

Avoiding^{the} three. deadly sins

To contribute greater value, CPOs need to develop and promote a more sophisticated approach to negotiation that considers all parties' interests

by Tom Kinnaird and Hal Movius

The procurement profession has changed dramatically in the past 20 years, but many of the issues and challenges facing CPOs have remained stubbornly and frustratingly consistent. They include: Why doesn't procurement have a seat on the board? Why does it have a reputation for only caring about price? Why is it often excluded from strategic business debates and decisions? And why does it find it so hard to make strategic supplier management work properly?

These are complex questions with no simple answer. However, we believe that there is a common theme to each – “value”. Specifically, the ability of CPOs (and the procurement profession at all levels) to recognise, create and release value for their organisations, and to be recognised by their peers and the wider business for their ability and skill in doing so.

A recent major survey of business and procurement leaders by the International Procurement Leadership Forum¹ concluded that significant value could be

released from strategic supplier management (an incremental 23 per cent, close to €500 million for each respondent), but not through traditional means. Instead, this required a training investment in “softer” skills such as strategic negotiation and relationship development.

And there's the rub. A generation of procurement practitioners and leaders has grown up with, and been consistently taught, the notion that world-class procurement is built on the foundation of a rigorous strategic sourcing process, which focuses primarily on the creation of leverage and the exercise of power.

But what if the strategic sourcing process is fundamentally flawed in encouraging too much of a focus on price? What if, in the pursuit of apples-for-apples supplier comparisons and the “perfect” sourcing decision, procurement is actually restricting its ability to identify, create and release value from the supply base?² What if existing negotiation training methodologies and toolkits are simply not up to the job? And what if, through its own actions and

words, procurement simply reinforces the functional stereotypes that are at the root of the challenges and issues facing all CPOs today, preventing them from moving away from the role of master price tactician to that of trusted commercial partner?

The principles of value-creating negotiation

What is meant by “value” in the context of negotiation? We would argue that value is created when two or more parties develop options that allow each to get more of what they care about most, at the expense of things they care about least. A common example: rather than splitting an orange in half, two negotiating parties might ask one another *why* they want it. If one wants the juice and the other the rind to bake a cake, then value has been destroyed by cutting it in half. A more elegant trade would have given each what they needed.

Similarly, in the business world, parties often miss opportunities at the negotiating table to do better without risking being any worse off; in many cases, options for

joint gain go missing. For example, parties going issue by issue through a contractual agreement, arguing hard and compromising on each issue, may fail to discover that issues are valued differently. Recognising these differences permits elegant trades: the buyer agrees a higher price in exchange for speedier delivery, which more than offsets the price increase; or shipping costs shift to the seller, in exchange for a shorter payment cycle granted by the buyer.

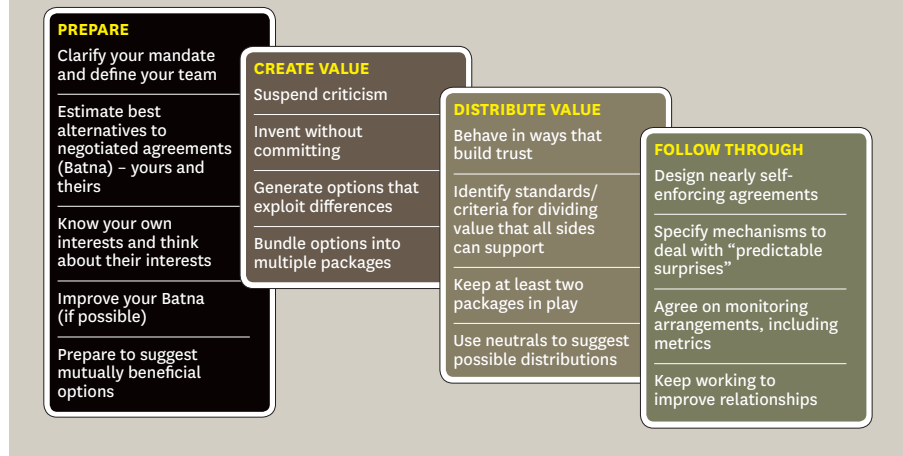
Over the past 30 years, researchers have shown that negotiators – even experts – fall prey to certain mistakes, including:

- assuming that one’s counterpart’s needs are diametrically opposite to one’s own;
- failing to see the other side’s perspective;
- becoming fixated on specific targets or aspirational numbers, even ones generated with little rationale;
- skipping over careful exploration of each side’s needs and the kinds of options that might make both better off.

