow for self review to understand where they sit on the industry benchmark scale. Addressing the third dimension to this measurement, supplier base, we must understand how rationalization takes place and address the potential damage this process will have on all stakeholders.

Supply base rationalization is an effective strategy to create efficiencies. However, part of the supply base rationalization strategy must include the process of reviewing overall impact. Effectively, the rationalization process must be rationalized itself, i.e., “Rationalize the Rationalization.” During the execution of the rationalization strategy conduct a review of how the process affects stakeholders. How does this process affect the, organizations overall performance, diverse supplier base, and, more importantly the value of the effect? Without careful analysis unintended consequences will result.

Supply base rationalization, once again in its truest form, means: “you have the right amount of suppliers that have the right capabilities to deliver your product/services in the right value added form to your customer” (Supply Base Rationalization). Supply base rationalization brings inherent risks which require mitigation.

To effectively mitigate unintended consequences there are activities which may support any organization’s strategy to rationalize the supplier base yet protect the erosion of revenues or diverse spend. Some of the potential actions an organization may take are: 1. exclude diverse firms from the rationalization process - establish guidelines by which diverse firms are excluded from being rationalized out; 2. shift non-diverse business to qualified DBEs that possess size, scale, capacity, capability, and elasticity to assume the new load of product or services; 3. assess the value of diverse spend which will be impacted – this presupposes that an organization knows how it will impact the diverse business; and, 4. commit to maintaining or improving current diverse spend performance. Unless an organization takes these types of actions to project and insure outcomes, an organization will self fulfill the inability to realize the full value of Supplier Diversity. Supplier rationalization is moving higher within the strategic plan into development of strategic partnerships. Development of these strategic partnerships is invaluable to achieving organizational efficiency.

Strategic partners share many elements which result in long-term relationships: shared vision – diverse firm’s roadmap aligned to mutually support each organization in the future; shared value systems; mutual dependency – positioned to scale in size, capabilities, and capacity; shared strategic framework - long-term goals aligned to helping both organizations achieve their goals; high level commitment to success; trust, and, value-add relationship. This level of partnership focuses on meeting qualitative elements in addition to the quantitative performance. As organizations go through development of strategic partners the same process of “Rationalize the Rationalization” must apply.

## Recommendation Summary

In spite of current trends: reporting, reduction in budgets and personnel, and supplier rationalization, positive outcomes will result given the above recommendations are examined. Upon examination it will become apparent that Supplier Diversity is not one dimensional, i.e., spend, percentage, and supply base. Supplier Diversity is multi-leveled and delivers value within multiple levels of the value chain framework. That is, Supplier Diversity delivers minority business development and growth, positive economic impact, true and measurable ROI, and increased strategic partnerships. These results, with the correct prioritization, can effectively be



measured quantitatively and monetized thereby demonstrating the True Value of Supplier Diversity.

## Value Proposition

Value Proposition Defined: Simple, clear statements directed at a specific and targeted customer, the quantifiable benefits they can achieve by solving business problems, and the investment needed to make this possible.

### Key Elements of a Value Proposition:

1. What Product/Service are you providing?
2. How is this helping your customer?
3. What is the cost associated with your product and/or service?

Given the fact we understand what a value proposition is, key elements of a value proposition, supplier diversity trends, and, more importantly how organizational activities can contribute to building the value of Supplier Diversity, what would a value proposition look like? It would look something like the following:

“Acknowledging or elevating your organizational Supplier Diversity process to a medium or high priority within your business strategy will deliver improved performance by: improving the view of your organization’s economic impact upon your local economies; increased incomes (gross and net) as a result of a more efficient supply chain due to increased competition, innovative solutions, improved time to market; and, increased market share due to diversity and inclusion within your organization’s business management process, and, improved more efficient supply chain management process, thereby improving your overall performance at a cost that will self fund.”

## Summary

Supplier Diversity is a True Value Add Proposition! However, to fully capture the true value of an organization’s Supplier Diversity efforts a measurement methodology must be instituted. First, Supplier Diversity must be prioritized and made part of organization’s growth strategy. Second, continue to measure Supplier Diversity through the traditional process of diverse spend, percentage of controllable spend, and diverse supplier base. Third, include the second level measurements - KPIs and ROI. Fourth, establish effective Supplier Diversity leadership and staff with commensurate budget. And, fifth make Supplier Diversity everyone’s everyday job. The results will become visible. Through a disciplined five element measurement process, you will clearly understand that in fact Supplier Diversity, when fully recognized and utilized, is A True Value Proposition.

## References

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## Reviewers

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