Seven Sourcing Business Models to Create Value and Manage Risk

The Forefront Group
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President

sig.org/eval
SOURCING BUSINESS MODELS

Seven Sourcing Business Models to Create Value and Manage Risk
A Certified Vested© Center of Excellence
(5 Certified Deal Architects, 3 UT Vested Faculty Members)

Organization
Organization Design
Integration
And Knowledge
Development

Process
Self- Sustaining
Methodologies and
Continuous Improvement

Tools
Self-Diagnostics,
Analytical and
Performance
Enhancement Tools

- Organization Maturity Assessment ©
- Organization Design Optimization & Integration
- Knowledge Assessment Program ©
- Training Portfolio: SIG U
- 4 Cornerstones of Strategy Development ©
- Team Development & Management Program
- Supply Relationship © Business Model Selection Guide ©
- Sourcing Strategy Development eWorkbook ©
- Category Team © Management Guide
- Supply Relationship Model Toolkit ©

Organizational Alignment/Stakeholder Alignment
Change Management Acceleration ©
Learning Objectives

At the conclusion of this workshop, students will be able to:

• Understand **seven (7) fundamental** supply business models that can be established with suppliers to support purchased requirements
• Understand how to **map the business requirements** to the appropriate supply business model for ongoing supply relationship and strategy management
• To understand and **apply the business model attributes** to each selected business model
• Determine how to **elevate or adjust the current** supply business model used to one that more appropriately aligns with the sourcing strategy and business requirements

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Overview

- Modern Research Supporting Business Model Frameworks
  - Introduction to Sourcing Business Models
  - The Seven Sourcing Business Models
  - Sourcing Business Model Selection
  - A Word About Relational Business Models
Incorporate Modern Thinking into your Procurement Practices

How do you incorporate more modern thinking into your procurement practices?

• Rethink your strategic sourcing processes to actively promote more modern approaches.

• Use a multi-step process, to incorporate the best thinking of leading economist and strategic thinkers.

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESSING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Research Supporting a Collaborative Business Model

- Ronald Coase
  Nobel Prize
  Total Cost Not Price

- Ian R. MacNeil
  Northwestern
  Flexible Relational Contracts

- Oliver Williamson
  Univ. of California, Berkeley
  Sourcing is a Continuum not purely Make or Buy

- John Nash
  Grow the Pie Don’t Fight over it

- Robert Solow
  Nobel Prize
  Innovation = Growth

- Kathleen Eisenhardt
  Stanford
  Transaction or Outcome Models

Large playground in the middle of “hybrid” models

SOURCING BUSINESS MODEL SELECTION ©
Ten Lessons For Commercial Relationships

1. Look at sourcing as a **continuum**, not a destination
2. Develop contracts that create “**mutuality** of advantage”
3. Understand the **transaction attributes** and their impact on risk and price
4. Understand that the greater the bilateral dependencies, the greater the need for **preserving continuity**
5. Use a contract as a **flexible framework** – not a legal weapon
6. Develop **safeguards** to prevent defection
7. Minimize transaction costs with predicted alignments
8. Be credible – the style of contracting matters
9. Build trust – leave money on the table
10. Keep it simple

Williamson’s astute insight into commercial relationships are transformative
“All complex contracts will be incomplete – there will be gaps, errors, omissions and the like.”

“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.”
Example: A Profile of GM’s Procurement Practices

• “Adversarial and arms length supplier relationships dating back to the 1950’s”

• 1990 Dr. Ignacio Lopez promoted to director of General Motors Worldwide Purchasing operations
  — “I do not want to hear any more that prices are already down too far and you are making no profits.”
  — Saved a whopping US $ 1.1 billion in 1991 and US $ 2.4 billion in 1992
The Lopez Effect Still Haunts GM

- Worst automaker by U.S. suppliers
- Tier 1 suppliers rate GM as their least favorite big customer
- Low marks for key measures such as overall trustworthiness, communication and protection of intellectual property
- 55% of suppliers rated their relationship with GM as poor to very poor

