Strategic Sourcing in the New Economy:
Harnessing Sourcing Business Models in Modern Procurement

University of Tennessee
Kate Vitasek
STRATEGIC SOURCING IN THE NEW ECONOMY
Harnessing Sourcing Business Models in Modern Procurement
Are We at the Dawn of a New Era?

There is an old saying that the first one to know Thanksgiving is getting close is the turkey.
The Sacred Cows of Procurement

- Porter’s Five Forces
- Kraljic Matrix
- Multi-Step Sourcing Models
- ATK’s Purchasing Chessboard
Porter’s Five Forces - 1979

- Born out of Michael Porter’s 1979 best selling book *Competitive Strategy: Techniques for Analyzing Industries and Competitors*
- An organization’s bartering power with its supplier is one of five key “competitive forces”
- Companies should seek ways to improve their power over suppliers to gain a competitive advantage

Porter misses the power of creating highly strategic collaborative supplier relationships.
• Logical and easy to use way to segment suppliers in a 2 x 2 matrix

• Suggested three “strategies” for working with suppliers
  – Leverage/exploit (preferred strategy)
  – Diversify
  – Balance (only use if you are unable to leverage or diversify)

Kraljic misses the power of creating highly strategic collaborative supplier relationships.
• Kraljic was asked “If you had the chance to rewrite the 1983 article with the benefit of 25 years’ hindsight, would there be anything to add?

• Kraljic replied, “The importance of trust in long-term relationships with suppliers. You need [trust] to create win-win.”
While successful, multi-step processes fall short

- Sourcing is not a destination, it is continuous process
- Best practice vs. best fit mentality
- Limited emphasis on end-to-end category management philosophies
- Failure to incorporate the concept of Sourcing Business Models
Sending the message to only be collaborative when you don’t have the muscle to win outright is myopic.

ATK Purchasing Chessboard– 2000s

- Born out of consulting firm A.T. Kearney
- A chessboard of 64 procurement strategies to help organizations “win” the procurement game
- Three quadrants are based on asserting market power
- Fourth quadrant seeks joint advantage with suppliers (occurs when buyers and suppliers “have equal market power”)

4 Purchasing Strategies
16 Levers
64 Methods
“Muscular buyers not only use their suppliers, but they often ‘use up’ their suppliers and discard them.

The muscular approach to outsourcing of goods and services is myopic and inefficient.”

Williamson won a Nobel Prize in Economics in 2009.
Power Based Approaches are Myopic

• Studied trust in service provider – automaker relationships
• General Motors was the least trusted automaker and Toyota the most trusted
• General Motors incurred six times higher transaction costs (procurement costs) than Toyota

Jeffery Dyer
Brigham Young University, Marriot School
Companies Are at an Inflection Point
Transactional Models Have Inherent Weaknesses

THIS CLASS WILL MAKE ME MORE EFFICIENT.

I DON'T WANT YOU TO BE MORE EFFICIENT. YOU'RE WORKING ON A GOVERNMENT CONTRACT AND BILLING BY THE HOUR.

NOW GO BILL THEM FOR THE TIME YOU STOOD HERE AND STARED AT ME LIKE A STUFFED DEER.

Dilbert.com DilbertCartoonist@gmail.com

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The Conventional Approach: Make vs. Buy

- Make: Create “Corporate Hierarchy”
- Buy: Use “The Market”
A New View: A “Hybrid” Approach

There is a whole playground in the middle!

Buy
Use “The Market”

“Hybrid” Approach

Make
Create “Corporate Hierarchy”
Jones Lang LaSalle and Procter & Gamble Finalize Real Estate Outsourcing Agreement

CHICAGO and CINCINNATI, June 17 /PRNewswire-FirstCall/ -- Jones Lang LaSalle Incorporated (NYSE: JLL) and The Procter & Gamble Company (NYSE: PG) today finalized a 5-year agreement for one of the most geographically diverse assignments to outsource corporate facilities management and project management services. Already the world’s largest provider of property management services and a leader in business process outsourcing, Jones Lang LaSalle will now manage all P&G-owned and leased corporate real estate -- a total of nearly 13.8 million square foot (1.28 million square meters) of offices and technical facilities located in 60 countries on six continents. Consistent with P&G’s continuing efforts to focus on its core consumer products business, Jones Lang LaSalle will provide a comprehensive range of property management and strategic occupancy planning services as well as Transition nearly 300 employees by January 2004.

The transition process will begin in the United States, where employees and properties located in 20 states and 55 cities will be under management by Jones Lang LaSalle by September 1. The business and employee transition for other countries will occur between November 2003 and January 2004, subject to appropriate government and regulatory approvals. The first transitions to occur in November include properties located in South America, Australia, Canada, Japan, Malaysia, Philippines, Singapore, Thailand and parts of Europe.
Sourcing Business Model Theory

BUY

“Market”

MAKE

“Hierarchy”

“Hybrid”

SOURCING CONTINUUM

TRANSACTIONAL

Basic Provider Model

Approved Provider Model

Preferred Provider Model

Performance Based/Managed Services Model

Vested Business Model

Shared Services Model

Equity Partnerships

RELATIONAL

INVESTMENT
Systems Thinking is Key

A well designed system creates feedback loops and creates desired results
We Need “Rules” for Creating Each System!

