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# Best Practices for Negotiating with Key Suppliers

Excerpted from the Vantage Partners study
Negotiating and Managing Key Supplier Relationships:
A Cross-Industry Study of 20 Best Practices

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# Introduction

Based on 15 years of working with clients in the sourcing and procurement arena, Vantage Partners identified twenty best practices for managing critical supplier relationships. These practices represent a reasonably comprehensive (though certainly not exhaustive) approach to maximizing value in important supplier relationships. While not a recipe for guaranteed success, these practices comprise a roadmap for systematically negotiating and managing key supplier relationships more effectively.

Today's sourcing and procurement professionals face a multitude of negotiation challenges: from internal negotiations with business units around sourcing strategies; to negotiating agreements with single and sole source suppliers; to ongoing negotiations over individual statements of work, change orders, issues of scope, and the like. This excerpt describes the four best practices related to negotiation and offers some practical ideals about how to implement them.

## About the study

The study was based on data collected from sourcing and supply chain executives at more than 100 companies about relationship management practices with their key suppliers, across six fundamental areas:

- Evaluation and Selection
- Negotiation
- Post-Deal Relationship Management
- Termination
- Performance Monitoring
- Portfolio Governance and Management

One hundred fifteen survey respondents were asked to answer scaled questions on specific practices, as well as open-ended questions about their company's overall approach to supplier relationship management. The bulk of the study details specific findings about each practice, including a description of the practice, benefits of instituting the practice, barriers to implementation, and ways in which the practice has been implemented.

To request a copy of the complete study, Negotiating and Managing Key Supplier Relationships: A Cross-Industry Study of 20 Best Practices, please contact us at info@vantagepartners.com or on the web at www.vantagepartners.com/publications.

# Negotiation

Leading companies approach supplier negotiations as an opportunity to create value, rather than to simply battle over price concessions. These companies consider cost as only one of many important factors in supply relationships, and recognize that price is rarely an indicator of true total cost. Negotiations are viewed as a forum both for crafting the substantive arrangements that will govern interactions between customer and supplier and for developing more productive working relationships. Through a more sophisticated approach, these companies find that negotiations can build a foundation for longer-term competitive success.

Many companies, however, continue to take an adversarial approach to supplier negotiations — one in which each side feels compelled to stake out relatively extreme positions, to make concessions grudgingly, and to engage in brinkmanship in an effort to ensure that they do not miss an opportunity to wring one last dollar out of the other side. Such an approach to negotiation rewards deception and encourages stubbornness. It is based on a zero-sum view of negotiation in which gain for one side is assumed to come only at the expense of the other. Such a mindset creates barriers to identifying creative solutions that dovetail different interests and expand the total value for both parties. Not surprisingly, companies that view negotiation in this fashion capitalize on temporary advantages in negotiating leverage to extract and lock in onerous concessions whenever possible.

As companies become increasingly dependent on suppliers to provide not only critical products and services, but also to participate in activities such as new product development and post-sales service, they find that an adversarial approach to negotiation often quickly becomes counterproductive. A newly-rationalized supply base raises a company's reliance on a small number of sources for key business inputs, and companies quickly find that concessions that hamstring their suppliers' ability to perform effectively negatively impact their company as well.

To ensure success in a rapidly-changing business environment, many companies find that a collaborative approach to negotiations with their key suppliers is most effective. Such an approach allows companies and their suppliers to explore their respective interests, and work together to craft innovative deals that increase sustainable value for both sides.

## Best practices for negotiation

Supplier negotiations are managed as a collaborative process

Focus is on maximizing value for both sides, while coercive tactics aimed at "squeezing the last dollar" out of suppliers are avoided.

Negotiation is used as an opportunity to build a strong foundation for a good working relationship

Focus is as much on setting the stage for working together effectively once a deal is signed as it is on arriving at specific contract terms.

Negotiators are assessed and compensated based on overall quality of the deal

Assessments and incentives are based on multiple dimensions beyond price, including, for example, total value created, positive or negative impact on the relationship, value created for the supplier, and the like.

Formal transition activities are conducted when new supplier relationships are established

Such events involve anticipating and jointly planning for challenges, agreeing on decision-making and escalation procedures for when disagreement or conflict arises, and jointly defining shared performance and relationship health metrics. Transition and joint launch events may also occur when major new contracts are signed.

## Supplier negotiations are managed as a collaborative process

Focus is on maximizing value for both sides, while coercive tactics aimed at "squeezing the last dollar" out of suppliers are avoided.

