HASLAM COLLEGE OF BUSINESS
THE UNIVERSITY OF TENNESSEE, KNOXVILLE

SIG

CORE CENTRE FOR OUTSOURCING RESEARCH & EDUCATION

IACCM International Association for Contract and Commercial Management

Unpacking Sourcing Business Models

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21st Century Solutions for Sourcing Services

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PURPOSE AND BACKGROUND

This white paper—now in its second edition—is a collaborative effort among the University of Tennessee (UT), the Sourcing Industry Group (SIG), the Center for Outsourcing Research and Education (CORE), the International Association for Contracts and Commercial Management (IACCM). It was also the inspiration for the 2015 book, *Strategic Sourcing in the New Economy: Harnessing the Potential of Sourcing Business Models in Modern Procurement.*

The organizations and authors have teamed to drive awareness and clarity on how Sourcing Business Models can help private and public procurement professionals improve their sourcing effectiveness by using the most appropriate Sourcing Business Model for their sourcing situation. The original white paper, published in 2012, centered on applying Sourcing Business Model theory to outsourced services. This edition expands that thinking and asserts that Sourcing Business Model theory can be applied to all types of sourcing initiatives.

This white paper has five primary purposes:

1. *Establishes that sourcing is a continuum.* In this section, we highlight Dr. Oliver E. Williamson's Nobel Prize-winning concepts and challenge organizations to consider a "hybrid" approach for sourcing more complex initiatives.

2. *Shares a high-level overview of the various Sourcing Business Models,* including traditional transaction-based models and more sophisticated output and outcome-based models. In addition to the overview, we explore the pros and cons of each model. We also examine how Sourcing Business Models can be applied in a "Shared Services" environment.

3. *Provides guidance for determining the appropriate Sourcing Business Model* based on a set of common business attributes.

4. *Illustrates real examples* of how organizations are applying each Sourcing Business Model in action.

5. *Challenges procurement professionals to embrace Sourcing Business Model theory,* encouraging the acceptance and adoption of alternative models purposely designed to create value and drive innovation with suppliers.

The paper is divided into sections that address the five focus areas. Enjoy the read – and share with your colleagues, management, suppliers and customers to help expand their learning of strategic sourcing in the new economy

INTRODUCTION

Adam Smith, an eccentric Scottish academician at Glasgow University, observed the human propensity for self-interest and formulated the invisible hand theory of supply and demand in 1776 with the publication of *An Enquiry into the Nature and Causes of the Wealth of Nations.* His theory said that society benefits as a whole from a multiplicity of trading transactions because humans seek what is best for them, resulting in fairness and honesty among equals. He also encouraged "division of labor" – a key justification for helping early businesses drive efficiencies in operations and work with trading partners that may be more efficient.

As demand for repeat transactions emerged, trading preferences evolved and modern transaction-based business models were born. Transaction-based business models remain the cornerstone of conventional business relationships and form the backbone of today's procurement processes.

For the most part, transaction-based approaches served procurement professionals well through the 20th century. Organizations formed back-office functions to manage the "buying" of goods and services needed to support their organizations.

The procurement profession got a boost beginning in the early 1980s when pioneers such as Peter Kraljic and Michael Porter pushed procurement professionals to think more strategically about the art, science and practice of procurement. In the early 1990s organizations such as A.T. Kearney encouraged an even broader perspective, with a rallying cry for procurement professionals to shift their thinking to that of strategic sourcing and commodity management. Many individuals and organizations around the world have responded, embracing concepts such as the Kraljic Matrix, Porter's Five Forces model, and A.T. Kearney's popular seven-step framework for strategic sourcing. The procurement profession has slowly evolved from one of a clerical "buy desk" to a full-fledged function driving strategic value for organizations.

There's no debate these pioneers led an evolution in procurement that made a lasting impact. Procurement organizations would not be where they are today without the thinking (and tools!) from these progressive thinkers.

Even though the procurement world began its evolution in the early 1980s, the nature of the business transitioned slowly. First, all around the world, C-suite executives took the advice of legendary management guru Peter Drucker to "*Sell the Mailroom*,"[1] which started a subtle shift where organizations began to outsource anything that was not a core competency. Thomas Friedman[2] pointed out in 2005 that the world is "flat." The world had indeed embraced outsourcing as a formidable way for organizations to focus on what they do best.

The lens through which organizations look at traditional "goods" has also changed. Today, suppliers couple goods and services together to create a solution. A case in point is Rolls Royce, which pioneered the "Power by the Hour" concept by coupling the sale of engines with post-sales support maintenance and selling engine availability in terms of price per flight hour. These early ideas were the beginnings of what would become common practice in today's defense maintenance contracts.

While the statistics vary, most experts in the procurement field agree that typical organizations spend between 40-80% of revenue with suppliers that help them develop, manufacture, sell and services their goods/services.[3] For example, the automobile industry spends 70% of its revenue with suppliers.[4] And if you are like most – this means roughly half of your procurement spend is on services that require a more sophisticated approach to sourcing.

Many refer to the subtle shifts that have taken place as "the "new economy." The authors borrow the term *VUCA* from the military to describe the business environment of today. VUCA stands for *v*olatility, *u*ncertainty, *c*omplexity, and *a*mbiguity. Those adjectives resonate with the day-to-day experiences of many business leaders.

Whatever it is called, the shifts are clear. Today's procurement professionals must maneuver in an evolving environment that is more dynamic than ever. They must embrace and evolve with modern business needs, and more and more this means balancing what seems to be insurmountable, conflicting goals of reducing cost structures while driving innovation and mitigating risks.

Simply, put, the tried and true tools and tactics adopted over the last 30 years as the "gold standard" are no longer as effective as they once were.

These shifts point to a clear message: the business battlefields of this century will be based on harnessing the power of your suppliers. Tomorrow's winners will no longer play yesterday's competitive win-at-all-costs game with key suppliers. The playing field is no longer one of lowest cost or best value, but one of highly collaborative relationships with suppliers that can drive transformation and innovation for your organization. If firms are going to compete 'supply chain to supply chain,' shouldn't all the links in the supply chain work together?

The rest of this white paper is devoted to helping procurement professionals in the private and public sectors gain a basic understanding of how to harness the power of Sourcing Business Models for their sourcing initiatives.

PART 1. OUTSOURCING IS A CONTINUUM, NOT A DESTINATION

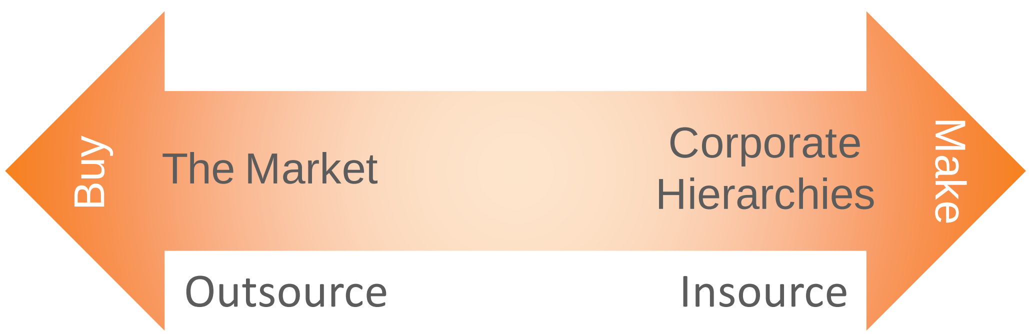
For centuries organizations have thought of procurement as a “make vs. buy” decision. This is especially true as organizations began to explore outsourcing. Many falsely assume if they “buy,” they should use competitive “market” forces to ensure they are getting the best deal. In doing so the default approach is to use a transaction-based model. This works well for simple transactions with abundant supply and low complexity where the “market” can correct itself. After all, if a supplier does not perform, just rebid the work.

However, as organizations outsource and procure more complex goods and services, this logic no longer works. All too often buyers become co-dependent on suppliers, switching costs are high, and suppliers have a “locked-in” position.

Dr. Oliver E. Williamson – professor of economics at the University of California, Berkeley – challenged the traditional view of sourcing practice with his work in Transaction Cost Economics. Williamson received the Nobel Prize for his work in 2009. One of Williamson’s key lessons is that organizations should view sourcing as a continuum rather than a simple market-based make vs. buy decision.

Perhaps the best way to think of Williamson’s work is to consider (**Exhibit 1** below) free-market forces on one side and what Williamson refers to as “corporate hierarchies” on the other. In the middle, Williamson advocated that organizations should use a “hybrid” approach for complex contracts.

