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Sourcing with the 40/20/40 rule

There's more to supply strategy than negotiation

Leaders should not underestimate the resources and time it takes to put strategic supplier relationships in place. People think of a “negotiation” as a discrete event that takes days or weeks, but the end-to-end process of defining and capturing the value in new supplier agreements can take months.

Getting full value out of negotiations depends on three components: effective strategy with pre-work, effective execution of the negotiation, and effective implementation of the agreement to lock in value. We summarize these three components below.

Key message:

For sourcing initiatives, consider the 40/20/40 rule for allocating resources: 40% effort on strategy, 20% on negotiations, and 40% on implementation planning.

Pre-negotiation:

- Sourcing teams must have skills such as gathering information, market research, analysis (e.g., modeling total cost of ownership), strategic thinking, and communications. The buying organization can fill the gaps by investing in training, recruiting, or contracting.
- The team develops and validates (1) the overarching supply strategy and value drivers, (2) objectives for each negotiation, (3) an approach to design implementation and manage change.

- The team prepares for face-to-face negotiations by (1) developing analysis to set targets, (2) producing a plan and a script for each negotiation, (3) holding dry runs, and (4) managing change: executives and end-users must align on goals and how to qualify and select suppliers.

Negotiations:

- Negotiations entail formal and informal coordination to schedule meetings, set expectations with all parties, and to generate proposals and evaluate counteroffers. Any interaction with a supplier by any representative of a buyer’s company contributes to the negotiation, so the degree of coordination is high.
- Negotiation teams must deliver documentation—a Memorandum of Understanding (MOU)—of the negotiated agreements for review and approval by executive sponsors, and for contract writing by legal counsel.
- Along the way, the negotiation teams will draft a framework for implementation, including process, technology, or infrastructure requirements, plans for change management and supplier management, and for governance (accountabilities, reporting, escalation paths). The goal is to get up to speed quickly, generate value sustainably, and drive continuous improvement.

Post-negotiation (implementation):

- After a negotiation is completed, executive sponsors approve the terms outlined in the MOU (mentioned above), and the legal team steps in to convert the MOU into a contract.
- At the same time, the executive sponsors will have approved any investments required for implementation. The sourcing team focuses on change management to start up the new supplier relationship and implementing governance (KPIs and targets, reporting, accountabilities, escalation paths, and decision making processes) to manage the value.

Strategy finds value, negotiation catches value, and implementation locks in value

Many people think of negotiations as a series of meetings with people making demands while pounding on a table. If the strategy is good, negotiations will unfold gracefully. A negotiation is a transaction to instantiate a strategy that should be attractive to the supplier, and the purpose of the negotiation is not necessarily to discover new value, but to agree on and document commitments needed to capture value already identified.

Similarly, implementation does not necessarily create new value. At a minimum, implementation should lock in the value already on the table. This means onboarding the supplier and establishing governance to manage performance, to monitor value, and to drive continuous improvement.

Actions:

- Put the horse ahead of the cart: prepare a supply strategy before you negotiate.
- Put the cart behind the horse: prepare the implementation plan as you negotiate.
- Design for governance (decision making and accountability) in implementation.

Whatever effort is required to complete the negotiations, that strategy and implementation are usually a multiple of that effort. Notionally, we expect 80% of resources and time to focus on strategy and implementation relative to negotiation. This gives us the 40/20/40 rule: 40% strategy, 20% negotiation, 40% implementation.

Of course, all sourcing initiatives are unique, and your experiences will vary.

Author

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