Managing supplier negotiations in a manner that seeks to maximize value for both sides requires that negotiators actively avoid creating adversarial dynamics, and work collaboratively to develop creative solutions that meet the needs of both parties. Rather than assuming that there is a fixed amount of value at stake in a negotiation and employing coercive tactics to "squeeze the last dollar" out of suppliers, negotiators craft deals that expand the pie and are sustainable and defensible for both parties. To do so, companies and their suppliers adopt a joint problem-solving mindset and work side-by-side to first identify each of their underlying goals or interests (e.g., low overall cost, appropriate allocation of risk, appropriate service levels, effective inventory management, maintained manufacturing schedules) and then brainstorm possible options that meet those interests. When considering the options on the table, negotiators rely on objective, relevant criteria (e.g., marketplace standards, agreed-to formulae, industry best practices) to determine which of these options is most appropriate. In the process, negotiators are open to compromise and the consideration of new, creative, joint-gain ideas, as opposed to being intractable or simply pressuring their counterparts to agree to preconceived (and often one-sided) solutions.

### Benefits

#### Creates greater value at the table

The traditional approach to negotiating — starting with an extreme position, and then subsequently making concessions to reach accord — results in split-the-difference solutions that often leave substantial value unrealized. The common process of haggling between positions makes it impossible to craft deals that take advantage of things a supplier can do at little cost which add huge value to their customer, and vice versa. Supplier negotiations that are conducted in a collaborative manner, however, enable parties (together) to discover together previously unimagined solutions that maximize the value of the deal. When companies work with their suppliers to explore all of the resources they jointly bring to the table and openly discuss each of their interests, each side is then better equipped to offer creative options that have the potential to meet both sides' interests.

For example, consider the case where a company and its supplier disagreed over a just-in-time delivery clause. The customer was adamant about its position that the supplier had to agree to flexible just-in-time delivery, while the supplier was equally wedded to its position of deliveries on the 1st and 15th of each month. In a haggle or concessions game, one side would have caved in, the deal would have blown up, or the two sides would have reached some split-the-difference compromise after an arduous battle.

However, by approaching the problem collaboratively, the customer shared with the supplier that its key interest in receiving just-in-time delivery was a reduction of its inventory costs. The supplier shared that its key opposition was not to just-in-time delivery at all, but rather to the up-front financial investment required to integrate with the customer's order and inventory management system — without which, just-in-time delivery would not be possible. By understanding each other's interests, the customer was able to calculate that the inventory costs it would save over the life of the deal by receiving just-in-time delivery far outweighed the minimal costs of using internal IT resource to help with the systems integration at the supplier facilities. By getting underneath stated positions to underlying interests, and exploring possible solutions together, the two sides were able to reach agreement.

#### Results in a more efficient negotiation process

By negotiating collaboratively and working to develop joint-gain solutions, companies are able to avoid haggling, posturing, and other time-wasting games that impede the process of reaching an agreement. Supplier negotiations are therefore conducted more quickly. Furthermore, the number of times negotiators are called back to the table to renegotiate with frustrated or dissatisfied suppliers decreases since this approach to negotiations ensures companies and suppliers reach deals which both parties see as meeting their key needs and which are, ultimately, seen as fair and appropriate. As a result, the transaction costs associated with renegotiating or amending deals are greatly reduced.

#### Enables more predictable negotiation outcomes over time

When negotiators use a coercive approach at the table, they maximize their advantage during times when they have the upper hand. While a company may see significant short-term benefit from such a deal, there is also potential long-term downside in employing a coercive approach. As market factors change, a supplier may gain the upper hand. When that happens, a supplier will look to renegotiate the deal and get even with the company that took advantage of it during past negotiations.

For example, during a time when supply is high and demand is low, a company which aggressively and coercively plays two rival suppliers off one another to extract extremely onerous concessions from the winning supplier can realize tremendous short-term advantage. However, a year or two later, when the supplier who lost out on the contract goes out of business and the supplier who won the contract now has no competition and is the only supplier that makes the components that the customer requires for its products, the power dynamics have changed. When the existing contract expires, the supplier is likely to employ the same coercive approach to extract concessions from their customer that their customer used with them.

When negotiation outcomes depend largely on whether companies or their suppliers have more negotiation leverage, the results are uncertainty about negotiated outcomes and an inability to plan accurately. Companies that train their negotiators to employ a collaborative approach are able to reduce the dramatic fluctuations in deal structures and terms from year to year, which in turn leads to more accuracy and predictability in forecasting future spend.