Exhibit 1: A Continuum of Outsourcing Solutions



Developing Corporate Hierarchies (“Make” or Insource)

Organizations have long debated the merit of making versus buying goods and services. The industrial revolution enabled corporations to capitalize on big business, resulting in vertically integrated companies designed to build and leverage their power. For the most part, big business was met with big government. The default was for organizations to “make” versus “buy” the goods and services they needed to sustain themselves whether in the private or public sector. The result? Large powerful organizations that many would classify as “bureaucratic.”

The make versus buy debate was reinforced when well-respected management visionary Peter Drucker encouraged CEOs to “sell the mailroom” in his 1989 *Wall Street Journal* article.[5] Big thinkers Peters and Waterman jumped on the bandwagon in their best-selling book *In Search of Excellence* in 1982.[6] By 1990, scholars C. K. Prahalad and Gary Hamel took the debate to a new level in their pioneering and popular Harvard Business Review article titled *The Core Competence of the Corporation* which encouraged organizations to evaluate their “core competencies.”[7] Their advice? Most organizations cannot focus on more than five or six core competencies.

Logic prevailed, and CEOs and government officials the world over began to shed internal assets. Organizations turned to outsourcing for goods and services customarily controlled in-house (information technology, call center/customer care, supply chain services, back-office finance functions).

Government agencies got on board as well. Water agencies began to outsource the design, build and maintenance of water treatment facilities. Public-private partnerships emerged for public works projects. Defense agencies began buying weapons systems maintenance capabilities instead of simply buying spare parts.

The bottom line was about the bottom line; the result was a steady shift to the procurement of more complex goods and services.

Scholarly work into the make versus buy debate brings further clarity. Williamson’s work on Transaction Cost Economics (TCE) puts math behind Peter Drucker’s common-sense approach. TCE theory points out there are many hidden transaction costs associated with performing work that is non-core to the organization. When work is performed by an organization’s internal resources, there is not any competition. This provides little incentive to drive inherent improvements in cost and quality. There is also high administrative control and a legal system that is “deferential to the management.” As a consequence, innovations that might come from the market or third parties are not shared or developed as rapidly as management typically likes — if at all.

Because these are additional bureaucratic costs, Williamson advises, “The internal organization is usually thought of as the organization of last resort.” In other words, if at all possible, organizations should not invest in developing goods and services that are “non-core.”

Using the Market (“Buy” or Outsource)

Organizations that procure goods or services typically use what Williamson calls the “market” to buy goods and services. The market uses the conventional free-market economy to determine how organizations will do business, including establishing a price. The assumption is that free-market forces incentivize suppliers to compete on low cost and high service. This approach also features an absence of dependency; if buyers or suppliers are not happy, they can switch at any time with relative ease. Governance of the supply base is typically accomplished by switching suppliers or customers when a better opportunity comes along. As a result, the market approach relies purely on classical contract law and requires little administrative control.[8]

The big advantage of using the market lies in its simplicity. The market mode enables a competitive process to determine whether an organization is getting a good transaction price. The heart of the market is a transactional business model. Competitive bidding processes establish market prices for everything from a per-unit price for a spare part, to a price per call for technical support, to a price per pallet stored in a warehouse, and even price per hour for a janitor to clean a building.

The downside to the market mode is that it often assumes that the purchase is somewhat standardized and therefore available from a variety of suppliers. Consequently, suppliers often "compete" into contracts that pose unnecessary risks.

For example, Williamson points out that service providers might have "specialized investments" that can easily expose the business to significant loss if the contract fails and for which no safeguards have been provided.

Innovation is one form of specialized investment that creates value, such as asset-specific product and process improvements designed to create competitive advantages for the buyer. As suppliers make specialized investments to support innovation, they look at risk versus reward. Often, they raise prices to reflect their increased level of risk. However, buyers still want reduced prices as well as the benefits of innovation. Buyers and suppliers often find themselves in a "give and take" as a normal part of market-based negotiations and suppliers seek to develop contractual safeguards.

Williamson's research shows that using the market for more complex contracts drives up transaction costs. He argues that more complex contracts should use what he calls a "hybrid" approach with a conscious decision to build more trusting and secure supplier relationships. The goal should be to drive out opportunism and inject efficiencies in the buyer-supplier relationship.

Hybrid Relationships

Capitalism informs us that the best results come from competition. On the surface this makes sense. After all, it's hard to argue with 200 years of progress under Adam Smith's teachings. However, big thinkers are challenging the concept that highly competitive market forces always end with the best result. Transaction Cost Economics and Game Theory point out there is a better way.

Although both a market and hierarchical approach offer advantages, both also have clear disadvantages. Williamson believes that the market doesn't always work as efficiently as theory leads one to believe. And buyers may find they don't have skills or money to invest in certain competencies. Game theory teaches us to view a problem through a different lens: one designed to optimize for the problem under review. Every day, more and more research is proving that collaborative, not competitive, strategies yield consistently better results.[9]

Unfortunately, most procurement tools promote commoditization and competition. This can put a buyer in a Catch-22.[10] The Catch-22 emerges for organizations that want to drive innovation and create a competitive advantage, yet still want to rely on a supplier for a particular good or service.

Why is there are Catch 22? Organizations say they want a "strategic" supplier, but the nature of how they buy and contract tells a different story—one of commoditization and competition.

Procurement professionals are taught to commoditize goods and services, using Kraljic's "leverage" and "exploit" techniques to help them increase their buying power. They are encouraged to have uniformly available goods and services (e.g. commodities) where a buyer can easily compare "apples to apples" and avoid potential supplier protests due to subjectivity in the supplier selection process. In some cases, public procurement policies are even written in such a way that buyer/supplier communication about potential innovative solutions is limited.

To make matters worse, it is not uncommon that procurement professionals are measured on (and often incentivized on!) driving cost reductions through a Purchase Price Variance metric.[11] This drives short-term emphasis on "price" paid versus overall value or a focus on reducing total ownership costs. To top it off, far too many lawyers hunker down with the single-minded goal of shifting risk and emphasizing shorter-term contracts to limit supplier dependency.

These practices are magnified when combined with a conventional transactional business model where a supplier is paid for every activity. The more hours, the more units, the more calls, or lines of code written—the more revenue and profit for a supplier. Buyers find their suppliers meet contractual obligations and service levels, but they do not drive innovations and efficiencies at the pace the organization wishes. Suppliers argue that investing in their customer's business is risky because buyers will simply take their ideas and competitively bid the work. In short, a transactional model pits buyer against supplier with conflicting goals.

On the one hand, organizations want suppliers to close gaps when they lack core competency. They desire suppliers to be innovative and provide solutions. Yet on the other hand they drive competition and commoditization, preventing suppliers from wanting to invest in innovation. The result is that the industry is at a crossroads, with both buyers and suppliers wanting innovation — but neither wanting to make the necessary investments.

PART 2. SEVEN SOURCING BUSINESS MODELS

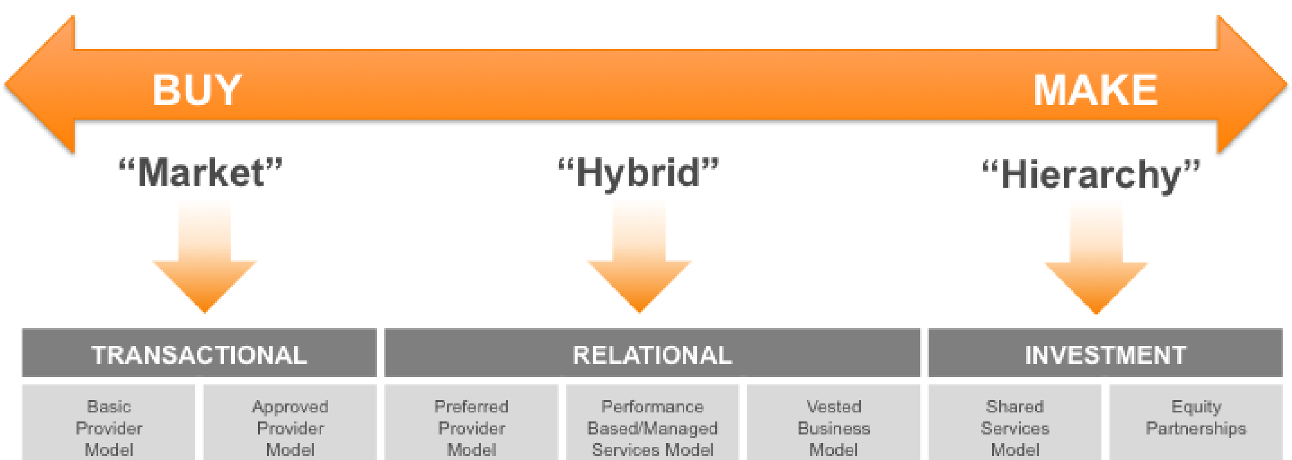
Research by the International Association for Contract and Commercial Management (IACCM) shows that most organizations operate under conventional transaction-based models constrained by a formal, legally oriented, risk-averse, and liability-based culture.[12] There is a growing awareness that transactional-based approaches do not always give each party the intended results.[13] University of Tennessee research and the authors' industry-specific experiences apply alternative output and outcome-based approaches for complex contracts. That experience demonstrates that alternative Sourcing Business Models are viable approaches to conventional transactional methods.[14] As senior leaders see positive results from carefully crafted collaborative agreements, momentum grows for both output and outcome-based approaches.

