

Procurement's 'Gold Standard' Tools:

Time for a **RESET?**

P sychologists and economists have long studied the phenomenon of being stuck in past successes. This inertia is often referred to as “the curse of knowledge.”

Similarly, today's procurement organizations can often find themselves stuck in their own inertia. Simply put, while there has been a great deal of progress made in the sourcing profession, far too many organizations still rely on such best practices as Porter's Five Forces, the Kraljic matrix and the popular “seven step” strategic sourcing process.

We challenge the efficacy of these tried-and-true — but power-based — tools, arguing instead for a shift to using “best fit” sourcing business models that are more suited to today's complex, global and fast-paced world.

CURRENT TOOLS AND THEIR SHORTCOMINGS

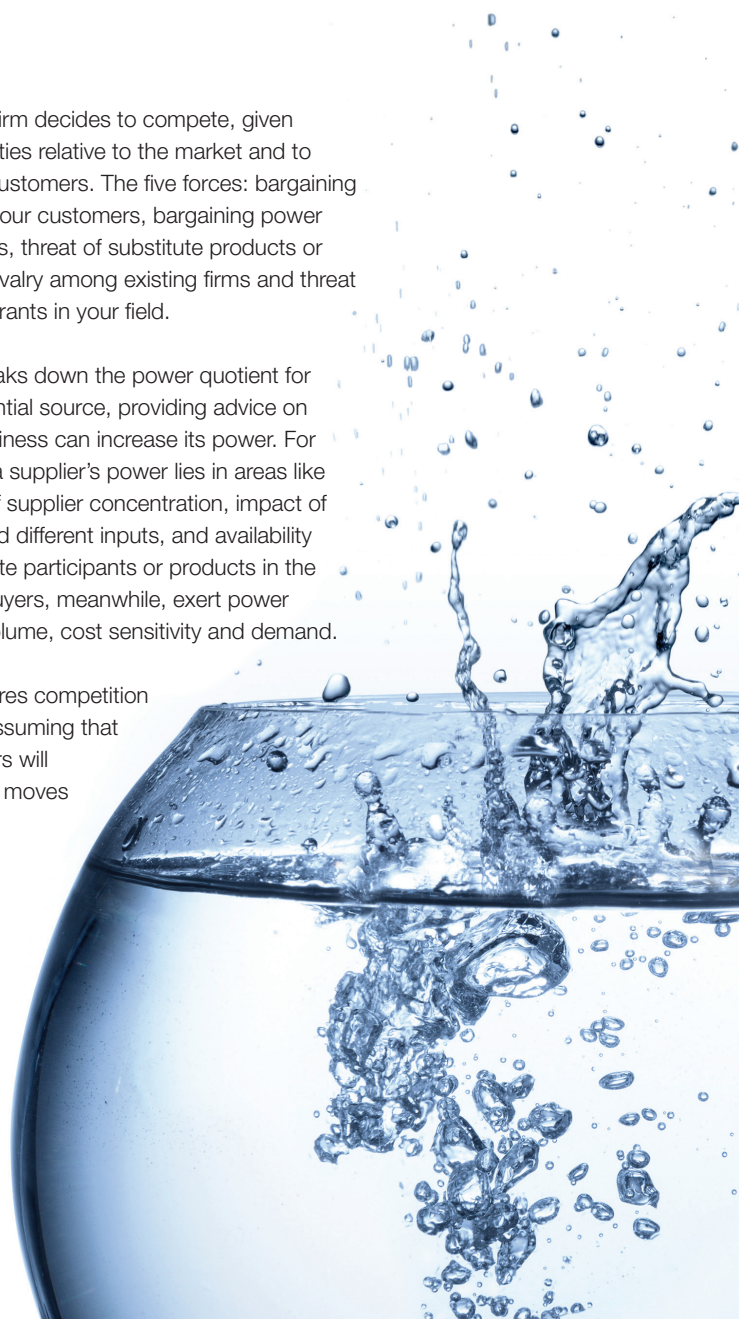
First, a refresher course on the primary tools currently available to you — and, more importantly, where we believe they can fall short.

Porter's Five Forces: In 1979, Michael Porter gave power a boost with his interpretation of understanding the forces within a competitive marketplace in his book, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. In it, he notes, industry rivals have four influential elements: customers, suppliers, potential entrants and substitute products. Competition within an industry is determined

by how a firm decides to compete, given its capabilities relative to the market and to potential customers. The five forces: bargaining power of your customers, bargaining power of suppliers, threat of substitute products or services, rivalry among existing firms and threat of new entrants in your field.

Porter breaks down the power quotient for each potential source, providing advice on how a business can increase its power. For example, a supplier's power lies in areas like the level of supplier concentration, impact of volume and different inputs, and availability to substitute participants or products in the market. Buyers, meanwhile, exert power through volume, cost sensitivity and demand.