Source: Reuters Business News, May 12, 2014

2014 Reuters report cites GM
• General Motors was the least trusted automaker and Toyota the most trusted
• General Motors incurred six times higher transaction costs (procurement costs) than Toyota

A Muscular Approach has Limited GM’s Profits

Jeffery Dyer
Brigham Young University
Marriott School
A Clear Message is Emerging

• This century’s business battlefield will be based on **harnessing the power of your suppliers**

• The playing field is no longer one of **lowest cost or best value**, but one of highly collaborative supplier relationships helping drive transformation and innovation

• **Tomorrow’s winners will:**
  – Abandon win-at-all costs game with their key suppliers
  – Surpass lip service “saying” strategic supplier but then apply rooted tactics that do not harness the power of suppliers

If organizations are going to compete ‘supply chain to supply chain,’ shouldn’t supply chain partners work together?

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESSING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Overview

• Modern Research Supporting Business Model Frameworks

• *Introduction to Sourcing Business Models*

• The Seven Sourcing Business Models

• Sourcing Business Model Selection

• A Word About Relational Business Models
The Evolution of Sourcing Business Model Theory

- Concept first introduced in the book *Vested Outsourcing: Five Rules That Will Transform Outsourcing*
- Built on in *The Vested Outsourcing Manual: Creating Successful Business and Outsourcing Agreement*
- Expanded on in a white paper published by the University of Tennessee, SIG, CORE, and IACCM
- Refined in the book *Strategic Sourcing in the New Economy: Harnessing the Potential of Sourcing Business Models in Modern Procurement*
What is a Sourcing Business Model?

• A Sourcing Business Model is a combination of an organization’s Relationship Model and Economic Model

• There are seven Sourcing Business Models, each serving to optimize for 25 key business attributes

• An organization should consciously select the Sourcing Business Model that is most appropriate for their sourcing situation in order to optimize for their business environment
# Relationship Model and the Economic Model

<table>
<thead>
<tr>
<th>Relationship Model</th>
<th>Economic Model</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>What is It?</strong></td>
<td>An economic model determines how you will manage the economics of the relationship</td>
</tr>
<tr>
<td>A relationship model determines how you will formally control or influence your supply source</td>
<td></td>
</tr>
<tr>
<td><strong>What are your decisions</strong></td>
<td>Three economic models:</td>
</tr>
<tr>
<td>Three relationship models:</td>
<td>• Transaction-Based</td>
</tr>
<tr>
<td>• Transactional Contract (Market)</td>
<td>• Activities drive behavior, e.g. pay per Unit, Hour, Activity</td>
</tr>
<tr>
<td>• Relational Contract (Hybrid)</td>
<td>• Output-Based</td>
</tr>
<tr>
<td>• Investment / Vertical Integration (Hierarchy)</td>
<td>• Pay for supplier output such as SLAs or Guaranteed savings glidepath</td>
</tr>
<tr>
<td></td>
<td>• Outcome-Based</td>
</tr>
<tr>
<td></td>
<td>• Boundary Spanning/Business Outcomes with shared risk or shared reward</td>
</tr>
</tbody>
</table>

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESSSING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
A Sourcing Business Model is a combination of an organization’s Relationship Model and it’s Economic Model.

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<tr>
<td></td>
<td>Performance Based/Managed Services Model</td>
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<td>Vested Business Model</td>
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<td>Investment / Vertical Integration (Hierarchy)</td>
<td>Shared Services Model</td>
<td></td>
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<td></td>
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Overview

• Modern Research Supporting Business Model Frameworks
• Introduction to Sourcing Business Models
• **The Seven Sourcing Business Models**
• Sourcing Business Model Selection
• A Word About Relational Business Models
The Seven Sourcing Business Models

1. Basic Transaction Provider
2. Approved Provider
3. Preferred Provider
4. Performance –Based Agreement
5. Vested Business Model
6. Shared Services
7. Equity Partnerships

In this section we will do an in depth review of each Sourcing Business Model
Basic Provider Model