## Barriers

### Adversarial, fixed pie assumptions about negotiation

Assumptions that there is a fixed pie to be distributed or that negotiation is a zero-sum game, (where a satisfactory outcome for one side necessarily means an unsatisfactory outcome for the other side) are extremely debilitating and result in lost value. When negotiators or organizations adopt this mentality, they forego opportunities to work collaboratively with suppliers to devise creative, joint-gain solutions that expand the pie and increase value for both parties.

### Negotiators receive positional instructions

Negotiators often receive instructions from their direct supervisors that are essentially positional demands. Instructions that involve asking for a final price, certain concessions, or rigid deal terms do not allow negotiators any flexibility at the table to develop innovative solutions. For example, if a company is really concerned about total cost of ownership, it makes little sense to constrain negotiators to bargaining in pursuit of a certain price per unit. Instead, negotiators should be given more flexibility to look for ways to reduce costs with their counterparts at the table (e.g., through inventory reduction, more efficient order processing, or changes to the manufacturing process). Successfully implementing this practice involves incorporating all those who are involved in a deal — managers of negotiators, internal constituents who will be required to carry out deal terms, and the negotiators themselves — into a preparation process that pushes them to gain alignment around the underlying interests driving positional requests.

### Misaligned incentives

Negotiators tend to be motivated by the metrics by which they are evaluated and the norm for what is "applauded" in their organization. Negotiators who are rewarded, through praise, bonuses, raises, or promotion practices, to close deals at the lowest unit cost to their company will tend to focus their negotiation efforts primarily on unit cost. Only when companies develop more robust incentive systems that reward negotiators on other factors (e.g., technology alignment, service level agreements, defect rates, constituent satisfaction, delivery schedules, inventory management) will their negotiators be more likely to follow this practice and work collaboratively with suppliers to find optimal solutions that meet their company's broader spectrum of interests.

### Distrust of suppliers

Collaboratively crafting deals at the table requires companies to disclose information on their interests and capabilities. Some companies fear that if they are open about their interests, suppliers will unfairly use that information to their advantage to extract concessions. In effect, a supplier could hold its customer's key interests hostage, insisting on not meeting them until the customer concedes on other points. To manage this concern, it makes sense to take a conservative approach to sharing information — for example, by disclosing information incrementally and evaluating how negotiation counterparts respond. In addition, by sharing interests without fully disclosing their respective weight of importance, companies are able to gain the benefits of enabling their suppliers to become problem solvers on their behalf, while minimizing the risks they incur of lost leverage at the negotiating table.

## Enablement

Of the twenty best practices identified in the overall study, respondents placed this practice among the top five that could be implemented at the lowest cost for the highest value.

Implementation requires that companies put in place a structured, end-to-end negotiation process designed around collaboration and maximization of joint gain. A robust process provides negotiators with a roadmap for understanding and clarifying their company's underlying needs, gaining alignment on priorities for the negotiation, brainstorming a wide range of possible options that meet each party's critical needs, researching relevant and objective criteria to help the parties agree on appropriate solutions, researching and analyzing

**Commonly-Cited Benefits**

"We don't find ourselves renegotiating three-year deals after just six months."

"If you hammer away at the supplier on price year after year after year, you end up paying for it somewhere else — usually in quality or service — because they have to find ways to make a margin and survive."

"By sharing information and being open to new ideas, we've produced numerous agreements that have increased innovation and achieved greater total cost savings."

walk-away alternatives, planning how to manage communication and commitments, and considering the importance of the working relationship.

Enabling such a process entails training negotiators on how to follow the process effectively and providing them with tools and guidelines (e.g., analytical preparation tools, strategy handbooks, guides to dealing with difficult tactics, reference guides of persuasive standards, and the like). In addition, negotiators need to be trained on how to react strategically to their supplier counterparts' actions so that both parties work together effectively and do not default back to the traditional haggling, concessions-based negotiation style.

Furthermore, to ensure that this approach is employed consistently across the organization, it is critical for senior management to send clear messages about the importance of looking for joint gains and of modeling collaborative behavior when negotiating. Another extremely effective practice is to reinforce those messages with performance reviews and incentive structures that reward negotiators based on overall quality of the deal, using multiple dimensions that go beyond price reductions (including total value created, impact on the working relationship, and efficiency in closing the deal).1

**Practice in Action**

A large steel company has developed a detailed preparation checklist which every buyer must complete prior to engaging in a negotiation with a supplier. Among other things, the checklist requires the buyer to do some basic information gathering on the supplier, to assess what both the company and the supplier might want and need out of the negotiation (their underlying interests), to detail some possible ways to satisfy both parties, and to think about compelling arguments or pieces of data that explain and justify the company's needs and wants.