Researchers at the Harvard University-Massachusetts Institute of Technology (MIT) Program on Negotiation (PON), among others, have developed an interest-based theory of negotiation that has been presented in books such as Roger Fisher and William Ury’s *Getting To Yes*, Howard Raiffa’s *Negotiation Analysis*, and Lawrence Susskind and Jeffrey Cruikshank’s *Breaking the Impasse*. These different works all emphasise the importance of 1) distinguishing interests from positions; 2) exploring interests and issues; 3) developing options for mutual gain; 4) using criteria for allocating value that both sides can live with; and 5) rigorous preparation that involves thinking through all sides’ alternatives to agreement and all sides’ interests.

The Consensus Building Institute, working with the PON, has developed a model that incorporates the key findings and prescriptions from several decades of research. The Mutual Gains Approach to

FIGURE 1: THE MUTUAL GAINS APPROACH TO NEGOTIATION



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Negotiation (MGA) focuses on creating more value for parties, doing so efficiently and in ways that enhance reputations and relationships (see figure 1).

The model has four steps: preparation, value creation, value distribution and follow through. At each step, there are prescribed tasks for increasing the chances that the parties will reach wise, efficient and stable agreements. Central to this model is the notion that parties should clarify their mandate and rank their interests (the kinds of things they care about) prior to negotiations. Moreover, parties should pay equal attention and care to thinking about the other side’s interests and alternatives.

Even when others show little interest in anything other than a traditional, adversarial approach, using the value-creation process can influence behaviour at the table by, for example, continuing to seek feedback to options as a way of bringing underlying interests and preferences to the surface. The MGA is emphatically *not* about being nice in the hope that others will reciprocate. Rather, it reflects enlightened self-interest and a focus on careful analysis and process management.

The three deadly sins of value destruction

1 | Sins of strategic sourcing

The proliferation of strategic sourcing processes in organisations, and their subsequent embedding into procurement best practice, owes much to their proven

success in consistently delivering price reduction. We believe there is nothing wrong with strategic sourcing processes *per se*, particularly within relatively straightforward, tactical spend categories. However, the unthinking application of these processes and tactical negotiation, particularly when combined with e-sourcing tools such as e-RFPs and e-auctions, threatens potential for value creation through negotiation. This is especially the case when dealing with suppliers that can genuinely be termed “strategic” – those capable of making a significant contribution to an organisation’s success, however broadly or narrowly that is defined.

E-sourcing delivers well-documented advantages to procurement over a traditional manual approach. However, its widespread adoption has also encouraged practices that, although apparently optimal when viewed through the lens of procurement process, have (largely) unintended consequences that greatly reduce the opportunity for value-creating negotiation. Common examples include:

i) “Tick box to acknowledge you agree to our standard terms and conditions (attached). If you do not tick this box you will be excluded from taking any further part in this RFP process.”

PROCUREMENT’S INTENTION: to reduce the likelihood of suppliers disagreeing with elements of the standard contract, at the point in the process where market leverage is at its highest. ↘

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UNINTENDED CONSEQUENCES: removes a number of potential negotiation variables from the mix. Examples include termination provisions, intellectual property rights, competition clauses and payment terms, all of which may have valid trading value for both parties.

ii) *“All communications must go through procurement. Any attempt to talk to the internal client will result in automatic exclusion from the RFP process.”*

PROCUREMENT’S INTENTION: primary purpose – to control the communications flow to the extent that all suppliers receive identical information. Secondary purpose – to prevent “cosy” relationships between suppliers and stakeholders interfering with the process.