Primary purpose: gain access to goods or services at the lowest cost

- **Transaction-based** economic model and a *transactional relationship* model (price per unit, per activity, per hour)
- **Competitive mind-set**
- **Generic or standards with broad supply options**

A basic transaction provider is a supplier that operates under a simple buy–sell arrangement where buyers typically pay a set “transaction” price for products or services
**Approved Provider Model**

**Primary purpose:** leverage volumes, gain pricing discounts and reduced administrative costs with fewer proven suppliers

- **Transaction-based economic model and a transactional relationship model**
- **Master Agreements**
- **Reduced Competition**

An approved provider is a supplier that meets a predefined set of qualification characteristics, quality standards, prior proven performance or other selection criteria.

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Preferred Provider Model

**Primary purpose:** to gain access to value-added capabilities at best value or volume discounts through a longer-term contract

- **Transaction-based economic model and a relational contract model**
- **streamline buying processes** and allow for **easy repeat business**
- may have an **exclusive arrangement**, but competitors exist
- shift the procurement lens from price to value

A preferred provider model uses a transaction-based approach, but the buyer chooses a more strategic relational model with specifically chosen supplier(s)

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESSING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Primary purpose: drive efficiencies and ensure predefined service levels with provider expertise

- **Transaction-based with output performance incentives and penalties** economic model and a relational contract model
- **Longer-term contract** with the intent that the supplier invests in improvements to meet predefined service-levels and/or savings targets
- **Shifts risk to the supplier** - Also known as “pay for performance” or “painshare/gainshare”, managed services agreement with fixed fee

A performance-based model combines a relational contracting model with an output-based economic model
Vested Business Model

Primary purpose: co-developed, co-managed collaborative solution with expert to generate and optimize value not individually gained

- A Vested model combines an outcome-based economic model with a relational contracti model (WIIFWE Mindset)
- Creates a longer-term relationship (5-15 yrs.) to develop solutions that achieve boundary spanning business outcomes
- Ideal for managing risk
- creates a highly collaborative environment that drives innovation

A Vested business model creates highly collaborative win-win relationships in which both buyers and suppliers are equally committed in each other’s success.

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Vested Business Model

- Developed by University of Tennessee researchers studying the world’s most successful buyer-supplier partnerships
  - Turned lessons learned into a **systematic model** following the Nobel Prize-winning concept of **behavioral economics** and the principle of **shared value**
- **Key differentiator is a “What’s in it for We” mindset**
  - The more efficient and effective the business outcomes, the more profit the supplier makes
  - Suppliers are rewarded for reducing cost structures (not prices) if work scope stays the same

Source: *STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT*, Keith, Vitasek Manrodt & Kling, Palgrave 2015
The Vested methodology follows five rules:

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

Source: Vested®

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Shared Services Model

**Primary purpose:** Create **internal functional business unit** or stand-alone entity that **provides goods or services** to an overall broader organization

- **processes typically are centralized** into organization that **charges business units** and users for the services they use

- An **SSO consolidates services** across an organization and places them into a distinct entity designed to be **competitive with “buy” solutions**

- A shared services model is like an entity that creates its own internal supplier and outsources to itself

A shared services model is one of two investment-based categories and is constructed as an internal organization based on an arm’s length outsourcing arrangement

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**Source:** STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
The Shared Services Model

- **Cost Transparency**
- **Business Management**
- **Service Culture**
- **Market Responsiveness**
- **Process Standardization**
- **Best Practice Proliferation**

The Appeal to Organizations

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESSING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Equity Partnerships

**Primary purpose:** legally bind potential business partners through formal structures to effectively meet business objectives

- Organizations creating equity partnerships make a direct investment in building capabilities with a formalized entity
- Typically asset-based with a formal and comprehensive governance framework
- Setting one up can be a costly and complicated process
- There are multiple types of equity partnerships

Equity partnerships are the second category of investment-based models along the sourcing continuum
If an organization decides to invest in an equity partnership, they can take different legal forms:

- Acquisitions
- Joint Ventures
- Subsidiaries
- Purchasing Cooperatives

Equity Solutions are typically created by a senior executive team which may include Sourcing.
Because of this variety of investment-based models, there is no one right way to structure such a model. Investment-based models can use any of the three economic models: transactional, output or outcome based. Due to organization financial nature, the stakes typically are high, therefore most investment-based models benefit when following a highly collaborative what’s-in-it-for-we (WIIFWe) approach with an outcome-based economic model.