Once the checklist has been filled out, the buyer and his or her manager review the checklist together. During that meeting, they identify any changes or additions that should be made to the checklist and devise an appropriate strategy for engaging with the supplier. Finally, before the buyer can engage the supplier at the table, the manager must sign off on both the completed checklist and the strategy to be employed, in effect approving the preparation and allowing the conduct phase of the negotiation to begin. Following this practice ensures that the buyers understand the company's true interests and effectively prepares them to engage in collaborative, joint gain negotiations with suppliers.

### Bottom Line

- By focusing on the creation of deals that make sense for both sides, companies create more valuable deals and ensure, throughout their ongoing relationship with suppliers, more value is created and realized.
- Deals that are created using a hard-bargaining approach typically incur indirect costs for companies that often outweigh whatever direct savings negotiators achieved at the table.
- Adopting a collaborative approach to negotiations requires organizations to develop new skills in individual negotiators and to implement a standard negotiation process.

## Negotiation is used as an opportunity to build a strong foundation for a good working relationship

Focus is as much on setting the stage for working together effectively once a deal is signed as it is on arriving at specific contract terms.

Of the twenty best practices identified in this study, this practice had the third highest percentage of respondents rate it as "critical" or "very valuable." Companies that follow this practice consciously try to build strong working relationships with suppliers during negotiations by attempting to understand their counterparts' goals, needs, and constraints, and by developing a set of creative options that meet the needs of both sides. These companies approach negotiations from the point of view that a strategic supplier relationship needs to create sustainable value for both sides if it is to last. Negotiators ensure that the way they conduct negotiations sets good precedents for problem solving later by using defensible, objective criteria to evaluate options, rather than willpower and coercion; instead of simply demanding a price, negotiators explain how they arrived at a price figure using market standards and precedents, for example.

1 For a more complete discussion on assessing and compensating negotiators to encourage them to follow the standard negotiation process and to negotiate collaboratively, please refer to best practice #7 (Negotiators are assessed and compensated based on overall quality of the deal) below and on page 14.

In order to build trust with their counterparts, negotiators differentiate between attacking issues and attacking individuals who have a different or opposite views. For example, when one negotiator proposes delivery terms that seem ridiculous to his counterpart, instead of asking "Why are you low-balling me?" his counterpart asks what standard the other negotiator used to come up with those terms and why he thinks they are fair. Such a response focuses on deal terms, rather than implicitly impugning the character or motivations of the other negotiator. The difference may seem subtle or insignificant, but this shift in mindset helps to create more collaborative dynamics, begins to alleviate doubts about motives, and minimizes the personal disagreements that can derail or stall a negotiation.

## Benefits

### Creates an atmosphere where sensitive issues can be raised

Companies sometimes avoid particularly sensitive issues during negotiations and leave them to be resolved at an undefined later time. For example, during negotiations between a railroad company and one of its suppliers, negotiators considered an arrangement specifying that suppliers must deliver standard items within 24 hours when the railroad company has a shortage of them, and the railroad must assume ownership of unused consignment inventory at the end of the year. The railroad's supplier was concerned that this arrangement would motivate the railroad to underestimate requirements to reduce inventory costs, but the supplier worried that raising this fear would suggest a lack of trust. By addressing these issues in a way that focused on the needs of both organizations (the railroad's need for inventory availability and the supplier's need to minimize on-hand inventory), rather than questioning the negotiators' motives ("You're just trying to stick us with your inventory costs"), the two organizations were able to resolve their issues directly and thus to avoid future problems related to issues that were never fully resolved at the table.

### Sets a precedent for collaborative interactions

Companies that follow this practice realize that negotiations serve as a model for future interactions with suppliers and that mistrust and ill will created during negotiations can be difficult and costly to overcome later. In complex relationships, there will be a number of "informal negotiations" — issues to resolve day-to-day throughout the duration of the relationship. If early, formal negotiations create an atmosphere of mistrust and suspicion, then these informal negotiations will be colored by mistrust as well. Often individuals focus on any data that confirms their suspicions about the other side, rather than seeking data that would disprove those suspicions. If a supplier thinks that a company cares only about improving its own bottom line, the supplier will view its customer's cost cutting initiative not as an opportunity for both organizations to save money, but as another way for its customer to squeeze dollars from them. Early negotiations, therefore, are an opportunity not only to create a value-maximizing deal, but also to take specific actions to start a working relationship off on the right foot.