UNINTENDED CONSEQUENCES: prevents or restricts suppliers from having an open dialogue with internal budget holders. This can undermine the supplier’s ability to fully understand the business requirements, or indeed challenge them (“Are you sure that’s what you really want? Have you thought about it this way instead?”). It also reinforces the perception of procurement as little more than a policing function.

iii) *“Please restrict your answers to the business requirements included in the RFP and complete the pricing matrix attached.”*

PROCUREMENT’S INTENTION: ensure that all suppliers respond as closely as possible to a standard format, thus enabling an apples-for-apples comparison and therefore an “optimal” decision-making process.

UNINTENDED CONSEQUENCES: restricts the supplier’s ability to be creative in the way it answers the brief. Prevents – or at least restricts – its ability to respond with alternatives, options and packages.

iv) *“The price submitted during this e-auction will be contractually binding and this will be the only opportunity for the supplier to submit pricing during the process.”*

PROCUREMENT’S INTENTION: primary purpose – to use the highly leveraged environment of an auction to establish a baseline for the lowest possible market price. Secondary purpose – to remove the need for any subsequent negotiation, as by this time contractual terms and

conditions should also have been largely agreed to by both parties.

UNINTENDED CONSEQUENCES: isolates price as a variable, thus preventing proposals of either multiple packages or price-related trades within the negotiation, which may actually create more value for the client organisation. Potentially forces the supplier to quote unsustainably low pricing simply to remain in the process.

2 | Sins of traditional negotiation

Many CPOs and other procurement managers will already be aware at some level of the idea of creating value through negotiation and using an interest-based approach, but most we’ve encountered quickly default to a “traditional” mindset (see *Insight* box).

There are a number of practical problems in most organisations with adopting such an approach:

- The negotiator misses opportunities to create options that could leave all sides better off. He or she spends their entire effort on carving up a value pie that could be made much bigger.
- A typical lack of candour means that each party guesses about what the other really wants, and may hide information that could affect implementation and other commitments down the road, as well as other issues that were not initially contemplated but which could represent enormous new opportunities.
- Agreements become less stable because there are no clear criteria for how or why different options were selected. Each side then seeks to renegotiate terms at the first opportunity because its interests were not well met and compelling criteria for fairness were not identified, so each side could make a strong case for the agreement to its own stakeholders and leadership.
- When key negotiations happen, either ad hoc or through a value-constricting sourcing process, there are limited opportunities for the organisation to learn more about what matters to its suppliers, customers, partners and employees.
- Operational and financial relationships are often not enhanced, which means that future negotiations are more difficult and unknown operational risks are potentially

INSIGHT

PROCUREMENT'S USUAL APPROACH

- Open with a long list of requirements or demands (typically including an arbitrary price cut figure) without clarifying which are most important.
- Argue why those demands should be met, often using price benchmarking as a weapon.
- Make concessions grudgingly, using each as an opportunity to extract something in return.
- Whenever possible, discredit the other side’s data or arguments.
- Use power plays, tricks and tactics to get the other side to give you what you want.
- Adopt a “take it or leave it – we can always find another supplier” stance.

incurred because there is no trust built. This often means that problems (actual or potential) in the supply chain are not shared proactively.

- Brand is potentially compromised as counterparts cynically observe that espoused corporate values are apparently irrelevant during negotiation.
- Research has shown that it is extremely stressful for parties to behave in ways that run counter to their own values and standards. As Jared Curhan at MIT has shown, negotiators have a “subjective utility” for negotiations that is a more powerful predictor of future behaviour towards counterparts than the objective results. Simply put, people who feel uncomfortable with their own actions in a negotiation do not want to negotiate again.

This represents a potentially enormous competitive disadvantage, as Hal Movius and Lawrence Susskind demonstrate in a forthcoming book³.

3 | Sins of underestimating the value in relationships

Procurement has traditionally viewed close relationships between internal stakeholders and suppliers with distrust, and there is often a suspicion that side conversations are taking place between

SPREADING THE MESSAGE

WPP and the Consensus Building Institute (CBI) have been working together for three years, exploring how value-creating negotiation can assist in building sustainable client-supplier relationships. During this time, CBI has delivered tailored negotiation training to over 600 senior executives from WPP marketing and communications agencies around the world.

In turn, the WPP commercial and procurement services team plays a leading role in internal workshop design and facilitation, and offers “beginner to improver” level negotiation training and train-the-trainer programmes to WPP agencies in all geographic regions.

