

QUANTIFYING COMPETITIVE SUPERIORITY

The Challenge: Efforts to increase share of wallet are often hampered by the customer’s procurement organization, which focuses on “price” for specific transactions rather than overall “value creation.”

Practice #8

Value-Creation Scorecard

Performance scorecard jointly developed by supplier and customer and based upon the customer’s boardroom-level key performance indicators is used by the customer to assess all of its suppliers.

Company Profiled: Baker Hughes, Inc.



- Oil Services
- FY2001 Sales: \$5.4 billion
- FY2001 Net Income: \$438 million

Situation

Consolidation within Baker’s customer base across the 1990s prompts massive cost cutting and a resulting focus on price in supplier negotiations. In 1999, Baker finds that its sales force lacks strong “corner-office” relationships relative to competitors, inhibiting its ability to circumvent price-only discussions.

Action

Baker develops scorecards based on customer business objectives (rather than just product expectations) and asks customers to assess Baker’s performance, as well as that of competitors, using the tool.

Result

Since implementing the scorecard, Baker has witnessed impressive share-of-wallet gains within key accounts that use the scorecard while maintaining margins on incremental business. More importantly, the process has resulted in greater trust and more openness between customer and supplier, and the focus of discussions with these customers has transitioned to value, not just price.

Consolidating Customer Base Seeking Cost Efficiencies

As is the case in many industries, Baker Hughes's customer base is consolidating into fewer, bigger providers. The resulting pain to suppliers is familiar: customers' bold cost-savings announcements followed by greater empowerment of purchasing professionals to squeeze suppliers and drive down costs of goods and services.

Account Managers Stalled in Procurement

Faced with aggressive cost-cutting measures, Baker struggles to elevate discussion with customers beyond procurement's focus on price. Baker conducts a study of its strengths and weaknesses relative to its competitors, and concludes that, while it tends to outperform competitors in service delivery, it lacks the strong "corner-office" relationships necessary to communicate the value it can bring to the relationship. As a result, account managers end up discussing the value and savings it can deliver with purchasing professionals who are rewarded primarily for driving down unit costs.

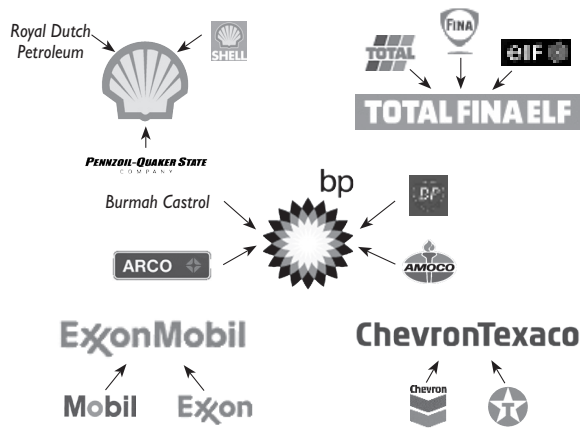
Rising Sense of Urgency

Thus, Baker faces two painful realities: 1) its level of access to the customer limits its ability to exploit its strength, and 2) it is not being rewarded for the value it delivers.

GETTING SQUEEZED ON PRICE

Ferociously competitive environment...

Schematic of Recent Consolidation in the Petroleum Industry




ONE-TRACK MIND

“After a year of merger planning...we expect synergies directly attributable to the merger itself to amount to \$3.8 billion annually on a pre-tax basis.”

Lee R. Raymond, Chairman and CEO
ExxonMobil 1999 Annual Report 

“...[We] now aim to deliver the \$2 billion pre-tax benefits of the merger in around a year’s time.”

Sir John Browne, CEO
BP Amoco 1998 Annual Report 

...leads to standoff between Baker and customer’s procurement groups

| Costs of Drilling Mistakes | |
|--|-------------|
| Drilling deepwater well | \$50 M |
| Delays due to ice-clogged well | \$250 K/day |
| Sand clog due to poor well engineering | \$5 M |
| Risk of injury/fatality | ? |



BAKER HUGHES’S PROBLEM

| | |
|--|--|
| <p>Strength</p> <p>+ Execution—Delivery on promises made to customers</p> | <p>Weakness</p> <p>— Influence—Competitors possess stronger high-level relationships</p> <p>— Size—Competitors have bigger service range to discount on</p> |
|--|--|

Developing a Customer Scorecard

To get beyond procurement, Baker develops a scorecard built back from the customer’s key performance indicators. Baker and the customer jointly identify specific goals for each of five performance areas. Baker then commits to achieving specific performance targets that support the customer’s overall business goals. In turn, the customer commits to measuring Baker’s performance, as well as Baker’s major competitors, using the same criteria. Thus, the scorecard serves as a tool supporting account managers’ efforts to promote a value-based discussion.