## Barriers

### Perception of a trade-off between substance and relationship

It can be difficult to negotiate an optimal deal while simultaneously building a good working relationship; some companies feel that trade-offs must be made between important substantive issues (such as price and delivery terms) and a good relationship (amicable interactions). This view is simply wrong; when a company and its supplier trust one another and work to create options that benefit both organizations, the likelihood they will craft a strong deal is enhanced. On the other hand, companies are likely to leave value on the table when they attempt to coerce or deceive their suppliers.

> **Commonly-Cited Benefits**
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> "The time we spend up front to build the relationship with our supplier is well worth the investment. It pays immediate dividends by fostering a more creative atmosphere while at the negotiating table, but perhaps more importantly, we find that resolving issues over the course of the relationship becomes a much more manageable process. That value continues long after we've shaken hands on the deal."
>
> "We are able to deal with the tough issues head-on and on the merits, without fear that speaking candidly or having principled, respectful disagreement will blow up the relationship."

### Assumption that damage done to a working relationship during negotiations is easily reparable

Many companies act as if they do not need to worry about their working relationships with suppliers until after negotiations. They combine one erroneous assumption (that getting a good deal means being adversarial, uncooperative, and uncompromising at the negotiating table) with another erroneous assumption (that a poor working relationship can always be repaired after a deal is signed). For example, when negotiating outsourcing arrangements, many companies send a team of negotiators to squeeze providers and drive price as low as possible. After the deal is signed, those companies create a "relationship team" to repair bitterness arising out of negotiations.

This common strategy almost always yields disappointing results. Bitterness and mistrust created by a company's negotiation team is generally projected (with good reason) onto the entire company. Simply changing the players, even when they are talented relationship managers, rarely solves what is a much deeper issue. Companies that employ this approach also discover that because they have driven price so low through negotiations, quality is reduced, innovation that they had expected is not recognized, and they waste a great deal of time and resource trying to enforce unrealistic contract terms. In the end, they often find they need to reopen negotiations.

## Enablement

Respondents reported that, of the twenty best practices cited in the study, implementing this practice would generate the second highest value for the lowest cost.

Many companies rely on training as the primary means of implementation. In order to ensure effective implementation, training programs focus on building skills not only related to managing analytical deal components of a negotiation, but also to approaching interactions collaboratively, as described above. Some companies also provide their key suppliers with training to approach negotiation in this way; the results they see discredit the notion that in order to gain value in a negotiation, companies need to beat or outsmart their suppliers. In addition, many companies employ mentoring or apprenticeship programs that reserve a portion of every session to focus on how to foster strong working relationships during negotiations without making concessions in an attempt to "buy" a good relationship.

Those companies that go beyond training and mentoring do so most frequently by more tightly coordinating between negotiators and those who manage ongoing relationships with suppliers, in many cases making sure there is at least some overlap in membership of teams responsible for negotiation and teams responsible for supplier management. Rather than changing the players and trying to create a distinction between the negotiation process and the relationship — a distinction often lost on suppliers who feel mistreated — companies acknowledge and systematically manage the unavoidable connections. Some companies also employ 360-degree feedback on negotiators from suppliers, assessing the degree of trust that was built between counterparts and asking what actions negotiators took to support a strong working relationship.

### Practice in Action

A large manufacturing firm has developed a simple yet effective process for succeeding at this practice. At the beginning of every negotiation, they let their supplier know that one of their organizational goals is to build strong working relationships with suppliers, explicitly separating relationship factors (trust, ease of interactions, etc.) from deal terms (price, quality, etc.). Along with their supplier, the company develops 'relationship ground rules' for negotiations, specifying which behaviors are appropriate or inappropriate.

Throughout the course of the negotiation, if either party feels the other has deviated from those ground rules, that party calls a 'Relationship Time Out' to initiate a specific, in- the-moment conversation about that deviation. By addressing these relationship issues as they arise, the parties can resolve relationship conflicts immediately and get back to the substantive work at hand, rather than letting the working dynamic fester and worsen over time.