He compares competition to war: “Assuming that competitors will retaliate to moves that a firm





You have options when procurement's tried-and-true models fall short in today's complex and fast-paced world.



initiates,” he writes, “its strategic agenda is selecting the best battleground for fighting it out with its competitors. The ideal is to find a strategy that competitors are frozen from reacting to, given their present circumstances.” Completing a market analysis, he says, means a business can recognize elements of risk and position itself within the marketplace, and possess the flexibility and nimble movement to withstand surprises.

While Porter’s Five Forces model is an excellent guide to analyze and assess market influences and risks, it’s incomplete. His approach is too narrowly steeped in the concept of using leverage to gain advantage, and the focus is on maintaining competitive advantage through defensive maneuvering. Trying to outmaneuver your suppliers is a short-sighted, win-lose philosophy — cooperative efforts can drive innovation and create value for everyone.

The Kraljic matrix. Peter Kraljic’s 1983 *Harvard Business Review* article challenged businesses to take a fresh look at purchasing departments. He suggested buyers categorize purchases across two dimensions — profit impact and risk. Once the spend categories were classified, Kraljic suggested a buying organization’s next step was to “weight the bargaining power of its suppliers against its own strength as a customer.” Based on an organization’s power relative to its supplier, he notes, there are three primary purchasing strategies: exploit (in the case of buyer dominance), balance (in the case of a balanced relationship) and diversify (in the case of supplier dominance). To help organizations simplify the approach, he devised a quadrant “matrix,” an instant hit due to its simplicity. Today, many consider the Kraljic matrix the standard purchasing portfolio management model.

The “exploit” strategy, viewed by Kraljic as the most desirable, reinforces the time-honored standard of using power for one’s own advantage. The concept means just what you think: Reduce supply risk and get the best price by using your power — whether by consolidating volumes or simply because you’re the industry’s 800-pound gorilla. Kraljic’s advice sends

a clear signal for buyers: Use your power when possible to gain an advantage.

A.T. Kearney’s (ATK) Purchasing

Chessboard. ATK’s Chessboard, developed in 2008, provides companies with a toolkit to address every possible supply-and-demand market condition. It consists of a “chessboard” of 64 procurement strategies that organizations can use to help them “win” the procurement game. Each strategy represents “a stand-alone, differentiating way to work with suppliers to reduce costs and increase value. These methods are derived from 16 approaches and four purchasing strategies,” an ATK white paper states. The four major purchasing strategies outlined by ATK: leverage competition among suppliers, seek joint advantage with suppliers, change the nature of demand and manage spend.

Like Porter and Kraljic, the ATK Chessboard is rooted in a classical competitive mindset. Three of the four quadrants are based on reasserting market power and seizing the transactional advantage, while the fourth — seeking joint advantage with suppliers — occurs only when buyers and suppliers in a transaction have equal market power. ATK’s Purchasing Chessboard *does* bring incremental improvements to the procurement profession by introducing 64 options, but in our mind, it can send the wrong message: If you are simply playing a game with your suppliers — especially your most strategic suppliers — you’re not really inspiring them to drive true collaboration and innovation to your organization.

Multistep strategic sourcing

processes. The concept of adopting a formal step-by-step methodology has been around since 1994, when Toshihiro Nishiguchi introduced it in *Strategic Industrial Sourcing: The Japanese Advantage*. The eight-step process resonated, and countless organizations and consulting firms jumped on the bandwagon by creating their own variations. Many organizations live and die by these multistep models to help them create a more standardized approach for buying goods and services.

What’s the weaknesses of a multistep process? First, applying a “best practice” sourcing process could easily be overkill for many things you buy. Second, while many sourcing initiatives are one-time projects from “needs” to “disposal,” there is tremendous opportunity to create value before and after the sourcing cycle. This is especially true (1) for direct-spend items, where early supplier involvement in design can yield significant value and (2) in outsourcing relationships that demand ongoing, more collaborative supplier relationships. Research shows that as much as 70 percent of the cost impact of a spend category is determined at the product- or service-design stage. Consider: If a buyer is asked to purchase a category after design, that buyer can address only 30 percent of the cost, inhibiting the ability to meet cost-reduction targets.

Third, many sourcing initiatives like complex outsourcing contracts are not “once and done.” Instead, they require ongoing collaboration and governance, and there is no “disposal” aspect — but rather an ongoing evolution and demand for innovation over the duration of the outsourcing contract.