Every situation is different!
As goods and services become more strategic and the business environment more unpredictable, organizations should shift to more sophisticated Sourcing Business Models.

The seven Sourcing Business Models are “mapped” to Williamson’s Sourcing Continuum.
Overview

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• Introduction to Sourcing Business Models
• The Seven Sourcing Business Models
• **Sourcing Business Model Selection**
• A Word About Relational Business Models
**Sourcing Business Model** theory suggests sourcing should be thought of as a business model between a two parties with the goal to **optimize the exchange**.

Sourcing Business Models are based on two factors: **relationship models** and **economic models**.
Supply Business Model Selection

• When selecting a supply business model for the category you are managing, it is important to understand that a single model will not work for every requirement.

• Understanding how the requirement supports and is viewed by your business as well as the internal and external influences will impact your model choice.

• The level of effort you apply in your sourcing and ongoing supplier management approach.

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
The Seven Sourcing Business Models

BUY

“Market”

“Hybrid”

“Hierarchy”

MAKE

SOURCING CONTINUUM

TRANSACTIONAL

RELATIONAL

INVESTMENT

Basic Provider Model
Approved Provider Model
Preferred Provider Model
Performance Based/Managed Services Model
Vested Business Model
Shared Services Model
Equity Partnership

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Which Sourcing Business Model is Best?

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<td>Equity Partnerships</td>
<td></td>
</tr>
</tbody>
</table>

What is the right Relationship Model?

What is the right Economic Model?

Results in the best Sourcing Business Model

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESSING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Determining which Sourcing Business Model is best for your situation is easy when you complete a Sourcing Business Model Mapping exercise!

• A Sourcing Business Model Mapping exercise where you assess your category against **25 key attributes** will help you answer two key questions
  – What relationship model should you use?
  – What economic model should you use?

• Based on your answers, you will then “map” your answers to the Business Model Map Matrix

• The Sourcing Business Model you pick greatly depends on your level of dependency/risk and your potential to create value
### Business Model Mapping Matrix

The Business Model Mapping matrix allows you to “map” your business environment against the complete list of attributes.

<table>
<thead>
<tr>
<th>Economic Model</th>
<th>Transactional Contract (Market)</th>
<th>Relational Contract (Hybrid)</th>
<th>Investment (Vertical Integration / Hierarchy)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Outcome-Based</strong></td>
<td>Mismatch – Not a Viable Strategy</td>
<td>Vested</td>
<td>Equitable Partner</td>
</tr>
<tr>
<td>Economics tied to Boundary Spanning/Business Outcomes</td>
<td></td>
<td></td>
<td>Vested Shared Services</td>
</tr>
<tr>
<td><strong>Output-Based</strong></td>
<td>Mismatch – Not a Viable Strategy</td>
<td>Performance-Based (Managed Services) Agreement</td>
<td>Equitable Partner</td>
</tr>
<tr>
<td>(Performance-Based / Managed Services)</td>
<td></td>
<td></td>
<td>Shared Services</td>
</tr>
<tr>
<td>Economics tied to Supplier Output</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Transaction-Based</strong></td>
<td>Basic Provider</td>
<td>Preferred Provider</td>
<td>Equity Partner</td>
</tr>
<tr>
<td>Economics tied to activities drive behavior</td>
<td>Approved Provider</td>
<td></td>
<td>Shared Services</td>
</tr>
</tbody>
</table>