## Bottom Line

- Companies need to negotiate on two tracks — crafting a deal with terms that create maximum value and developing a strong working relationship that will enable them to work jointly with a supplier.
- The belief that one must choose between getting a good deal and building a strong relationship is simply not true.
- Since negotiations serve as a model for future interactions, negotiators cannot abdicate responsibility for building a strong relationship. The underlying assumption that relationships can be easily repaired post-deal is a dangerous and damaging one.

# Negotiators are assessed and compensated based on overall quality of the deal

Assessments and incentives are based on multiple dimensions beyond price, including, for example, total value created, positive or negative impact on the relationship, value created for the supplier, and the like.

Companies often find that the way they measure the success of their supplier negotiations directly impacts how negotiators approach and conduct those negotiations. Although many companies say that maximizing value in negotiations and forging strong relationships with critical suppliers is important, in many cases, this goal remains an aspiration that is disconnected from the day-to-day practices employed by negotiators. When

companies fail to align criteria used to measure and reward negotiators' performance with espoused goals, a disconnect results between these goals and reality. When performance and compensation measures center on achieving the lowest price, for example, negotiators focus primarily (and understandably) on cost and price issues during negotiations. By incorporating a variety of important objectives related to supplier contracts — a focus on total value created, satisfaction of relevant business units' critical interests, creation of strong working relationships — into negotiators' performance reviews and compensation structures, senior management credibly communicates the importance of meeting those objectives. When a change in a company's definition of success is mirrored by a change in how success is measured, a strong message is sent to negotiators that successful supplier contracts incorporate a broader spectrum of elements than just volume discounts or price breaks.

## Benefits

### Ensures deals are crafted to meet critical business needs

While many companies select suppliers that are able to meet a variety of requirements (assessing them on factors that go beyond price and often include quality, responsiveness, and flexibility),[2] it generally falls to negotiators to ensure that deals are structured such that suppliers are motivated to actually meet those requirements. When companies do not measure and compensate negotiators on their ability to craft a deal that maximizes total value along all dimensions a company deems important, negotiators tend to under-exploit potential sources of gain and focus primarily on the dimensions along which they are measured.

For example, consider a negotiator who is measured and compensated primarily on volume discounts and is struggling to close a deal with a supplier where the two remaining open issues are a volume discount and warranty length. This negotiator is likely to be willing to trade-off warranty duration in order to secure a discount, even if an extended warranty is as important, or even more important, in terms of total savings and value to the company. By defining success more broadly and measuring and compensating negotiators based on a robust definition of success, companies are more likely to achieve negotiated outcomes that reflect the relative importance of multiple objectives. Companies that have done so report an increase in overall deal utility as a result of a more robust effort on the part of negotiators to meet a broader set of needs and objectives.

### Satisfies internal constituents, thereby improving sourcing strategy compliance

When companies adjust performance measures and incentive structures to match broader objectives, a primary benefit is that those objectives are more likely to be met, as described above. Another related benefit is that by meeting those objectives, negotiators are more likely to satisfy and create value for their internal constituents — thereby often increasing compliance with an organization's overall sourcing strategy. For example, if a contract features higher service level agreements and extended warranties that require suppliers to stand behind their products, business units that incur the costs of defects or problems will realize greater value. By the same token, a deal featuring highly flexible delivery schedules may be critical to accommodate the production timelines of a variety of different divisions, thus helping them to reduce their inventory costs.

Renegade purchasing often occurs when business units continue to work with suppliers that they believe meet a variety of important needs beyond price better than an alternate source approved by corporate procurement. Sometimes such perceptions are correct, and sometimes not. In either case, better aligning the incentives of negotiators with the full range of needs and objectives for the entire enterprise tends to produce better outcomes and increase internal customer compliance.

**Commonly-Cited Benefits**

"The time we spent to create an incentive system that mapped to the type of relationships we needed to develop with our suppliers was significant. Yet within months of changing the way we evaluated our buyers, we saw positive changes in our supplier relationships."

"While it would be nice to believe that purchasing agents will put what's best for the company ahead of what is best for themselves, that's a bit naïve. If you truly want people to change their behaviors, you have to put some teeth behind it."

"Employees are evaluated based on total value created for our company. While that is more difficult to measure than annual price reductions, we've found it to be a worthwhile endeavor."