We outline seven Sourcing Business Models (featured in detail in the book *Strategic Sourcing in the New Economy: Harnessing the Potential of Sourcing Business Models in Modern Procurement*) that fall into the three categories along Oliver Williamson's sourcing continuum.

- Transactional (Williamson's "Market" category)
    - Basic Provider Model
    - Approved Provider Model
- Relational (Williamson's "Hybrid" category)
    - Preferred Provider Model
    - Performance-Based/Managed Services Model
    - Vested Business Model
- Investment (Williamson's "Hierarchy" category)
    - Shared Services Model
    - Equity Partnership Model (e.g. joint ventures, subsidiaries)

A brief overview of each follows. The models differ from a risk/reward perspective and should be evaluated in the context of what is being procured. The characteristics and attributes for each approach are reviewed in detail below. **Exhibit 2** (below) shows how the Sourcing Business Models fall along the sourcing continuum.

Exhibit 2



BASIC PROVIDER MODEL

A basic provider model is transaction-based. It typically has a set price for individual products and services for which there are a wide range of standard market options. Typically, these products or services are readily available, with little differentiation in what is offered.

A basic provider model is used to buy low-cost, standardized goods and services in a market where there are many suppliers and switching suppliers has little or no impact on the business. Buyers typically use frequent competitive bidding (frequently with pre-established electronic auction calendar events). Often a purchase requisition triggers transactions that signal that the buying company agrees to buy preset quantities of goods or tasks (e.g., widgets or hours). Some organizations even use purchase cards for these types of simple purchases.

The buyer-supplier relationship is based largely on a review of performance against basic criteria. For example, did the supplier work the hours claimed? Did the goods received meet the agreed-to quantity, cost and delivery times?

APPROVED PROVIDER MODEL

An approved provider model uses a transaction-based approach where goods and services are purchased from prequalified suppliers that meet certain performance or other selection criteria. Frequently an organization has a limited number of preapproved suppliers for various spend categories from which buyers or business units can choose. Multiple suppliers mean costs are competitive, and one firm can easily be replaced with another if the supplier fails to meet performance standards.

An approved provider is identified as a pre-qualified option in the pool of basic providers. Approved providers fulfill conditions for specified service through a set of criteria or previous experience with performance reliability. To reach approved status, suppliers frequently offer some level of differentiation from other transactional suppliers and provide a cost or efficiency advantage for the buyer. The differentiation could come in the form of geographical location advantage, a cost or quality advantage, or a minority-owned business.

Procurement professionals often turn to approved providers as regularly solicited sources of supply when bidding is conducted. An approved provider may or may not operate under a Master Agreement, which is an overarching contract with the buying organization. Approved providers may or may not also have volume thresholds to be in an “approved” status. In addition, approved providers may or may not participate in supplier management reviews.

To create a seamless and readily accessible supply chain, many organizations develop lists of approved providers. The advantages are many. For example, a preapproved list saves time when seeking particular goods and services. The approval process ensures parity between bidding qualified suppliers. As an organization selects its approved provider list, it molds the required qualifications to its unique business objectives and strategy.

PREFERRED PROVIDER MODEL

Like the basic and approved provider models, a preferred provider model uses a transaction-based economic model. A key difference between a preferred provider and the other transaction-based models is that the buyer has made the choice to move to a supplier relationship where there is an opportunity for the supplier to add differentiated incremental value to the buyer's business to meet strategic objectives. This insertion of the supplier's contribution into the buyer's business processes creates the need for a relational model. Thus, contracts with specifically chosen supplier(s) assume a more collaborative relationship. Repeat business and longer-term and/or renewable contracts are the norms.

Similar to an approved provider model, buyers seek to do business with preferred providers to streamline their buying processes. Buying organizations typically enter into multi-year contracts using master agreements that allow them to conduct repeat business efficiently. Preferred providers are still engaged in transaction-based economic models. However, the nature and efficiencies of how the organizations work together go beyond a simple purchase order and consider how a supplier can provide value-added services.

A preferred provider is a prequalified supplier. Often, they offer unique differentiators such as value-added benefits and services and/or demonstrated acceptable and predictable levels of performance. For example, a preferred provider may have superior software that interfaces with an organization's own system. Sometimes a preferred provider is chosen because of its high-quality workforce and difficult-to-duplicate expertise. Typical conditions for supplier down-selection of a preferred provider are:

- Previous experience
- Supplier performance rating (if the buying organization has a rating system)
- Previous contract compliance performance
- Evidence of an external certification (e.g., such as ISO certification)
- Additional contributions to control costs, such as inventory management, training resources and aligned geographical positioning

It is common for preferred providers to work under blanket purchase orders (POs) and rate cards that make conducting repeat business easy. For example, a labor-staffing firm may have a rate card that lists the hourly rate set for various types of staffing needs. The buying organization can readily request staffing support from the preferred provider using the predetermined blanket purchase orders and rate cards.

PERFORMANCE-BASED/MANAGED SERVICES MODEL

A performance-based (or managed services model) is generally a formal, longer-term supplier agreement that combines a relational contracting model with an output-based economic model. A performance-based model seeks to drive supplier accountability for output-based service-level agreements (SLAs) and/or cost reduction targets. A performance-based agreement typically creates incentives (or penalties) for hitting (or missing) performance targets.

Sourcing decisions are based not only on a supplier's ability to provide a good or service at a competitive cost but also on its ability to drive improvements based on its core competencies. Performance-based agreements shift thinking away from activities to predefined *outputs* or events. Some organizations call the results outcomes*.* However, it is important to understand that a performance-based agreement should hold a supplier accountable only for what is under its control. For that reason, in performance-based models, the word *outcome* typically means a supplier's "output*.*" An output is a well-defined and easily measured event or a deliverable that is typically finite in nature. Performance-based agreements require a higher level of collaboration than preferred provider contracts because there is a higher degree of integration between the supplier and the buying organization. In addition, buyers need to apply more formalized supplier relationship management efforts to review performance against objectives and specify the incentive or service credit **(**also referred to as a malice payment or penalty) embedded in the contracts.

Some service industries are seeing an evolution in managed services agreements where a supplier guarantees a fixed fee with a pre-agreed price reduction target (e.g., a 3% year-over-year price decrease). The assumption is that the supplier will deliver on productivity targets. These guaranteed savings are often called a "glide path" because there is an annual price reduction over time. Managed services agreements are a form of a performance-based Sourcing Business Model.

VESTED SOURCING BUSINESS MODEL

A Vested Sourcing Business Model is a hybrid relationship that combines an outcome-based economic model with a relational contracting model that incorporates the Nobel Prize-winning concept of behavioral economics and the principle of shared value.[15] Using these concepts, companies enter into highly collaborative arrangements designed to create and share value for buyers and suppliers above and beyond conventional buy-sell economics of a transaction-based agreement. In short, the parties are equally committed (Vested) to each other's success.

Vested Outsourcing (Vested for short) is a highly collaborative Sourcing Business Model where the organization and the supplier have an economic interest in each other's success. A good example is Microsoft and Accenture's multi-year agreement, in which Microsoft challenged Accenture to transform Microsoft's back-office finance operation processes. The agreement is structured so the more successful Accenture is at achieving Microsoft's goals, the more successful Accenture itself becomes.[16] (See also the case study, "Vested for Success: Microsoft/Accenture OneFinance")

The Vested business model was popularized when University of Tennessee researchers coined the term after studying highly successful buyer-supplier relationships.[17] It is also referred to as a Vested mindset and, even, the Vested movement as more and more organizations experience outstanding results.

A Vested business model is best used when an organization has transformational and/or innovation objectives that it cannot achieve by itself or by using conventional transactional sourcing business models (Basic Provider, Approved Provider, Preferred Provider) or a Performance-Based agreement.