The Business Model Mapping matrix allows you to “map” your business environment against the complete list of attributes. It helps in understanding the economic models, relationship/contract models, and investment models. The matrix categorizes the business models into Outcome-Based, Output-Based, and Transaction-Based categories, each with specific economic models and contract models. The Economic Model column includes Outcome-Based, Output-Based, and Transaction-Based, with their corresponding economic models. The Relationship/Contract Model column provides transactional, relational, and investment models. The Investment model includes Vertical Integration/Hierarchy, and the economic models include Vested Partner, Vested Shared Services, Performance-Based (Managed Services) Agreement, Equitable Partner, and Equity Partner. The matrix helps in making informed decisions by mapping the business environment against these models.
Most organizations understand the need to have more strategic supplier relationships. As you work with suppliers in a more strategic manner your dependency increases.
# The Value Connection

<table>
<thead>
<tr>
<th>Economic Model</th>
<th>Relationship/Contract Model</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Outcome-Based</strong>&lt;br&gt;Economics tied to Boundary Spanning/Business Outcomes</td>
<td><strong>Transactional Contract</strong>&lt;br&gt;(Market)</td>
</tr>
<tr>
<td><strong>Output-Based</strong>&lt;br&gt;(Performance-Based / Managed Services)&lt;br&gt;Economics tied to Supplier Output</td>
<td><strong>Relational Contract</strong>&lt;br&gt;(Hybrid)</td>
</tr>
<tr>
<td><strong>Transaction-Based</strong>&lt;br&gt;Economics tied to activities drive behavior</td>
<td><strong>Investment</strong>&lt;br&gt;(Vertical Integration / Hierarchy)</td>
</tr>
</tbody>
</table>

When appropriately applied, an organization can derive more value by thinking in terms of “outputs” or “outcomes” versus simple “transactions”.
Simplified Sourcing Business Model Framework

The Business Model framework is another way to visualize the impact of dependency/risk and the optional to create value.

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
As you map your sourcing situations across the 25 attributes, you will likely find the results somewhat like a funnel.

The majority of your sourcing situations will likely need transactional sourcing business models.

Likewise you will likely find there are very few situations that call for an investment based model.

* the complete Business Model Mapping template contains 25 attributes
Exercise:

• Select a category and use the provided map to determine the best response for your business
• Count and total the number of decisions that fall in each column
• Highlight the column that has the most responses
Business Model Mapping Exercise
Step 1: Select the Defined Spend Categories You are Sourcing

• Review the spend categories you will be sourcing

• If you already follow category management practices, this will likely be easy; if not, look for logical groupings

• For example, if you are outsourcing facilities management you may have the following categories
  – Cleaning/janitorial
  – Maintenance
  – Project management (e.g. remodeling an office)
  – Employee moves/relocations

• Once you have determined the categories, use the Business Model Mapping template to “map” the attributes of your sourcing situation
Step 2: Determine the Best Relationship Model

• The second step is to determine the relationship model that is best suited to meet your needs

• There are three relationship models
  – Transactional Contract (Market)
  – Relational Contract (Hybrid)
  – Investment / Vertical Integration (Hybrid)

• There are 14 Mapping Attributes covering three areas*
  – Level of Dependency / Need for Continuity of Resources
  – Strategic Impact/Core Competency for the Buyer
  – Degree of Business Risk

* the complete Business Model Mapping template contains 25 attributes
Step 2: Determine the Best Relationship Model

- To develop your “map”, go through each of the attributes.
- Simply mark the response that best relates to your sourcing situation.
- It is OK to “span” answer boxes such as in the example below where “high” and “very high” were selected.

The example indicates a relational contracting model is best suited for your situation; however, don’t pass judgment until you have mapped all of the attributes.

* the complete Business Model Mapping template contains 25 attributes.
Step 3: Determine the Best Economic Model

- The third step is to determine the **economic model** that is best suited to meet your needs

- There are three categories of economic models
  - **Transaction-Based** (economics tied to activities drive behavior, e.g. pay per unit, per hour, per activity)
  - **Performance-Based** / Managed Services (economics tied to supplier output)
  - **Outcome-Based** (economics tied to boundary spanning business outcomes—typically support business strategies)

- There are **11 Mapping Attributes** covering four areas*
  - Potential to Create Value / Mutual Advantage
  - Nature of workscope/tasks
  - Level of criticality of work
  - Commercial preferences

* the complete Business Model Mapping template contains 25 attributes.