## Barriers

### Concern that some factors will be inappropriately emphasized

Companies sometimes worry that by providing incentives for negotiators to craft deals that meet a range of goals, negotiators will inappropriately weight or prioritize "soft" objectives and avoid driving hard bargains to get the best price. Companies that successfully implement this practice define and communicate

2 For a more complete discussion on supplier selection, please refer to best practice #2 in the "Evaluation and Selection" section of Negotiating and Managing Key Supplier Relationships: A Cross-Industry Study of 20 Best Practices (Jonathan Hughes and Mark Gordon).

the relative priorities that different goals should be given in different contexts. They typically do this not only through a weighted incentive structure, but also by frequent and active management coaching and review of negotiation teams.

### Difficulty of determining and gaining alignment on appropriate measures of success

It is one thing to align around the notion that negotiated outcomes ought to be measured across a variety of dimensions, and quite another to build alignment among multiple divisions and functional groups (e.g., legal, finance, service, manufacturing, sourcing) about what the enterprise's measures of success for supplier negotiations should be, and what relative weight they should be given. Understanding the key interests of each internal constituency (as opposed to their stated positions), assessing the relative importance of those needs, and creating an appropriate weighting system to balance conflicting needs often entails significant analysis and internal negotiation.

Moreover, measuring the success and value of a deal often requires an understanding of the context in which that deal was negotiated. For example, if a negotiation team has six months to close a deal with a supplier without impacting production, deal criteria are likely to be very different than if that team has two weeks to close a deal before production falls behind its timeline. In the former situation, price might be given significantly more weight than delivery schedule, whereas in the latter situation, delivery schedule is likely to be much more important.

Similarly, if a purchasing agent is acquiring a good in a situation where there are plenty of available suppliers and switching costs are low, then the relative importance of forging a strong working relationship with a supplier is likely to be much lower than in a sole-source situation. Success criteria need to be defined and weighted in a flexible fashion. The application of any incentive framework for negotiators needs to acknowledge the unique contingencies that often attend complex negotiations, while avoiding the trap of assuming that every negotiation is completely unique and impossible to assess against standard benchmarks.

### Difficulty of measuring some important factors

While incentives linked to final price tend to be easy to construct, companies encounter more difficulty in developing ways to easily and accurately measure intangible or less quantifiable outcomes such as a good working relationship, a sustainable and operational deal, different types of exclusivity provisions, or total cost of ownership. As a result, companies often default to price as a primary measure of deal value.

## Enablement

The first step in implementing this practice is to define the business goals and priorities that will be used to assess the success and value of negotiated outcomes. Typically, this requires broad consultation with various internal constituents, including internal customers in multiple divisions and functions. While such consultation generally requires considerable internal negotiation, implementing decision-making protocols that clarify how business units and corporate sourcing should interact can help make the effort more efficient. Such protocols can be used to help clearly define (and align the organization around) roles, rights, and responsibilities of different groups and individuals in the selection process, including who has the authority to make which decisions and whose input needs to be considered on which issues and decisions.[3]

The next requirement is to determine how to gather and assess data for intangible or subjective goals. For example, if a company determines that one of its goals is "collaborative relationships with suppliers," needs to find meaningful metrics to assess negotiated outcomes against this goal in a predictable, consistent manner.

Finally, measures of deal success need to be linked to evaluation and compensation processes so that they provide the right incentives for negotiators. To ensure that new and often more complex incentive or appraisal systems are practical and clearly understood, most companies consult extensively with purchasing officers and other negotiators before making significant changes. As with most decisions, an effective consultation process around new incentive systems greatly enhances the odds of successful implementation.

#### Practice in Action

Employees of a large professional services are assessed on a broad set of negotiation success criteria that focus on process, conduct, and outcome. Process and conduct each account for 25% of the overall success rating, with outcome making up the other half of the scale. One element of the process requires negotiators to demonstrate that they have established open and effective communication protocols with the supplier, while another requires the negotiator to have performed certain analytical assessments of the supplier's business to help prepare for negotiation.

For both process and conduct, a supplier account manager is surveyed at the end of the negotiation (regardless of the outcome) about a number of topics (e.g., whether negotiators were respectful, communicated effectively, and tried to craft deals that were fair for both sides) and those responses are factored into performance reviews.

3 For a more complete discussion on decision-making protocols, please refer to best practice #4 in the "Evaluation and Selection" section of Negotiating and Managing Key Supplier Relationships: A Cross-Industry Study of 20 Best Practices (Jonathan Hughes and Mark Gordon).

### Bottom Line

- Implementing a robust framework to measure the success and value of negotiated outcomes is a key step in maximizing the value of important supplier relationships.
- Maximizing the value created in negotiations requires linking metrics for assessing deal outcomes with formal and informal incentives for those charged with negotiating supply agreements.