A New Value Proposition

From the supplier’s perspective, the purpose of the scorecard is to expand the elements of value under discussion with the customer. If “cost” is the customer’s primary focus, the scorecard broadens discussion beyond the cost of a drill bit, for example, to include cost of downtime and injuries due to drill bit breakage.

Relative Value Leads to Increased Share of Wallet

The scorecard allows Baker to measure its performance relative to customer-defined standards, as well as relative to competitors. As the quote on the opposite page indicates, Baker’s strategy is to seek commitments from the customer that it will gain share of wallet if Baker outperforms the competition by delivering more value.

First Mover Advantage

The scorecard strategy is clearly bold, as Baker must feel that its value proposition is the strongest in order to suggest the idea. A bit of advantage, however, does accrue to Baker as the “first mover,” as it can work with the customer to define the scorecard metrics in a way that is sure to underscore Baker’s strengths. Suppliers can realize a strategic advantage by being a first mover, as it is in the process of defining the scorecard inputs that a supplier can influence customers to define value to the supplier’s strengths.

LIVE-FIRE EXERCISE

To Overcome Price Focus, Baker Proposes Use of Scorecards That Compare Baker to Competitors

By measuring competing suppliers with same metrics, relative value can be assigned to Baker's performance

| | | DIRECTIONAL DRILLING | WIRELINE | DRILLING FLUIDS | CEMENTING |
|--|--|---------------------------------|--------------|-----------------|---------------|
| Customer's Key Performance Indicators | | Customer Target | Actual | | |
| | | | Baker Hughes | Competitor #1 | Competitor #2 |
| Cost | Directional Drilling Services Cost | | | | |
| | Total Drilling Time | | | | |
| Efficiency | Non-Productive Time (NPT) | | | | |
| | Improved Production | | | | |
| Innovation (Incremental Benefit Drivers) | Improved HSE Performance | | | | |
| | Cost Savings | | | | |
| Health & Safety (HSE) | Days Away from Work Injuries | | | | |
| | | Objective Met (1 = yes, 0 = no) | | | |
| Quality | No Collisions or Unplanned Well Shut-Ins | ○ | | | |
| | No Unplanned Equipment Sidetracks | ○ | | | |

Note: Scorecard was originally developed with BPAmoco, and Baker now employs it selectively with other key accounts.

Scorecard facilitates balance of price and value discussions

The first supplier to propose the competitor scorecard to customers is able to influence the metrics that the scorecard tracks

REDEFINING "VICTORY"

"Our philosophy is not to go after all of the business or be the cheapest price. We tell our customer to split up the business and then measure our performance on the same metrics. If we beat our competitors and deliver more value, then we want more market share and a fair price uplift."

Vice President, Marketing and Technology
Baker Hughes, Inc.

Getting in the Door

Baker uses the scorecard at each customer facility—in this case, oil rigs—but the scorecard has greatest impact if used as a roll-up tool across multiple facilities in order to form the basis of a dialogue with the customer's senior managers. Baker uses the data it acquires on its performance relative to competitors to derive key performance indicators that inform discussions between its own executives and customer executives. The power of the tool is most evident at this executive level, where customer executives have shown a willingness to correct spending imbalances where Baker clearly outperforms rivals.