1. Business Model
2. Scope or Work
3. Performance Management
4. Pricing Approach
5. Governance

Source: Vested®
### The Rules of the Game

#### BUSINESS MODEL

<table>
<thead>
<tr>
<th>Economic Model</th>
<th>Basic Provider</th>
<th>Approved Provider</th>
<th>Preferred Provider</th>
<th>Perf.-Based / Managed Services</th>
<th>Vested Relationship</th>
<th>Investment (Equity Partner / Shared Services)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transactional (Market)</td>
<td>Transaction-based (per transaction, hour or unit)</td>
<td>Transaction-based (per transaction, hour or unit)</td>
<td>Transaction-based (per activity, hour or unit)</td>
<td>Output-based</td>
<td>Outcome-based</td>
<td>Transactional, output-based or outcome-based</td>
</tr>
<tr>
<td>Relational (Hybrid)</td>
<td>Transactional / no relationship</td>
<td>Transactional / supplier vetted on &quot;Approved&quot; list</td>
<td>Relational contract / emerging collaboration</td>
<td>Relational contract (collaborative)</td>
<td>Relational contract (highly collaborative)</td>
<td>Investment-based</td>
</tr>
<tr>
<td>Relational (Hybrid)</td>
<td>Supply at lowest cost</td>
<td>Recurring commodities at fair or lowest cost</td>
<td>Value-added capabilities at best value</td>
<td>Performance to SLA / process efficiencies</td>
<td>Shared Vision, Desired Outcomes &amp; Value Creation</td>
<td>Sustainable Value</td>
</tr>
</tbody>
</table>

#### SCOPE OF WORK

<table>
<thead>
<tr>
<th>Statement of Work &amp; Objectives</th>
<th>&quot;Who&quot; and / or &quot;How&quot;</th>
<th>&quot;Who&quot; and / or &quot;How&quot; (jointly defined &quot;How&quot;)</th>
<th>&quot;What&quot; and limited emphasis on &quot;How&quot;</th>
<th>&quot;What&quot;</th>
<th>&quot;What If&quot;, &quot;What For&quot; and &quot;When&quot;</th>
</tr>
</thead>
</table>

#### PERFORMANCE MANAGEMENT

<table>
<thead>
<tr>
<th>Performance Focus</th>
<th>Simple three-way accounting match</th>
<th>PO requirements</th>
<th>Activity-based service level agreements</th>
<th>Output-based service level agreements</th>
<th>Strategic Desired Outcomes</th>
<th>P&amp;L-based Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance Measures</td>
<td>Right quantity, right price, damage-free</td>
<td>Basic provider metrics + increased quality emphasis</td>
<td>Operational + customer satisfaction</td>
<td>Operational + relational (Values &amp; Behaviors)</td>
<td>Ops + transformational + relational system-wide KPIs</td>
<td>Joint Measures of Success</td>
</tr>
</tbody>
</table>

#### PRICING

<table>
<thead>
<tr>
<th>Pricing Model &amp; Incentives</th>
<th>Fixed price / typically no incentives / volume rebates</th>
<th>Fixed price / low-no incentives / volume rebates</th>
<th>Fixed price / low incentives / volume rebates</th>
<th>Price with incentives and / or penalties</th>
<th>Pricing Model with value-based incentives</th>
<th>P&amp;L-based Equity Sharing</th>
</tr>
</thead>
</table>

#### GOVERNANCE

<table>
<thead>
<tr>
<th>Relationship Management</th>
<th>Delivery &amp; pricing validation (3-way PO match)</th>
<th>Some performance &amp; pricing oversight</th>
<th>Limited Supplier Relationship Management</th>
<th>Oversight emphasis: Supplier Relationship Mgmt.</th>
<th>Insight emphasis: Strategic Relationship Mgmt.</th>
<th>Shared control and management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improve, Transform &amp; Innovate</td>
<td>None / market-driven</td>
<td>Limited / market-driven</td>
<td>Beginning to focus on incremental improvements</td>
<td>Supplier-driven to meet SLAs / price glide path</td>
<td>Joint &amp; proactive Transformation Mgmt.</td>
<td>Core innovation capabilities</td>
</tr>
<tr>
<td>Exit Management</td>
<td>One-way / limited commitment to buy</td>
<td>One-way / termination for cause &amp; convenience</td>
<td>One-way / termination for cause &amp; convenience</td>
<td>Perf.-based termination for cause w/ safeguards</td>
<td>Joint Exit Management Plan</td>
<td>Divestiture</td>
</tr>
<tr>
<td>Compliance &amp; Special Concerns</td>
<td>Compliance-driven / survey-based</td>
<td>Typically compliance-driven / survey-based</td>
<td>Typically market-based / minimum audit requirements</td>
<td>Corporate-based audit requirements</td>
<td>Outcome-based joint requirements</td>
<td>Investment-based joint requirements</td>
</tr>
</tbody>
</table>
Architecting the Right Agreement Matters!

Are you buying a commodity or a strategic partnership to create value?

Matt McClish
Purchasing Group Manager
Procter & Gamble
“Cherry Picking” the Rules Creates Chaos

- Mix and matching “best practices” without understanding the system implications creates a Business Model mismatch.

- Instead architect the “best fit” solution for your solution using a well structured agreement following the Sourcing Business Model rules.

Image from Audi commercial on YouTube https://www.youtube.com/watch?v=VetG_3_xF0c
The Dell Story

Profiled in Chapter 12 in the Vested Outsourcing Book
Key to sourcing strategy success is to integrate Sourcing Business Model theory into practice as you develop your sourcing solution.

This can be done by using the SIG U “Sourcing Wheel.”
Don’t be dinner in the dawn of a new era of procurement!
Thank you to JLL for sponsoring the books.
Enjoy the read!
Contact Me with Questions!

kvitasek@utk.edu

www.vestedway.com
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3. Select **Day**
4. Select **Session**
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Session #GS_TH_PM

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