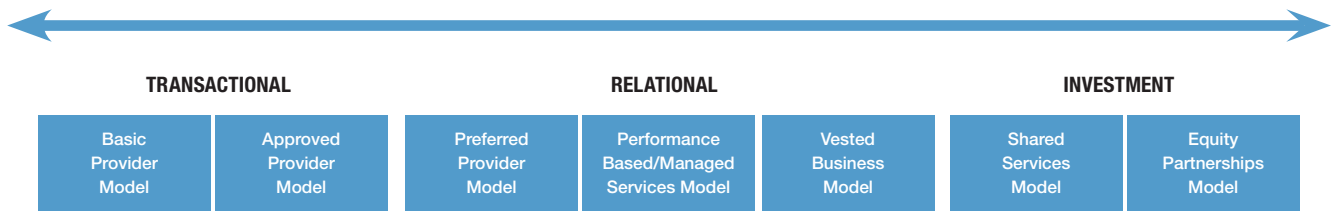
FINDING NEW SOLUTIONS

If the aforementioned models come up short in harnessing the power of today’s suppliers, what should you do? One solution could be Sourcing Business Model theory. Developed out of a collaborative research project led by the University of Tennessee, the Sourcing Business Model is a combination of two critical concepts: (1) What contractual relationship framework — transactional, relational or investment based — is used to work with the supplier? (2) What economic model — transactional, output or outcome based — is used?

Sourcing Business Model theory applies systems thinking where organizations architect a supplier relationship based on the nature of the relationship and the desired economic model. There are seven models; the figure on the next page shows where they fall along the Sourcing Business Model continuum:

- Basic Provider
- Approved Provider

THE SOURCING BUSINESS MODEL CONTINUUM



Sourcing Business Models shift away from spending time on applying the “best practices” of each sourcing step to thinking about sourcing as a continuum of business models that are a “best fit.”



- Preferred Provider
- Performance Based/Managed Services
- Vested Business
- Shared Services
- Equity Partnerships.

How is Sourcing Business Model theory different? First, the Sourcing Business Models shift focus from the “best practices” of each sourcing step to a continuum of sourcing business models that are a “best fit.” In other words, not all sourcing initiatives are worth the effort.

Second, as you move along the sourcing continuum, each model differs from a risk/reward perspective and should be evaluated in the context of what’s being procured. Learning to navigate through the options increases the ability to reach and surpass the organization’s business goals. For example, do you have a highly strategic and dependent outsourcing relationship with a supplier? Do you want to unlock potential value and innovation? Perhaps you should apply a Vested sourcing business model that incentivizes the supplier to drive improvements against mutually defined desired business outcomes. If multiple suppliers provide a component part, but one can add value by co-investing in early engineering design efforts, perhaps you should shift from an Approved Provider model to a longer-term Preferred Provider model.

Third, Sourcing Business Model theory shifts from using power as the key factor in segmenting suppliers. In fact, it embraces shifting up the sourcing continuum by unlocking the power of a *collaborative* supplier relationship. The more potential to create value with a supplier, the more important it is to

shift from power-based to collaborative approaches.

Finally, Sourcing Business Model theory formally incorporates post-contract governance and supplier relationship management (SRM) elements into the design of each model. While many organizations adopt sophisticated SRM practices after the contract signing, we believe that SRM should not be a “separate” process. Rather, it should be incorporated into an end-to-end strategic sourcing cycle. For complex outsourcing initiatives, for example, the skills a supplier (and buyer) bring in co-creating their governance structure can make or break the success of an outsourcing initiative.

UP TO THE TASK?

The University of Tennessee (UT) researchers behind Sourcing Business Model theory have made their Sourcing Business Model toolkit an open-source resource to help procurement professionals determine which sourcing model is most appropriate. (*Note: The Sourcing Business Model toolkit is available as a free download on the UT dedicated website to the Vested business model at vestedway.com/tools.*)

A business model-mapping exercise includes four steps that, when properly completed, can help you determine the most appropriate Sourcing Business Model for your specific situation:

- **Step 1:** Select the defined spend category/categories you are sourcing/potentially sourcing.
- **Step 2:** Use the relationship model mapping template to determine the best model for what you are sourcing. The template includes 14 attributes examining business factors to

determine if a transactional, relational or investment-based approach is best.

- **Step 3:** Use the economic model mapping template. The template features 11 attributes to determine if a transaction, output-based, or outcome-based economic model is most appropriate for your situation.
- **Step 4:** Use the Sourcing Business Model matrix to determine the best model, which will be based on the relationship and economic models chosen.

Once you have determined the most appropriate Sourcing Business Model for your situation, the toolkit provides a one-page “cheat sheet” for how to best architect a supplier agreement for each of the Sourcing Business Models. In addition, the toolkit includes a robust sourcing consideration checklist — a reference guide to ensure that all critical decisions are made before a sourcing initiative begins.

Pioneers like Porter, Kraljic and ATK led an evolution in procurement. The fact is, procurement organizations would not be where they are today without the research (and tools) from these progressive thinkers. However, the approaches to buying goods and services that today’s procurement professionals learned — and still use — may no longer be up to the task at hand. Don’t hesitate to look about for alternative solutions that might better prepare you for sourcing success. [ISM](#)

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