

Diverse supply chains are a win for society—and for business

September 3 2020, by Rachel Koon



As movements calling for racial justice have grown throughout the country in recent weeks, many businesses have increased visibility of their diversity initiatives. But few companies ever report on the results of

these initiatives, leaving some to doubt their efficacy.

In a new article published in *MIT Sloan Management Review*, Department of Marketing Assistant Professor Jonathan Zhang focused on the impact [supplier diversity](#) initiatives have on supply and procurement firms. Zhang and co-author Simha Mummalaneni from the University of Washington found that although many companies typically view these initiatives as investments in [corporate social responsibility](#) (CSR) and not the bottom line, they have a net positive effect on both.

Zhang and Mummalaneni demonstrate in their article that by increasing competition, supplier diversity initiatives are beneficial to both diverse small suppliers—defined as small and women-, minority- and/or veteran-owned—and the companies they supply, as well as their customers.

The 'Two Logics'

In his recent research, Zhang has theorized about the tension between the "two logics" of business: profit and social. Historically, business has focused almost exclusively on "profit logic," which is the idea that companies and their leaders have a singular focus on profits and a fiduciary duty to increase shareholder value. "Social logic," the idea that companies should implement policies that benefit society and the environment, typically takes a back seat to profit logic.

"Traditionally, companies' 'social efforts' were often lip service because there were no metrics to quantify the results and align them with shareholder value," Zhang said. "Thus, they aren't implemented widely and are perceived as being in conflict with the profit motive. The perception is that as a company, if I invest in these socially good outcomes, my expenses go up, which negatively affects firm performance and violates my fiduciary duty to my shareholders."

Now, Zhang says, more companies see that social, environmental and diversity initiatives are not only good for brand-building—they can also lead to increased profits. That's key, because most companies will only fully pursue CSR when they can document the financial benefits resulting from these initiatives.

With the recent push toward more diversity and inclusion in businesses across industries, Zhang says diverse supplier initiatives are a good example of a policy that can benefit and align both the social and profit logics.

"In the past, there has been hesitation in fully embracing supplier diversity programs because diverse suppliers are perceived as being less efficient than larger and established suppliers," he said. "And if the goal is to reduce procurement cost, companies don't want to do that because then they violate the profit logic. But what if having diverse suppliers contributes to financial benefits? Then the two logics align."

Increased Competition, Lower Prices

Although it seems counterintuitive, Zhang says including diverse suppliers who charge higher prices in the [bidding process](#) can ultimately lower a business's procurement costs. The key is increased competition.

To illustrate his point, he gave an example of a big-box store and a small shop both bidding to supply a company with face masks. Because it has economies of scale, the big-box store is able to bid \$1 per mask, whereas the small supplier bids \$2. Many small suppliers know they charge higher prices than large suppliers, and they often don't participate in the bidding process because they think the procurement firm is focused solely on obtaining what they need for the lowest possible price.

As small suppliers drop out of the bidding process, that decrease in

competition can ultimately lead to bigger suppliers charging more for their products.

"If the big-box store knows that the buyer isn't pushing for supplier diversity—if they know small business isn't going to participate, whether because of lack of promotion from the procurement side or lack of awareness or because the small supplier thinks it's not going to matter because their costs are higher—what is the big-box store going to do? It's going to bid higher, say \$3 per mask, pocketing \$1 in excess profit."

Without small, diverse suppliers, big firms will charge a higher price for their products because they know the pool of competitors is smaller. Zhang argues that making the pool open to businesses of all sizes is better for everyone.

"Empirical evidence shows that for companies that institute supplier diversity initiatives, compared to those that did not, their costs are lower because there's more competition," he said.

Other Benefits of Supplier Diversity

In addition to benefiting the bottom line, supplier diversity initiatives have other advantages for companies that implement them. Population demographics in the United States are shifting, and companies' customer bases are diversifying. In the MIT Sloan Management Review article, Zhang and Mummalaneni note that supplier diversity initiatives strengthen customer relationships and let companies connect with these increasingly diverse customer bases, which could have "significant implications for future growth, given that minority population growth will account for as much as 70 percent of the total increase in purchasing power from 2020 to 2045."

By providing insights into what a diverse customer base might want,

diverse suppliers can become valued partners for businesses. And implementing supplier diversity initiatives can also make a company and its products more attractive to consumers who value equity and inclusion.

"Consumers might view the [company](#) as doing some social good, which adds to the brand premium," he said. "From a market intelligence perspective, diversity initiatives are also useful in providing diverse consumer insights."

Ultimately, though, most companies will hesitate to implement social, environmental and other efforts unless they benefit the bottom line. Zhang says that's why research like his, which clearly proves the financial benefits of diversity and inclusion, is so compelling. By demonstrating that supplier diversity aligns the profit and social logics, Zhang hopes his research can incentivize buyers to fully embrace supplier diversity and boost small businesses' participation in procurement markets, promoting shared prosperity for all and making the world a better place.

More information: Maximizing the Benefits of B2B Supplier Diversification. sloanreview.mit.edu/article/maximizing-the-benefits-of-b2b-supplier-diversification/

Provided by Colorado State University

Citation: Diverse supply chains are a win for society—and for business (2020, September 3) retrieved 26 April 2024 from <https://phys.org/news/2020-09-diverse-chains-societyand-business.html>

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