These transformational or innovation objectives are called Desired Outcomes. A Desired Outcome is a measurable strategic business objective that focuses on what will be accomplished as a result of the work performed. Desired Outcomes are not a task-oriented service-level agreement (SLA) such as those typically outlined in Preferred Provider or Performance-Based agreements. Rather, Desired Outcomes are strategic in nature and often can be achieved only with a high degree of collaboration between the buyer and provider and/or with investment by the supplier.

Desired Outcomes form the basis of a Vested relationship because the provider is rewarded for helping the buyer achieve mutually defined Desired Outcomes — even when some of the accountability is shared with the buying organization. Desired Outcomes are generally categorized as an improvement to cost, schedule, market share, revenue, customer service levels or overall business performance.

SHARED SERVICES MODEL

Organizations that struggle to meet complex business requirements with a supplier can always invest to develop capabilities themselves (or insource). One approach is to develop an internal shared service organization (SSO) to centralize and standardize operations that improve operational efficiencies. A shared services model is typically an internal organization based on an arms-length outsourcing arrangement.[18] Using this approach, processes are often centralized into an SSO that charges business units or users for the services they use.[19] In some instances, SSOs are formed externally to the company (such as a subsidiary).

The authors’ experiences indicate that SSOs typically act like outsourced suppliers, performing services and then “charging” their internal customers on a per-transaction or actual cost basis. SSOs generally mirror conventional preferred provider models. The main difference is that the SSO is an internal supplier rather than an external supplier.

Organizations can use a shared services model for a variety of functional services, such as human resources (HR), finance operations, or administrative services (such as claims processing in health care). For example, large organizations may centralize HR administration into an SSO to provide benefits management to their own employees and even external clients. Small enterprises can benefit from a shared services model by joining forces to create specialized service centers that economically provide a functional service to each of the smaller firms.

EQUITY PARTNERSHIPS

An equity partnership creates a legally binding entity. They take different legal forms, from buying a supplier (an acquisition), to creating a subsidiary, to equity-sharing joint ventures or entering into cooperative (co-op) arrangements. Equity partnerships are best used when an organization does not have adequate internal capabilities and does not want to outsource.

Some organizations decide they do not have internal capabilities yet they do not want to invest in a shared services organization. In these cases, organizations may opt to develop an equity partnership such as a joint venture or another legal form to acquire mission-critical goods and services.

Equity partnerships, by definition, bring costs “in house” and create a fixed cost burden. As a result, equity partnerships often conflict with the desires of many organizations to create more variable and flexible cost structures on their balance sheet.

DIFFERENT MODELS – DIFFERENT SYSTEMS

While business needs have evolved, the fundamental nature of how we procure goods and services has not. The vast majority of organizations (public and private) still use the same transaction-based approach for procuring complex goods and services as they do to buy more simple commodities and supplies.

Unfortunately, many business professionals wrongly assume that a transaction-based business model is the only way to architect a supplier contract. *For simple transactions with abundant supply and low complexity, a transaction-based business model is the most efficient model.* The real weakness of a transaction-based approach emerges when any level of complexity, variability, mutual dependency or customized assets or processes are part of the transaction. A transactional approach cannot produce perfect market-based price equilibrium in variable or multi-dimensional business agreements. Often, hybrid Sourcing Business Models built with relational contracts and output or outcome-based economic models are more appropriate.

For this reason, it is imperative that organizations consciously select the most appropriate Sourcing Business Model for their situation. We like to think of a Sourcing Business Model as a “system,” as each is purposely built to optimize the business needs given critical operating factors. Think of a system like a Slinky toy[20] – it’s designed to work all by itself once put in motion. The book *Strategic Sourcing in the New Economy: Harnessing the Potential of Sourcing Business Models in Modern Procurement* goes into great detail about each of the seven Sourcing Business Models and shares insights into how to strategically source and architect each model. **Exhibit 3** (following page) provides a “cheat sheet” into how each of the Sourcing Business Models should be structured.

TRANSACTIONAL (MARKET) — RELATIONAL (HYBRID) — INVESTMENT (HIERARCHY)

	BASIC PROVIDER	APPROVED PROVIDER	PREFERRED PROVIDER	PERFORMANCE-BASED/MANAGED SERVICES	VESTED	INVESTMENT (EQUITY PARTNER/ SHARED SERVICES)
BUSINESS MODEL						
Business Model: Economic Model	Transaction Based (per Transaction, Hour or Unit)	Transaction Based (per Transaction, Hour or Unit)	Transaction Based (per activity, hour or unit)	Output Based	Outcome Based	Transactional, Output or Outcome Based
Business Model: Relationship Model	Transactional/ no relationship	Transactional/ Supplier Vetted on "Approved" List	Relational Contract—Emerging Collaboration	Relational Contract—Collaborative	Relational Contract—Highly Collaborative	Investment Based
Vision & Intent	Supply at Lowest Cost	Recurring Commodities at Fair or Lowest Costs	Value Added Capabilities at Best Value	Performance to SLA—Process Efficiencies	Shared Vision, Desired Outcomes & Value Creation	Sustainable Value
SCOPE OF WORK						
Statement of Work & Objectives	"Who" and/or "How"	"Who" and/or "How"	"Who" and/or "How" with Jointly Defined "How"	"What" Limited Emphasis on "How"	"What"	"What if", "What for" and "When"
PERFORMANCE MANAGEMENT						
Performance Focus	Simple Three Way Accounting Match	PO Requirements	Activity Based Service Level Agreements	Output Based Service Level Agreements	Strategic Desired Outcomes	P&L Based Measures
Performance Measures	Right Quantity, Right Price, Damage Free	Basic Provider Metrics + Increased Quality Emphasis	Operational + Customer Satisfaction	Operational + Relational (Values & Behaviors)	Operational + Transformational + Relational System Wide KPIs	Joint Measures of Success
PRICING						
Pricing Model & Incentives	Fixed Price/Typically No Incentives/Volume Rebates	Fixed Price/Low No Incentives/Volume Rebates	Fixed Price/Low Incentives/Volume Rebates	Price with Incentives and/or Penalties	Pricing Model with Value Based Incentives	P&L Based Equity Sharing
GOVERNANCE						
Relationship Management	Delivery & Pricing Validation (Three Way PO Match)	Some Performance & Pricing Oversight	Limited Supplier Relationship Management	Oversight Emphasis: Supplier Relationship Management	Insight Emphasis: Strategic Relationship Management	Shared Control and Management
Improve, Transform, & Innovate	None/Market Driven	Limited/Market Driven	Beginning to Focus on Incremental Improvement	Supplier Driven to Meet SLAs/Price Glide Path	Joint & Proactive Transformation Management	Core Innovation Capabilities
Exit Management	One Way/Limited Commitment to Buy	One Way/Termination for Cause & Convenience	One Way/Termination for Cause & Convenience	Perf Based Termination for Cause w/Safeguards	Joint Exit Management Plan	Divestiture
Compliance & Special Concerns	Compliance Driven/ Survey Based	Typically Compliance Driven/ Survey Based	Typically Market Based/Minimum Audit Requirements	Corporate Based Audit Requirements	Outcome Based Joint Requirements	Investment Based Joint Requirements

PART 3. DETERMINING THE RIGHT MODEL

To help organizations determine the best Sourcing Business Model for their situation, the University of Tennessee led a collaborative effort with academic and industry experts to develop a Business Model Mapping process that is easy to use.[21]

Determining the most appropriate Sourcing Business Model is a factor of two components: the most appropriate relationship model *and* the most appropriate economic model.

The concept of relationship models stems from Oliver E. Williamson's pioneering work that classifies an organization's sourcing needs into three categories: "Market" (transactional Sourcing Business Models), "Hybrid" (relational/hybrid Sourcing Business Models), and "Hierarchical" (investment-based Sourcing Business Models). [See Part I] The most appropriate relationship model is determined by factors such as dependency on the product or service being sourced, the level of risk associated with the product or service, and an organization's perspective on whether it should develop a core competency for that particular category of goods or services.

The Business Model Mapping process is a 4-step process. A sourcing professional skilled in Business Model Mapping typically facilitates this process. Stakeholders assess (or "map") 25 key attributes across 7 dimensions using an open-source Business Model Mapping toolkit that will indicate which Sourcing Business Model is the right choice. (The Toolkit is available as a free download at http://www.vestedway.com/tools/)

There is not a "one size fits all" Sourcing Business Model. What might be a good Sourcing Business Model for buying pencils will likely not be a viable Sourcing Business Model for a highly complex IT outsourcing initiative. It is also important to realize that no model is "better" than another. It might be tempting to think a Vested relationship sounds good because a supplier will drive innovation; but if the Business Model Mapping indicates a Preferred Provider model is more appropriate, you will have over-engineered your efforts and will likely not realize the value you are seeking.