This team has delivered 50 commercial workshops each year for the past three years. Thousands of WPP staff have attended at least one of these workshop programmes.

The procurement leadership team in WPP is regularly called upon by agencies within the group as negotiation advisers and process coaches.

executives, on the golf course or over lunch, which somehow threatens procurement’s attempts to manage suppliers transparently and fairly. These concerns can be particularly acute during a pitch process. However, all business leaders intuitively know and understand that there is enormous value in relationships and open dialogue with key advisers and suppliers. In the world of business and commerce, it’s often trusted relationships that enable major deals to get done or significant problems to be resolved.

We therefore have an obvious disjunction. On the one hand, business leaders who want to be able to sit down and talk freely with their counterparts, shaping deals and exploring potential options. On the other hand, we have procurement attempting to constrain dialogue within a process that it insists on controlling, seemingly fearful of the very relationships that business leaders want to cultivate. It is therefore not surprising that CPOs often

find themselves and their staff excluded from the really key supplier relationships and the vital strategic discussions and decisions. Equally, it’s not surprising that procurement’s efforts to release value from strategic supplier management activities often fall short, largely as a result of its inability to switch seamlessly from a traditional strategic sourcing approach to a less familiar situation where it has to be able to think and act effectively outside the normal process boundaries.

Imagine a better way

Imagine a better (or at least different) way, where CPOs and senior procurement managers view themselves (and are positioned and recognised within the organisation) as value-creating commercial specialists first and foremost, and procurement functional specialists second. Where procurement teams are expected to use strategic sourcing processes where it is appropriate to do so, but are also encouraged to experiment with different approaches and to embrace and explore the value of relationships. Where price, while still important, is only one of several metrics of value with which to assess the overall impact of a supplier relationship. Imagine what the potential of procurement might be then.

We advocate the following major areas of opportunity for CPOs.

1 | Change the training

Negotiation training is often viewed as largely generic in terms of content, which is then applied generically to all procurement staff, irrespective of role or seniority. In addition, much existing negotiation training for procurement is more about harnessing and applying power and winning than recognising that value can be created for both parties. So, careful selection of a negotiation training provider and process of negotiation is key, followed by segmentation of the right kind of training to support a variety of procurement roles.

However, training procurement itself is only the beginning of what could be a large untapped opportunity for CPOs to play a different and much broader commercial role. As procurement raises its own negotiation game and is seen to do so through

actions as well as results, our experience is that many other functions within a typical organisation will start to ask the CPO for help in a variety of ways:

- Requests for procurement to design and deliver negotiation training events to the rest of the organisation.
- Requests to deliver negotiation train-the-trainer, to enable individual business units to be self-sufficient with their own negotiation training programmes, while delivering a consistent, centrally developed negotiation message and philosophy.
- Requests to coach others as they prepare for, or even during, important negotiations (with the emphasis on negotiation process coaching rather than on content expertise, which is specific to the situation).
- Requests to organise joint training sessions with key suppliers or clients.

Each of these has the added benefit of opening up a new constituency of senior business contacts for procurement while clearly positioning the CPO in the role of a valued commercial partner – one who can help facilitate a better outcome for client and supplier organisations alike. This has certainly been the experience at WPP in recent times (see *Case study* box).

2 | Deal with organisational barriers

Many CPOs will have encouraged and invested in negotiation training for procurement teams in the past, only to be discouraged that months or years later little has changed in the way that negotiations are carried out, with individual behaviours appearing to be struck in a traditional mindset. Organisations that send individuals on training programmes, no matter how entertaining, will not position them to change the way they negotiate. We believe that moving in the direction of a more value-focused process requires a shift in thinking, away from negotiation as an *individual* competence to negotiation as an *organisational* competence.

We suggest three areas for attention:

- At the *strategic* level, there may be scope for the CPO to describe a broader commercial value proposition for procurement, propose a new strategy of alignment with other functions or leaders within the organisation, create a new value-based

way of measuring success, or better align staff rewards with the desired outcomes.

- At the *structural* level, it might mean re-engineering the negotiation preparation process, so that procurement negotiators routinely seek input and sign-off from a broad range of stakeholders and experts prior to the negotiation, spend much more time thinking about interests from both sides, and are granted increased authority to invent options at the table and fully explore alternative deal shapes.