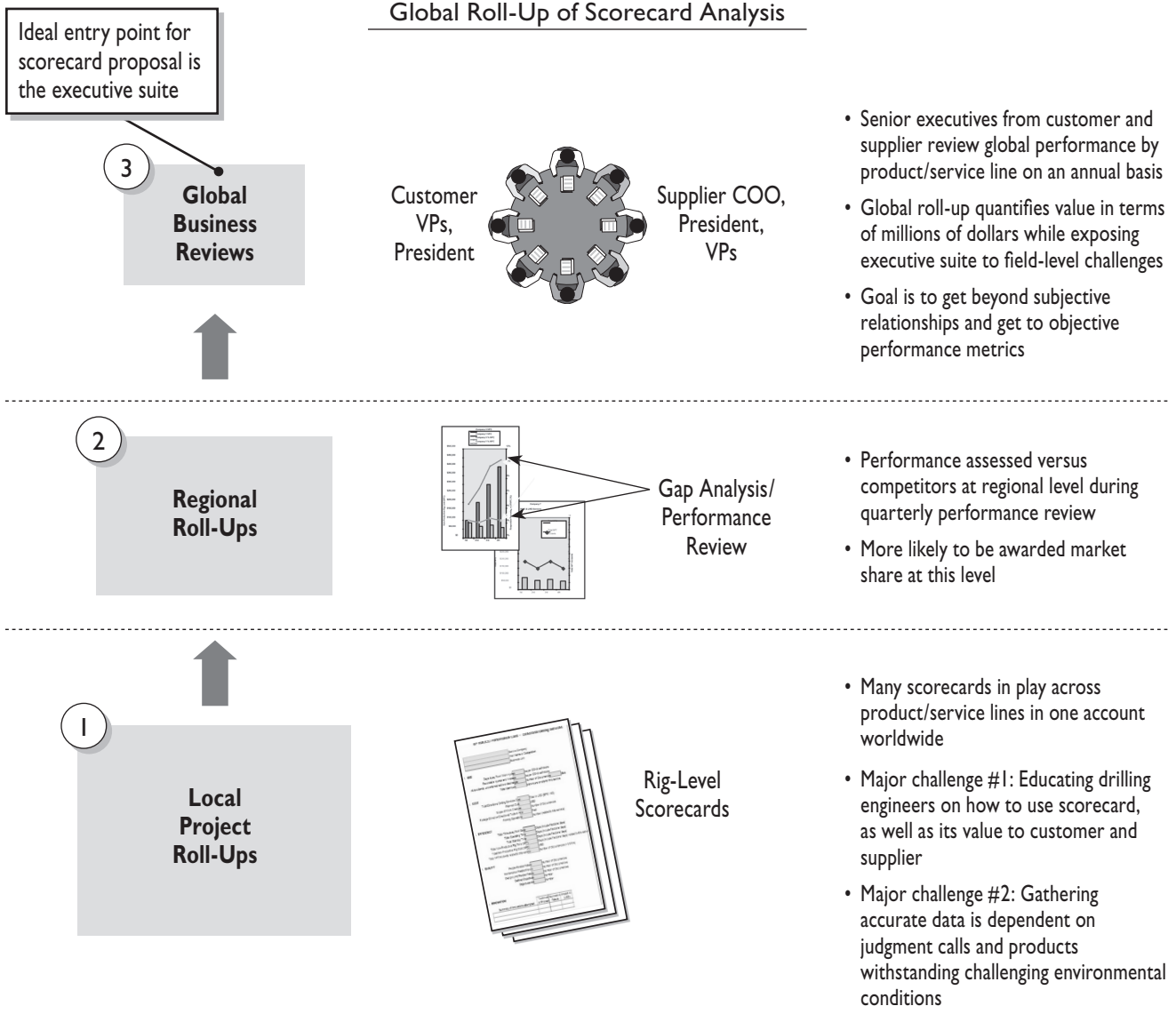
A Caution on the Difficulties of Operationalizing the Scorecard

For Baker, administration of the scorecard occurs at several levels, which are summarized on the adjoining page. While rolling up local scorecards to an aggregate level sounds simple, Baker has encountered two primary challenges:

- 1) *Heavy Training Burden*—Frontline training is necessarily intense. Data are rolled up from the local level, which has meant significant investments in training Baker and customer field engineers how to complete and submit scorecards at the end of each drilling project.
- 2) *Overcoming Subjectivity*—Some measures of value are not easily quantified or objective. Thus, the implementation challenge is further complicated by the subjective nature of some scorecard inputs. For example, in cases where Baker customers misuse a product (e.g., subjects drill bit to improper conditions), fairly assessing responsibility for rig “downtime” can be difficult. However, Baker has found that completing each scorecard becomes less contentious over time as trust builds. Moreover, Baker notes that, in a relative sense, usually they are not going to be worse off than competitors.

FROM THE FRONT LINE TO THE EXECUTIVE SUITE

Scorecard Roll-Up Facilitates Rich Discussion at All Levels of the Customer



A TALL ORDER

“We’re trying to implement this on a global basis. It isn’t easy. Many of the regions have an inconsistent approach to quantifying value. We’ve got to educate not only our own people, but the customer’s drilling engineers as well. Based on what we’ve seen so far, though, it’s definitely worth the effort.”

Global Account Manager
 Baker Hughes, Inc.