The four Business Model Mapping steps are:

Step 1: Select the defined spend category/categories you are sourcing or potentially sourcing.

Step 2: Use the Business Model Mapping template to determine the best relationship model for what you are sourcing (map the first 14 attributes on the first page of the template).

Step 3: Use the Business Model Mapping template to determine the best economic model for what you are sourcing (map the 11 attributes on the second page of the template).

Step 4: Use the Business Model Mapping matrix to develop a consensus view of the Sourcing Business Model right for you. The best Sourcing Business Model will combine your chosen relationship and economic models.

The Business Model Mapping template and Business Model Mapping matrix are part of a Business Model Mapping toolkit.

STEP 1: DETERMINE THE SOURCING "CATEGORIES" YOU ARE SOURCING

The first step is to define the requirements for the key **categories** of products/services your organization needs to either make or buy. This includes products/services that are currently insourced, currently outsourced, or perhaps not being accurately managed at all. We recommend the completion of a Business Model Mapping exercise for each category under the scope of the business. You can use the exercise for both "direct" or "indirect" spend categories. You can complete the Business Model Mapping exercise by asking, "What if I bundled smaller categories into a broader, more holistic category? How would that affect the dependency, risk and potential to create value?" This is exactly what Microsoft did when it outsourced its finance operations to Accenture. Bundling several of the smaller categories allowed Accenture to have an end-to-end perspective allowing synergies that could not be realized if the categories remained unbundled. Often organizations change their perspective on what should be insourced versus outsourced after completing the exercise.

STEP 2: DETERMINE THE BEST RELATIONSHIP MODEL

Once the organizations have gathered knowledge on categories, they begin the physical "mapping" part of the process. This involves determining the best relationship model and the best economic model for their particular environment. Step 2 focuses on the relationship model while Step 3 (discussed below) focuses on the economic model.

Think again about Oliver E. Williamson's classification of contracting relationships into three categories: "Market" (transactional Sourcing Business Models), "Hybrid" (relational/hybrid Sourcing Business Models), and "Hierarchical" (investment-based Sourcing Business Models).

Step 2 is designed to help you determine which relationship model is most appropriate. To complete this step, use the Business Model Mapping template to help map 25 attributes across three dimensions. Mapping helps you answer these questions:

- What is the overall level of dependency associated with the product or service?
- What is the strategic impact of the product or service category? Does this product or service provide your organization with a core competency or competitive advantage?
- What is the degree of risk associated with this product or service category?

Many procurement professionals observe the linkage between the Business Model Mapping attributes and the logic behind the Kraljic Matrix. In fact, the Business Model Mapping template directly leverages the concept of business risk and profit impact from Kraljic. The Business Model Mapping attributes are based on research and pull from the best thinking from Oliver Williamson[22] (transaction cost economics), Kathleen Eisenhardt[23] (agency theory), C.K. Prahalad and Gary Hamel[24] (core competency theory), Peter Kraljic[25] (spend categorization) and the University of Tennessee[26] (Vested and relational contract theory).

STEP 3: DETERMINE THE BEST ECONOMIC MODEL

Step 3 completes the Business Model Mapping exercise by mapping additional attributes that determine the best ***economic model*** for your situation. This will complete your template. The economic model determines how you will manage the economics of the relationship (e.g. pay the supplier). There are three economic models.

The most prevalent economic model in businesses today is transaction-based. Transaction-based models are also the easiest to administer; a transaction-based economic model is driven by behaviors or tasks. For example, a supplier is typically paid per activity. This can take the form a price per unit, per hour, per mile, per call answered. Record the number of miles, and you can easily determine how much to pay the supplier. Currently, there is a trend for buying organizations to shift risk to a supplier and hold it accountable for achieving results, not just performing a task.

To cope with this “risk-shifting” problem, two types of “results” oriented economic models have emerged. The first is an “output” based model in which a supplier’s payment is typically tied to the achievement of pre-defined measures such as SLAs. It is becoming more common for buyers to negotiate pre-defined efficiency targets as well—such as holding the supplier accountable for a 3% year-over-year price reduction that assumes the supplier will drive efficiencies. Output-based economic models are associated with Performance-Based (Managed Services) agreements.

The second model is an “outcome-based” model. An outcome-based economic model is more sophisticated than an output-based economic model because it ties supplier payment to mutually agreed boundary-spanning business outcomes. To achieve true business outcomes, a buyer and supplier must work together in a highly integrated fashion. There is shared risk to achieve the business outcome.

The Business Model Mapping template includes 11 attributes across four dimensions focused on economic models. By completing the exercise, the mapping helps you answer the questions:

- How much potential is there to create mutual advantage by collaborating with a supplier?
- What is the nature of the work scope?
- What is the criticality of the work?
- What are your risk tolerance preferences?

Based on the nature of what is procured, you will find the business environment and your preferences will lead you to one of the three economic models.

As with mapping the relationship model, sometimes your map will be very specific and lead you to one “column.” However, in other cases you may find your map indicates a general preference for an overall relational contract. It is OK at this point if your map simply indicates an overall preference for a transactional, output or outcome-based model, as you will use this as part of Step 4. However, some buyers have seen benefits from assigning a weight factor to the attributes to strengthen the final model decision.

STEP 4: DETERMINE THE BEST SOURCING BUSINESS MODEL

Steps 2 and 3 helped you identify the most appropriate relationship model and economic model. In step 4, you use this information to identify which of the seven Sourcing Business Models is most appropriate for your situation. The answer combines both the relationship model and the economic model.

To complete the Business Model Mapping exercise, use the Sourcing Business Model matrix. The Sourcing Business Model matrix (**Exhibit 4** next page) is a simple 3x3 matrix with the three relationship models on the vertical axis and the three economic models on the horizontal axis.

Determining the best Sourcing Business Model is simply a factor of plotting the relationship model and economic model onto the matrix. For example, if the most appropriate relationship model is a relational contract and the most appropriate economic model is output-based, then the best Sourcing Business Model for your situation is a performance-based Sourcing Business Model.

It is important to note that investment-based models (equity partner and shared services) can be developed using any of the three economic models. The key point is that the economics will be structured differently based on the desired economic model.

Exhibit 4

Business Model Map Matrix

Economic Model	Relationship/Contract Model: Transactional Contract (Market)	Relationship/Contract Model: Relational Contract (Hybrid)	Relationship/Contract Model: Investment (Vertical Integration / Hierarchy)
Outcome-Based *Economics tied to Boundary Spanning/ Business Otcomes*	Mis-Match – Not a Viable Strategy	Vested	• Equity Partner (e.g. Joint Venture, Subsidiary) • Vested Shared Services
Output-Based (Performance-Based / Managed Services) *Economics tied to Supplier Output*	Mis-Match – Not a Viable Strategy	Performance-Based (Managed services) Agreement	• Equity Partner (e.g. Joint Venture, Subsidiary, Co-Op) • Shared Services
Transaction-Based *Economics tied to activities drive behavior, e.g. per unit, per hour, per*	Basic Provider Approved Provider	Preferred Provider	• Equity Partner (e.g. Joint Venture, Subsidiary) • Shared Services

PART 4: CASE STUDIES – EXAMPLES IN ACTION

The purpose of this section is to provide actual case studies that show how organizations are applying each of the seven Sourcing Business Models.

Case Study — Basic Provider

A hospitality organization with several properties purchased a variety of low-cost basic food items such as salt, mustard and other condiments, snack items and pasta. Each property did its own purchasing and no specific requirements were applied to these basic food items because all items were standard in the marketplace and several suppliers provided the products. However, when the organization investigated the number of items being procured as basic food items, the estimated number exceeded 16,000 in items and multi-millions of dollars in annual spend.

The organization recognized the opportunity to save money through better management of these items. The organization sought to put in place a process that would obtain more detailed information across all properties on these items. The changes would be made without adding resources to manage them and to obtain the lowest market price. The organization implemented a standard e-auction tool that was used by all properties.

Item requirements were entered into the online e-auction tool, the suppliers in the marketplace placed their bids and the lowest pricing supplier won the order. No negotiations were conducted, a purchase order was generated using standard terms and conditions and distribution program and the properties exerted limited effort to manage a multi-million dollar spend which allowed their purchasing resources to focus on higher cost items. [27]

Case Study — Approved Provider

Intel uses approved providers as part of its Supplier Development Program (SDP), which identifies and confirms that all bidding suppliers are at parity. For that reason, Intel feels confident in its field of competitors. When it is time for the bid process, Intel can select the lowest-cost supplier without concern about the supplier's capabilities. Intel knows the supplier can meet its needs. In essence, Intel works very hard to commoditize what it is buying to drive pricing competition in the market.