- At the level of *individual learning*, it could mean teaching a clear negotiation model, process and language, providing opportunities to practise difficult negotiations, creating a learning organisation where negotiation experiences – good or bad – are shared, and promoting negotiation as a journey of learning.

3 | Give staff permission to experiment

This is a tough one for CPOs, who for years have been espousing consistency and purity of application of process to drive cost reduction. However, as outlined earlier, the unintended consequences of procurement's process-led approach risk destroying more value than it creates. Our recommendations are:

- Give procurement teams permission to step outside the strategic sourcing process where the situation warrants it.
- Encourage pilots of new approaches – for example, instead of issuing an RFP, bring in some valued strategic suppliers and encourage a dialogue about joint aspirations, interests and ideas for the relationship.
- Encourage suppliers to challenge the process – suppliers can only innovate if given the space and opportunity to do so.
- Reward and celebrate procurement teams and suppliers that take a few risks and deliver incremental value as a result.
- For strategic services or products, keep the primary focus on optimisation of the output value to the buying organisation, as opposed to the primary focus being the input costs. Yes, input costs will always be important to procurement and rightly so, but may be trivial when considered against the broader commercial picture. Getting strategic supplier relationships right can deliver so much more.

CHECKLIST

THE VALUE-CREATING APPROACH

- 1 Spend time up front compiling a **list of interests** (the kinds of things that business stakeholders care about) and think clearly about the other party's interests.
- 2 Engage **internal stakeholders** in assessing and agreeing the rank order of your interests, and attempt the same thing for the other party's interests.
- 3 Spend lots of time at the negotiation table **clarifying your interests** and understanding the other side's interests, capabilities and constraints.
- 4 Agree to **delay conversations** about benchmarks and "fairness" until interests and options have been elicited and understood.
- 5 Declare a period of "inventing without committing", to **brainstorm options** or packages that meet their interests well and your interests very well.
- 6 Construct **"nearly self-enforcing agreements"** – agreements in which each party has an interest in living up to its commitments.
- 7 Use **contingent commitments** to spell out what will happen in the event of future events or performance ("if X... then Y...").

4 | Define success differently

While recognising that traditional savings reporting will always have a role for procurement, we advocate that CPOs take the lead in designing and advocating a different approach to measuring the success of strategic negotiation and supplier relationships. We make the following observations:

- The debate should start and end with key business stakeholders – this is a business issue, not one solely for procurement.
- Whatever measures of value are chosen, these should be consistent with existing business objectives for client and supplier.
- Measures should reflect a commitment to long-term value, in the form of innovation, quality improvement, customer satisfaction, revenue growth, cost management, risk management and other key goals.



Procurement processes today tend to be linear and tightly controlled. There is a risk that strategic sourcing has become over-specified and therefore, paradoxically, extremely wasteful. When there is no process for creating value, based on exploiting the differences in the kinds of things each side cares about, then procurement predictably becomes an exercise in making demands, demonstrating marginal short-term savings and

ignoring the operational, financial and relational problems that occur downstream when value is compromised.

In this article, we have deliberately tried to be challenging – perhaps even controversial – with the specific intention of challenging CPOs to take themselves and their procurement teams out of a process comfort zone and towards making a more strategic business contribution, both personally and functionally.

The key to making this transition is a willingness to leave behind some of the process baggage that procurement has accumulated over the years and place more trust in the power of relationships and in a set of softer skills and techniques that are more in tune with value creation and less focused on process and price. **CA**

FURTHER READING

¹IPLF, *Business Relationship Management: The Four Faces of Building Value With Strategic Suppliers*, 2008 (available to download at www.futurepurchasing.com)

²See Jules Goffre, "Comparing apples with oranges", *CPO Agenda*, Winter 2006-07, pp32-36; and Jon Hughes and Lars Mikkelsen, "Negotiating with strategic partners", *CPO Agenda*, Autumn 2007, pp30-35

³Hal Movius and Lawrence Susskind, *Built to Win: Creating a World Class Negotiating Organization* (Harvard Business Press, forthcoming)