Scorecard Drives Quantifiable Market Share Gains

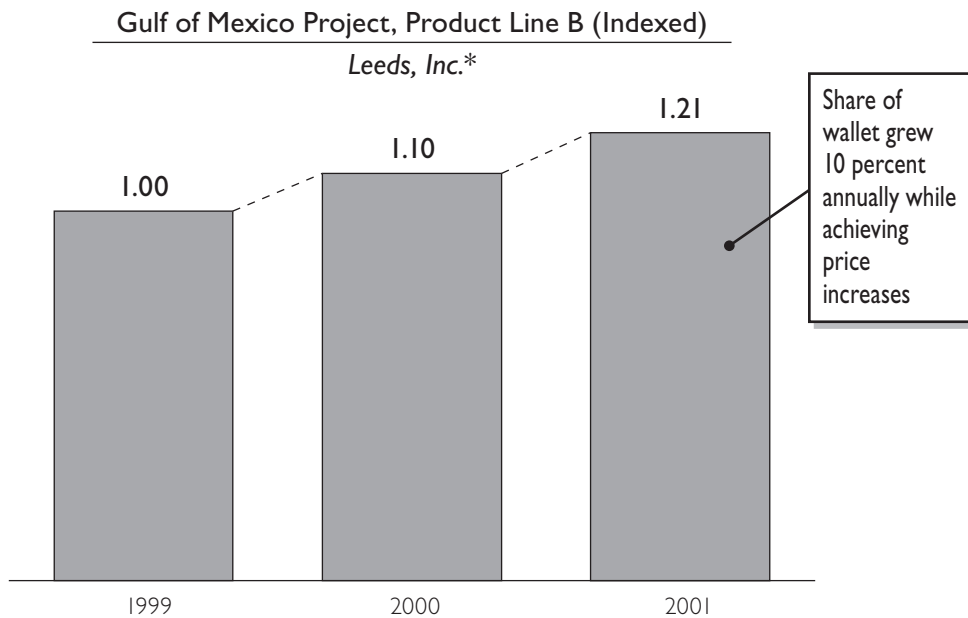
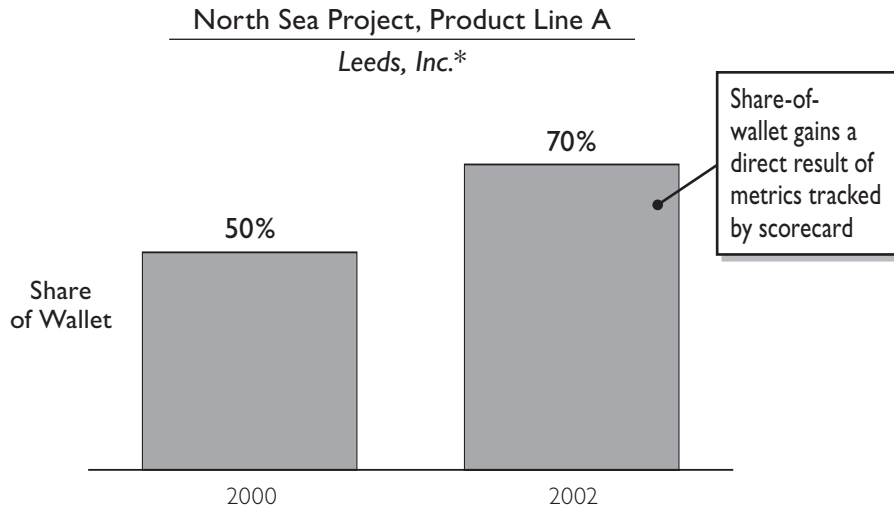
Of the strategic accounts that have adopted a scorecard, Baker has seen positive results that are best illustrated at the project level. Baker identifies two drivers of market share gains: 1) customers are now tracking and recognizing contributions beyond basic cost metrics, and 2) customers now have clearer visibility into relative supplier performance.

Relationship Depth Grows

Perhaps most importantly, Baker has been encouraged by the openness of relationships at a high level that has resulted from scorecard implementation. At multiple levels, Baker is having operations-focused discussions that transcend price.

TO THE VICTOR GO THE (SP)OILS

Implementation of Scorecard Leads Directly to Share-of-Wallet Gains



SEEING EYE TO EYE

“The best thing about this process isn’t the data results, it’s that it connects us on every level with the customer, from the field up to the top levels of management. We have a more open dialogue because the data are sanctioned by both sides, and both sides benefit.”

Global Account Manager
Baker Hughes, Inc.

* Pseudonym.

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Source: Baker Hughes, Inc.

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COUNCIL ASSESSMENT

The Council recommends a value-driven scorecard with competitor performance comparisons for limited use by members. Its use is limited by three factors:

- 1) The significant time and resources required to acquire scorecard data with sufficient granularity, as well as resources required to improve performance, suggest that the tool is best employed against only the most valuable accounts. (A scaled-down version of the tool may be possible for lower-value accounts, however.)
- 2) The market must have sufficient supplier concentration so that the majority of a customer's supply options are represented by a small number of firms. Otherwise, the tracking burden is likely to overwhelm the exercise.
- 3) The customer's purchasing posture must be open to the possibility of non-price negotiations. In the hands of Purchasing, the tool will simply be used to exert additional price pressure.

As a result of these restrictions, the number of settings in which the tool should be employed is rather small. However, because of its focus on highest-potential accounts, the impact on the organization is still likely to be quite significant.

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