Consider Intel's transportation category. First, Intel rates the capabilities of suppliers that serve the transportation category (e.g., DHL, UPS, Expeditors, etc.). Next, Intel works with suppliers to ensure they close any identified capabilities gaps. Intel then rates the suppliers again to confirm that they meet capability standards. Finally, when Intel is ready to seek a supplier, there are typically three capable, pre-approved vendors from which to choose. All offer a "standard" service offering. Intel's SDP is a solid strategy for commoditized requirements where there are multiple, interchangeable sources of supply. By ensuring adequate competition, Intel is assured it uses the market to get the lowest possible price. [28]

Case Study — Preferred Provider

In the Microsoft Preferred Supplier Program (MPSP), suppliers are divided into two distinct levels—Premier suppliers and Preferred suppliers. Preferred and Premier suppliers are a small subset of Microsoft's overall list of approved suppliers called the ASL (Approved Supplier List). Premier suppliers are the featured supplier by category in Microsoft's e-procurement system, meaning that when an employee seeks to buy goods or services, the Premier suppliers are the *recommended* source by Microsoft's procurement organization. This leads to substantial revenue increases when business units or employees "buy" products or services using the procurement group's recommendation.

Microsoft's Preferred and Premier suppliers also enjoy added benefits. Microsoft issues invitations to special events during which Microsoft executives share insights and strategies. Premier suppliers also have access to Microsoft Executive briefings. It is difficult to become a Preferred or Premier supplier at Microsoft. [29]

Case Study — Performance-Based/Managed Services Agreement

The United States Navy set out to improve the performance of the H-60 FLIR system which enables the Navy's H-60 helicopter to detect, track, classify, identify and attack targets like fast-moving patrol boats or mine-laying craft. When first developed, the FLIR was expected to have at least 500 hours of operation before failure but in reality was averaging less than 100 hours.

The Navy and Raytheon implemented a ten-year, fixed-price agreement that was priced per flight hour and valued at $123 million. This fixed price by flight hour contract gave Raytheon the incentive to improve reliability and help reduce the necessity for removal of these units from the aircraft.

Raytheon established an online Maintenance Management Information System that allowed for real-time data collection by the Naval Aviation Depot in Jacksonville; an online manual eliminated the need to have printed copies made and distributed.

In the first three years of the contract, the H-60 FLIR components experienced a 100% availability rate and achieved a 40% growth in system reliability improvement as well as a 65% improvement in repair response time. Originally cost savings were projected to be around $31 million but exceeded $42 million after just three years. The Navy won the United States Secretary of Defense "Performance-Based Logistics" award for excellence for their H-60 FLIR contract with Raytheon.[30]

Case Study — Vested Model

In 2003, Procter & Gamble signed a contract with Jones Lang LaSalle (JLL) spanning 60 countries. The groundbreaking contract included facilities management, project management and strategic occupancy services. P&G wanted an outsourcing relationship that challenged JLL to not just take *care* of its buildings, but to take *charge* of the buildings.[31]

P&G was clear: the primary reason it outsourced was to drive transformation and achieve "the power of AND." Its contracting approach motivated JLL to bring new ideas and determine the best way to get results. P&G shifted the economics of outsourcing to an outcome-based approach whereby P&G bought Desired Outcomes, not individual transactions or service levels. P&G paid JLL based on its ability to achieve mutually agreed outcomes. The partnership created a shared interest in achieving P&G's strategic goals.

A key component for P&G was to focus on the WHAT, not the HOW. Once P&G decided it was serious about trusting and delegating responsibility to JLL, contract negotiation was considerably simplified: it was JLL's job to figure out what was needed and how to do it. The parties developed a pricing model that incentivized JLL to achieve the Desired Outcomes and drive innovation.

P&G and JLL know that measurement drives behavior. Instead of focusing on time and tasks, they focus on measuring success against P&G's business priorities. Formal governance mechanisms allow P&G and JLL to re-focus priorities as needed.

Another important aspect of the P&G/JLL governance structure is that the companies live (and manage) the business following an insight – not an oversight – governance structure. They do this with what they call a "2 in a Box" approach that identifies both a P&G and JLL person as owners of a core process. This assures business plans and action plans are aligned between P&G and JLL.

JLL went from being a new P&G supplier to winning "Supplier of the Year" three of the last eleven years among a field of 80,000 suppliers. P&G is on record saying that Global Business Services (the entity that initiated the contract) has reduced cost as a percentage of sales by 33% for its outsourced operations. JLL exceeded the satisfaction target for six consecutive years. JLL continues to be a winner contracting extensions, expanding capabilities, increasing profitability and earning additional work scope during contract renewal.

Case Study — Shared Services

In 1995 Bell Canada's distribution operations were operating at service levels that were 10% to 15% below industry average and at a cost base of $100 million.[32] Bell Canada (the largest telecom services organization in Canada) decided to spin off the assets and the staff of the distribution business into a stand-alone, wholly-owned subsidiary known as Progistix Solutions Inc. (PSI). The idea was that by creating a separate shared services entity with its own P&L, PSI would be driven to operate more efficiently. PSI was chartered to provide a full range of order management and inventory management business processes for all of Bell's operating businesses and a new CEO was brought in to turnaround the business.

At its inception, PSI had an estimated revenue stream (benchmarked by Deloitte) of $55 million against its cost base of $100 million. Progistix had a mandate to achieve a financial breakeven state and to meet industry average service levels.[33]

With its own P&L, the shared services group carefully reviewed where it needed to invest in business processes and technology to meet its charter of becoming a profitable business unit and raising service levels to its Bell counterparts. PSI invested in three key areas:

- Replaced the aged technology infrastructure and outdated applications
- Renegotiated the four collective agreements to align wage rates and work rules with the logistics services market
- Commenced the long process of culture change from an entitlement-based telecom services organization to a market-focused logistics services competitor

Clearly, the cultural change would be the most difficult. By moving non-core functions to an organization dedicated to enhancing quality in their respective field (shared services or outsourcing), these employees gained respect and self-confidence enabling them to perform at much higher levels.

In addition, the management team was driven through profit-sharing incentives to dramatically reduce costs in all parts of the organization. Because of its efforts, PSI reduced its costs by $45 million yielding a breakeven position in 1998. Furthermore, systematic improvements raised service levels to industry standards, with over 95% of the orders processed during the day being picked, packed, shipped and delivered to customers by the end of the next day.

During the next two years, PSI was able to generate industry standard profits and grew revenues by 15%.

Case Study — Joint Venture

Consumer electronics giants Samsung Electronics and Sony established a 50-50 joint venture in 2004 for the production of liquid crystal displays for flat-panel televisions. The companies formed a new organization near Seoul, South Korea, S-LCD Corp., with an initial capital budget of nearly $2 billion.

The two tech giants — and fierce industry rivals — structured the venture so stocks in S-LCD were held by South Korea's Samsung at 50 percent plus one share of stock and 50 percent minus one by Japan's Sony. "The two organizations will invest evenly, but Samsung has the ultimate initiative," said a Sony spokeswoman.[34]

Upstart Samsung had begun construction of an LCD production facility in 2003 with a large projected capital expenditure for what was then a relatively new technology and market. Sony had no production base for large LCD panels. The joint collaboration was thus advantageous for both organizations. The deal was also controversial: Sony had pulled out of a Japanese-state-backed LCD-panel development group to close the deal with Samsung.

In 2006 *Bloomberg Business Week* described the venture as a win-win: "They have pulled off one of the most interesting and fruitful collaborations in global high-tech by jointly producing liquid-crystal display (LCD) panels. And it's an alliance that is reshaping the industry."[35] The venture was instrumental in Sony's introduction of the hugely successful Bravia LCD-TV lineup. It also put Samsung's own LCD-TV business on the map as a trend-setter in the LCD-panel industry, aided by Sony technology that helped ensure high-quality, sharp TV pictures. "The Sony-Samsung alliance is certainly a win-win," said Lee Sang Wan, president of Samsung's LCD unit.[36]

The alliance had an industry-wide impact on the TV market for large-screen sets. It also changed the pecking order among LCD-TV makers. In 2008 the organizations strengthened the venture by committing another $2 billion to build a new facility to produce so-called eighth-generation panels. In the intervening years, despite global economic and financial turmoil, currency fluctuations, heavy competition and new entrants in the LCD and electronics market, and more recently the earthquake and tsunami in Japan, the S-LCD venture has survived.