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Step 3: Determine the Best Economic Model

• To complete your “map”, go through the remaining attributes.
• Mark the response that most closely relates to your sourcing situation; the below example indicates potential efficiency gains are “very high” and indicates an outcome-based economic model is a good fit for your situation

<table>
<thead>
<tr>
<th>Attributes to Determine Best Economic Model</th>
<th>Transaction-Based Economic Model</th>
<th>Output-Based Economic Model</th>
<th>Outcome-Based Economic Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Potential efficiency gains</td>
<td>1 None</td>
<td>2 Low</td>
<td>3 Medium</td>
</tr>
<tr>
<td></td>
<td>4 High</td>
<td>5 Very High</td>
<td>6 Significant</td>
</tr>
</tbody>
</table>

• Again, it is OK to “span” answer boxes if you are uncertain
• Once you are complete you will likely have a map with a preference for a transaction-based, output-based, or outcome-based model
1) Review each attribute and score based on the rankings to the right.

<table>
<thead>
<tr>
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<th>Transaction-Based</th>
<th>Output-Based</th>
<th>Outcome-Based</th>
</tr>
</thead>
<tbody>
<tr>
<td>Potential to Create Value / Mutual Advantage*</td>
<td>None</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Potential Efficiency Gains*A</td>
<td>None</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Potential for Revenue Increase*A</td>
<td>None</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Potential for Innovation*A</td>
<td>None</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Size of investments needed to achieve outcomes (buyer or supplier)*</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Nature of Workscope/Task</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Degree of Supplier Control Over Outcome*</td>
<td>Transactional Task Metrics</td>
<td>Transactional Task Metrics</td>
<td>Transactional Task Metrics</td>
</tr>
<tr>
<td>Type of Success Measure Desired/Required*A</td>
<td>High</td>
<td>High</td>
<td>Medium</td>
</tr>
<tr>
<td>Ease at Which Task/Workscope can be Specified*</td>
<td>High</td>
<td>High</td>
<td>Medium</td>
</tr>
<tr>
<td>Criticality of the Work*</td>
<td>Minimal</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Risk related to operational safety*</td>
<td>Minimal</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Risk related to operational reliability*</td>
<td>Minimal</td>
<td>Low</td>
<td>Medium</td>
</tr>
<tr>
<td>Commercial Preferences</td>
<td>Low Risk</td>
<td>High Risk</td>
<td>Medium Risk</td>
</tr>
<tr>
<td>Financial Risk Tolerance for Client*</td>
<td>High Risk</td>
<td>High Risk</td>
<td>Medium Risk</td>
</tr>
<tr>
<td>Financial Risk Tolerance for Service Provider*</td>
<td>Low Risk</td>
<td>Low Risk</td>
<td>Low Risk</td>
</tr>
</tbody>
</table>

Source Key of Research Supporting the Attribute: *1 Williamson, *2 Eisenhart, *3 Prahalad and Hamel, *4 University of Tennessee, *5 Kraljic

*these attributes are used to determine both the relationship and economic model

2) Scores determine the economic model.

3) Select the best Economic Model.
If the business attributes are present for value creation, an organization can create the most value through the use of relational and investment-based relationship models combined with output of outcome-based economic models.

Organizations that do not have the capabilities or are not willing to take on investment risk should consider Vested or Performance-Based Agreements as ways to create the most value with supplier relationships.
• Each Sourcing Business Model is mapped to each “rule”
• When properly structured, the “rules” create a self-correcting system
• Not following the “rules” creates misalignment – often creating inherent perverse incentives

See next page for Business Model Architecture “Cheat Sheet”
Caution: Supply Business Model

• Many companies are not using the right Supply Business Model for their environment

• There are several conditions that could cause an inappropriate selection
  • Business cultural behavior may cloud the best solution
  • Category management is relatively immature, so it limits the ability to move to a more advanced model
  • Stakeholder misalignment creates ambiguity in how supplier relationships should be managed
  • The Sourcing organization does not truly “own” the supplier interface, and therefore is not able to impact the nature of the relationship

Using the right Supply Business Model will allow your company to optimize overall business execution, result in lower costs, high service levels, overall organizational performance and improved shareholder value
Systems Thinking Is Key

The purpose or function of a well structured system is to perpetuate or replicate a chosen result.