The earthquake and faltering global demand in the LCD market did force S-LCD to reduce capital by $555 million in April 2011. There were even rumors that the joint venture might be dropped due to losses in Sony's TV business, but Sony quashed that idea. "Televisions are a core business for Sony and it would be unthinkable for us to shrink that business," said Kazuo Hirai, Sony's executive deputy president. Hirai added: "We are absolutely not thinking of abolishing the joint venture, and it's not something that would be easy to do."[37]

The venture is unusual and remarkable in terms of its scope and duration. Two fierce competitors put their rivalry aside to achieve the win-win in an emerging market.

PART 5: CALL TO ACTION

In their book, *The Procurement Value Proposition,*[38] Professor Robert Handfield and Gerard Chick challenge procurement professionals to embrace the "new vantage point on modern procurement." They challenge short-term, cost-focused approaches to procurement, writing that value-based approaches to procurement will be "the Holy Grail for Procurement" in the new economy. The time for procurement professionals to embrace change is now, they add, because the procurement landscape is "shifting around us, often more radically and quickly than we might first realize" and go so far as to state that "existing procurement models may have reached their 'use by' date."[39]

We agree—and conclude that the procurement playing field is no longer one of simply using leverage to source commodities for assured supply. Rather it is one of truly understanding how to create value for your organization through its supply base. The future will be won by those that embrace more sophisticated Sourcing Business Models purposely designed to create value and harness the power of highly collaborative relationships with suppliers that can help drive transformation and innovation in your organization. Today's procurement professionals must embrace and evolve with modern business needs, and more and more this means balancing what seem to be insurmountable conflicting goals of reducing cost structures and driving innovation.

If your organization has struggling supplier relationships, is seeking supplier innovation, wishes to transform operations through strategic outsourcing, or needs to leverage assets of private entities to do the job, you will most certainly need to leverage all of the tools in your sourcing toolkit—including more sophisticated Sourcing Business Models purposely designed to harness the power of output and outcome-based approaches. This means understanding the fundamental differences of each type of Sourcing Business Model and consciously striving to pick the right model for the right environment—ultimately picking the right tool for the right job.

As you embark on the journey to create value for your organizations, we urge you to consider the fact that sourcing is more than a make-buy decision: it is a continuum. As a sourcing professional, public contracting officer, or outsourcing professional it is your job to understand your business environment and use the right Sourcing Business Model to best accomplish your objectives.

If you'd like to learn more about Sourcing Business Models, the book *Strategic Sourcing in the New Economy* provides a solid approach for charting a pathway to help organizations harness the power of Sourcing Business Models in the new economy.

Dawn Tiura, President and CEO of the Sourcing Industry Group shares her enthusiasm about the book: "Trust me when I tell you that after reading this book, you will be able to empty much of your bookshelf. This is truly the only sourcing book you need."

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The Sourcing Industry Group (SIG) is a membership organization that provides thought leadership and networking opportunities to executives in sourcing, procurement and outsourcing from Fortune 500 and Global 1000 companies. It has served these professionals and opened dialogues with their counterparts in finance, HR, marketing and other business functions throughout its 22-year history.

SIG is acknowledged by many as a world leader in providing “next” practices, innovation and networking opportunities through its: global and regional events, online webinars and teleconferences, member peer connection services, content-rich website and online Resource Center, which was developed by and for professionals in sourcing and outsourcing. The organization is unique because it blends practitioners, service providers and advisory firms in a non-commercial environment.

For more information about SIG, visit http://www.sig.org

The International Association for Contract & Commercial Management (IACCM) provides a global forum for innovation in trading relationships and practices. IACCM enables both public and private sector organizations and professionals to achieve world-class standards in their contracting and relationship management process and skills. With over 35,000 members representing over 14,000 corporations across 159 countries, IACCM is leading the way in responding to the demands of global networked markets.

IACCM membership is drawn from many industries and is made up of contract and commercial managers, negotiators, attorneys and supply chain professionals.

Through the world, IACCM members gain access to the thought leadership and practical tools essential for competitiveness in today's fiercely contested global markets. IACCM provides insight into the leading-edge contracting and commercial skills, policies, procedures and methods fundamental to managing enterprise and individual risks. This insight equips professionals and their leaders to implement best practice governance of contractual commitments and trading relationships.

For more information about IACCM, visit https://www.iaccm.com

The Center for Outsource Research and Education (CORE) is a unique non-profit organization in Canada that focuses on the Outsourcing Industry. CORE enables organizations to understand and apply innovative management approaches for productivity and competitive enhancement through effective outsourcing practices.

CORE was established in 2005 by thought leaders (buyers, providers and advisors), as a not-for-profit organization when the outsourcing industry was adolescent. Today, CORE's mandate is to help its member companies manage risks and optimize the value of outsourcing relationships, whether it is a simple domestic sourcing arrangement or a complicated global outsourcing deal. CORE helps by delivering information and education that enables members to be better informed, better educated and better prepared to execute all phases of the transaction lifecycle.

CORE provides thought leadership (knowledge and experience transfer) through its discussion forums held throughout the year. Each forum focuses on a timely and relevant topic presented by industry peers. These forums represent an excellent opportunity to learn from - and network with - industry leaders. CORE prides itself on delivering relevant, practical and ever-evolving Executive Education.

For more information about CORE, visit http://www.core-outsourcing.org

The American Society for Public Administration (ASPA) is the largest and most prominent professional association for public administration. It is dedicated to advancing the art, science, teaching and practice of public and non-profit administration. ASPA's diverse membership includes over 8,000 practitioners, teachers and students who serve the principal arena for linking theory and practice within the field of public administration.

ASPA is an advocate for greater effectiveness in government - agents of goodwill and professionalism - publishers of democratic journalism at its very best - purveyors of progressive theory and practice and providers of global citizenship. ASPA leaders believe that by embracing new ideas, addressing key public service issues and promoting change at both the local and international levels, the association can enhance the quality of lives worldwide. In 2014, ASPA celebrated its 75th anniversary as the premier organization representing public administration professionals and scholars.

For more information about APSA, visit http://www.core-outsourcing.org/home/index.php

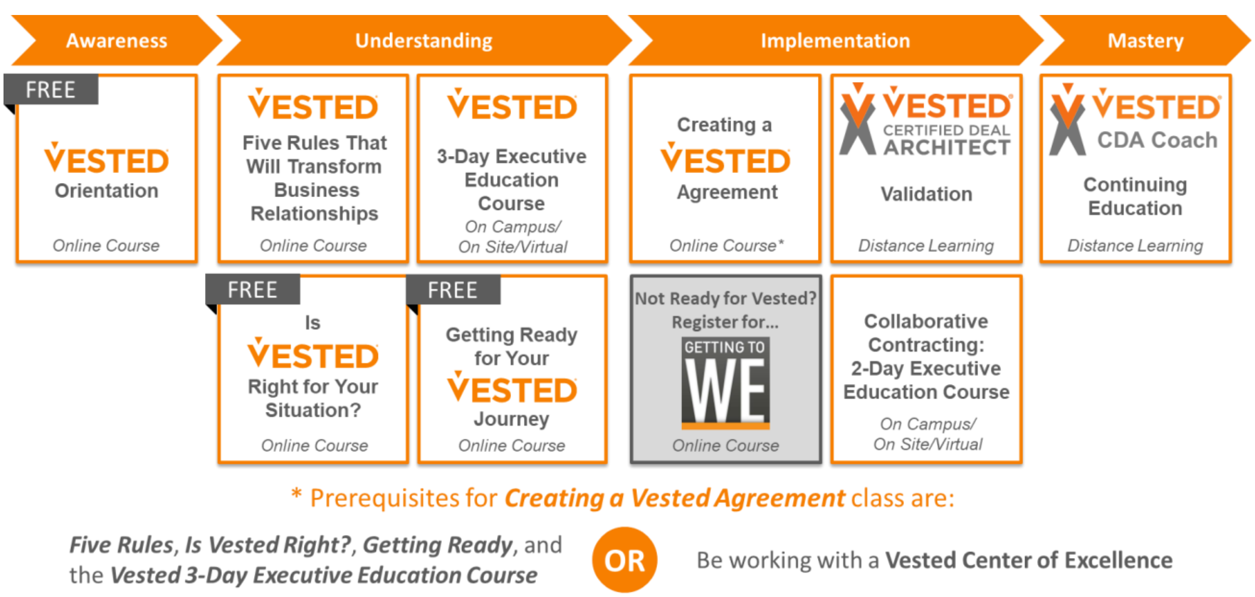
FOR MORE INFORMATION

The University of Tennessee is highly regarded for its Graduate and Executive Education programs. Ranked #1 in the world in supply chain management research, researchers have authored seven books on the Vested business model and its application in strategic sourcing.

WHY | WHAT | HOW | WHEN | NEGOTIATE THE RELATIONSHIP | TELLS THE REAL STORIES

We encourage you to read the books on Vested, which can be found at most online book retailers (e.g., Amazon, Barnes and Noble) or at [www.vestedway.com/books.](http://www.vestedway.com/books)

For those wanting to dig deeper, UT offers a blend of onsite and online courses including a capstone course where individuals get a chance to put the Vested theory in practice. Course content is designed to align to where you are in your journey ranging from Awareness to Mastery. For additional information, visit the University of Tennessee's website dedicated to the Vested business model at http://www.vestedway.com/ you can learn more about our Executive Education courses in the Certified Deal Architect program. You can also visit our research library and download case studies, white paper and resources. For more information, contact kvitasek@utk.edu.



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[8] The legal scholar Ian R. Macneil was instrumental in developing a wider view of the contract, known as relational contract theory. He said that most contracts are ill-equipped to address the reality of business needs. In his 1968 work, *Contracts: Instruments for Social Cooperation*, Macneil wrote, "Somewhere along the line of increasing duration and complexity [the contract] escapes the traditional legal model." He argued that contracts are rooted in the classical approach to contract law and thus crafted to address transactions and legal protections such as pricing and price changes, service levels, limitation of liability, indemnification and liquidated damages. He said business-to-business contracts should be "instruments for social cooperation."
[9] Nobel laureate John Nash's research into Game Theory showed that when individuals and organizations work together to solve a problem, the results are always better than if they had worked separately or played against each other. Similarly, the political science professor Robert Axelrod delved into the nature of competitive relationships, through his research into the Prisoner's Dilemma game. His book, *The Evolution of Cooperation*, showed that playing "nice"—or cooperating—led to the best results while maximizing mutual gains for all players.
[10] A Catch-22, based on the title of Joseph Heller's novel, generally is regarded as a no-win situation that uses contradictory circular logic. For instance, you may need a pass to enter a particular building, but in order to get a pass you have to visit an office in the same building.
[11] Purchase Price Variance (PPV) is a procurement metric that measures a procurement organization's (or an individual procurement professional's) effectiveness at meeting cost savings targets.The thinking about PPV is simple: If you spend $1.10 on a widget, then try to get the exact same widget next year for $1.00. The better the price that's obtained, the better the PPV. Many organizations reward their buyers on a PPV metric.
[12] "Contract Negotiations Continue to Undermine Value," International Association of Contracting and Commercial Management Ninth Annual Top Ten Terms Report, April 2010.
[13] Nobel laureate Oliver E. Williamson says that "muscular", or power-based transactional approaches in contracting and pricing relationships are "myopic and inefficient…companies not only use their service providers, they use up their service providers." (Oliver E. Williamson, "Outsourcing: Transaction Cost Economics and Supply Chain Management," Journal of Supply Chain Management 44.2 (2008): 5-16)
[14] See the Vested books *Vested Outsourcing: Five Rules That Will Transform Outsourcing, Vested: How P&G, McDonald's and Microsoft are Redefining Winning in Business Relationships*, *The Vested Outsourcing Manual*, and *Getting to We: Negotiating Agreements for Highly Collaborative Relationships*.
[15] Behavioral economics is the study of the quantified impact of individual behavior on the decision makers within an organization. The study of behavioral economics is evolving more broadly into the concept of relational economics, which proposes that economic value can be expanded through positive relationships with mutual advantage (win-win) thinking rather than adversarial relationships (win-lose or lose-lose). Shared value thinking involves entities working together to bring innovations that benefit the parties—with a conscious effort that the parties gain (or share) in the rewards.
[16] Kate Vitasek and Karl Manrodt, with Jeanne Kling, *Vested: How P&G, McDonald's, and Microsoft are Redining Winning in Business Relationships* (New York: Palgrave Macmillan, 2012).
[17] Kate Vitasek, Mike Ledyard, and Karl Manrodt, *Vested Outsourcing: Five Rules That Will Transform Outsourcing*; Second Edition; (New York: Palgrave Macmillan, 2013).
[18] SSOs can be structured with a highly collaborative Vested philosophies; however, in fact,

most SSOs are structured as conventional preferred provider transactional models that are arm's length in nature.

[19] SSOs can also be "center led," meaning resources may not physically be centralized.

[20] Slinky is a toy, a precompressed helical spring invented by Richard James in the early 1940s. It can perform a number of tricks, including travelling down a flight of steps end-over-end as it stretches and re-forms itself with the aid of gravity and its own momentum; or it can appear to levitate for a period of time after it has been dropped. These interesting characteristics have contributed to its success as a toy in its home country of USA, resulting in many popular toys with slinky components in a wide range of countries. Access more information at https://en.wikipedia.org/wiki/Slinky

[21] The original concept of business model mapping came from Jacqui Archer and the initial business model mapping template was developed as part of the Vested Outsourcing Manual in conjunction with Kate Vitasek, Jeanette Nyden and Katherine Kawamoto. UT researcher Kate Vitasek later expanded collaborative efforts and the concept of business model mapping evolved to what is presented in this book. The authors would like to give special thanks to David Frydlinger, Donna Massari and Angela Easterwood for their wonderful fieldwork, refinement and validation of the Business Model Mapping concept.

[22] "Outsourcing: Transaction Cost Management and Supply Chain Management," Oliver E. Williamson *Journal of Supply Chain Management* 44, no 2;; April 1, 2008;

[23] "Agency Theory: An Assessment and Review" Kathleen M. Eisenhardt
The Academy of Management Review Vol. 14, No. 1 (Jan., 1989), pp. 57-74

[24] "The Core Competence of the Corporation," C.K. Prahalad, Gary Hamel, *Harvard Business Review*, May 1990. https://hbr.org/1990/05/the-core-competence-of-the-corporation;

[25] "Purchasing Must Become Supply Management," Peter Kraljic *Harvard Business Review,* September; 1983. https://hbr.org/1983/09/purchasing-must-become-supply-management

[26] Kate Vitasek with Mike Ledyard and Karl B. Manrodt, *Vested Outsourcing: Five Rules That Will Transform Outsourcing,* Second Edition; (New York*:* Palgrave MacMillan, 2013).

[27] Bonnie Keith, Kate Vitasek, Karl Manrodt and Jeanne Kling, *Strategic Sourcing in the New Economy*, (New York: Palgrave MacMillan, 2015).

[28] Kate Vitasek and Jeanne Kling, Vested for Success Case Study, "The Innovator's Dilemma: How Intel and DHL Drove a Paradigm Shift in Procurement," University of Tennessee, Office of Business Administration; Teaching Edition.

[29] Keith, et al., *Strategic Sourcing*, op. cit.
Note: Microsoft shares its procurement program details on its Website at http://www.microsoft.com/en-us/procurement/msp-overview.aspx

[30] Department of the Navy, Commander, Naval Supply Systems Command, Nominations for the Secretary of Defense Performance-Based Logistics Award, June 5, 2005. Also see: The Secretary of Defense Performance-Based Logistics Awards Program for Excellence in Performance-Based Logistics; Summary of Criteria Accomplishments, Section 2, https://acc.dau.mil/adl/en-US/548810/file/68119/PBL%20Award%20Pkg%202006%20Sub-system_H-60%20FLIR.pdf.

[31] This case study is an excerpt from Kate Vitasek, Karl Manrodt, and Jeanne Kling, *Vested: How P&G, McDonald's, and Microsoft Are Redefining Winning in Business Relationships* (New York: Palgrave Macmillan, 2012), pp. 13–37.

[32] Kate Vitasek, Bonnie Keith, Jim Eckler, and Dawn Evans in collaboration with Jacqui Crawford, Karl Manrodt, Katherine Kawamoto, and Srinivas Krishna, *Unpacking Sourcing Models: 21st-Century Solutions for Sourcing Services*, University of Tennessee Center for Executive Education, Sourcing Interests Group, Centers for Outsourcing Research & Education, International Association for Contract and Commercial Management; http://researchdb.core-outsourcing.org/files/tables/research.document.248.pdf.

[33] Ibid.

[34] Yoshiko Hara, "Samsung, Sony complete LCD joint venture deal," EE Times-Asia, March 11, 2004.

[35] "Samsung and Sony's Win-Win LCD Venture," *Bloomberg Business Week*, Nov. 28, 2006.

[36] Ibid.

[37] "Sony rules out exiting TV business or LCD panel venture," *Reuters*, August 4, 2011.

[38] Gerard Chick, Robert Handfield, *The Procurement Value Proposition*, (London and New York: Kogan Page Ltd., 2015).

[39] Ibid. p. 52.