- A system is an interconnected set of elements, sub-elements and components that are coherently structured in a way that achieves a defined purpose.
- This interconnectivity between the elements forms a feedback loop in which information is derived.

Architecting a supplier agreement using the Sourcing Business Model rules creates the most appropriate “system” for your situation.
“Cherry Picking” the Rules Creates Chaos

• Mix and matching “best practices” without understanding the system implications creates a Business Model mismatch
• It is like creating a Doberhuahua; it sounds good but doesn’t work well
• Instead architect the “best fit” solution for your solution using a well structured agreement following the Sourcing Business Model rules

Audi 2014 Super Bowl Commercial - “Doberhuahua” by Tony Mack is available on YouTube. Photo is a screen shot from publically available YouTube video.
https://www.youtube.com/watch?v=2nrbF21Ybo0

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESSING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015
Overview

• Modern Research Supporting Business Model Frameworks
• Introduction to Sourcing Business Models
• The Seven Sourcing Business Models
• Sourcing Business Model Selection

• **A Word About Relational Business Models**
Relational deals are dynamic.

“87% of economic growth results from ‘technical change,’ which is driven by improvements in business process or technical improvements in products.”

- Robert Solow

Transaction deals are static.

A static deal in a dynamic or risky environment is a set up for failure.
A word of caution...

A more progressive Sourcing Business Model approach may not be the right choice given your environment or organizational constraints.

Your organization may lack the mindset or skills to lay the foundation for a more collaborative relational contract.

Maintaining fair and balanced value exchange takes effort and a focus on mutual benefits.
Stakeholder Involvement Along the Continuum

SOURCING CONTINUUM

TRANSACTIONAL  RELATIONAL  INVESTMENT

Basic Provider Model  Approved Provider Model  Preferred Provider Model  Performance Based/Managed Services Model  Vested Business Model  Shared Services Model  Equity Partnership

SOURCING BUSINESS MODEL SELECTION ©

Source: STRATEGIC SOURCING IN THE NEW ECONOMY: HARNESING THE POTENTIAL OF SOURCING BUSINESS MODELS FOR MODERN PROCUREMENT, Keith, Vitasek Manrodt & Kling, Palgrave 2015

Procurement Involvement

From Transactional Buyers  To Value Architects

Business Stakeholder Involvement

From Operations Managers  To Transformation Leaders

Supplier Involvement

From Vendors  To Solution Providers
Relational Sourcing Business Models are different:

- They are about negotiating the intent and behaviors of the relationship.
- They create a repetitive relationship with a supplier aimed at creating value.
- They lay a strong foundation where parties can fluidly adjust to business needs and risks as they arise.
- By agreeing to the foundational nature of the relationship itself, the organizations can get to a fair and balanced deal.
Relational Models and the Sourcing Continuum

As you move along the sourcing continuum each Sourcing Business Model brings higher levels of co-dependency.

• A Preferred Provider Model – is still a relationship and needs structure.

• Performance-Based and Vested agreements require laying a strong WIIFWe foundation.
Contact Me with Questions!

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www.vestedway.com
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- By signing and submitting your evaluation, you are automatically entered into a prize drawing

How?
Option 1: App
1. Select **Schedule**
2. Select Schedule by **Day**
3. Select **Day**
4. Select **Session**
5. Scroll to **Description**
6. Click on the **Evaluation link**

Option 2: Browser
1. Go to [www.sig.org/eval](http://www.sig.org/eval)
2. Select Session (**#WS05**)

COMPLETE & SUBMIT EVAL
Workshop # 5

Seven Sourcing Business Models to Create Value and Manage Risk

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