## Formal transition activities are conducted when new supplier relationships are established

Such events involve anticipating and jointly planning for challenges, agreeing on decision-making and escalation procedures for when disagreement or conflict arises, and jointly defining shared performance and relationship health metrics. Transition and joint launch events may also occur when major new contracts are signed.

As with alliances, contracts governing complex supply or outsourcing relationships are inherently incomplete. A static document, no matter how detailed, cannot exhaustively delineate every dimension of how a company and interdependent supplier will work together. Similarly, the strategic context for the structure and terms of complex sourcing contracts is at best partially reflected in the legal documentation of agreements. Put another way, a great deal of learning about each other and analysis of options and opportunities occurs during complex sourcing negotiations that often last several months — and such learning cannot be adequately captured in contract documents. Given this, and given that those who conduct negotiations and those will be responsible for managing key supplier or outsourcing relationships are not always the same people, many companies have begun to recognize the importance of effective transition from negotiation to implementation of a new deal or relationship. Very few companies, however, have yet implemented systematic approaches to managing this critical transition. Within an organization, transition requires ensuring that functional groups and other affected parties who were not intimately involved in negotiations are briefed on the terms of the contract and the reasoning and intent behind them, and are made aware of important or contentious issues that arose during negotiations. Internal transition also involves clarification of roles and responsibilities, and developing an understanding of how internal groups will work together to make decisions and resolve conflicts related to a particular supplier relationship. In addition to internal transition activities, some companies engage in joint planning and launch activities with their suppliers. Joint transition activities ensure that both organizations have a common understanding of why the contract is written the way that it is, and that relationship managers and account teams from both companies have a structured opportunity to plan together for implementation or management challenges as new agreements are operationalized. Sometimes new contract or relationship launches comprise multiple events that include briefings on each other's business processes and organizational cultures, training on common approaches to collaboration and joint problem solving, or joint development of operating protocols for communication, scope management, escalation of conflicts, and the like.

### Benefits

#### Sets the stage for a healthy relationship

Absent a common understanding of contract terms and explicit conversations about how companies and suppliers will work together, unaligned expectations can cause breakdowns in communication, and lead parties to unknowingly surprise and disappoint each other. For example, one contract specified that engineers from a manufacturing company and its supplier would together design a new component. Engineers at the customer company expected that they would work on-site with supplier engineers for several weeks, then supplier engineers would revise the designs on their own before prototyping. Supplier engineers, however, assumed that they would design the component initially, then share drafts with their counterparts for feedback. Without specifying a process for working together, a great deal of unnecessary conflict arose between engineering teams at both organizations, as each was continually frustrated by behavior from the other side that failed to conform with their expectations. Through a transition and launch process, companies and their suppliers are able to align mutual expectations and minimize the inefficiencies and conflict that otherwise result.

**Commonly-Cited Benefits**

"We are able to resolve any tensions left over from negotiations."

"We can address our relationship outside of the context of our day-to-day work."

"Our suppliers know what to expect from us and we know what to expect from them."

### Provides for smooth hand-offs

A smooth transition from negotiation to implementation avoids internal confusion as some people transition into, and some people transition away from, working with a supplier. For example, at some companies, a strategic buyer is responsible for managing supplier negotiations, but after a deal is signed, a new relationship manager becomes a supplier's primary contact. The timing of the hand-off between the two individuals is sometimes unclear, which causes frustration if the buyer makes decisions or sends messages that the relationship manager feels are his responsibility. Clearly defining roles also eliminates external confusion regarding who the supplier should contact about various issues as the deal goes into effect.

In some cases, those who negotiate supplier contracts are also those who will manage a supplier relationship. In these situations, companies tend to focus less on formal, internal transition and place greater emphasis on joint transition or launch activities along with their supplier counterparts. Other companies try to maximize the involvement during negotiations of those who will have significant interactions with suppliers post-deal.

### Enables rapid implementation

Given the many (often changing) people involved during negotiation and initial implementation of complex sourcing arrangements, it is all too easy for communication lines to become crossed and for things to slip through the cracks, leading to costly delays and frustration all around. A systematic transition and launch process is essential to facilitating smooth, efficient contract implementation in such situations.

## Barriers

### Resource constraints

Lack of time is often cited as a barrier to implementing a systematic transition process. In most companies, negotiators have neither time nor incentive to worry about implementation issues once the contract is signed. These individuals are compensated on getting deals signed and moving on quickly to the next contract that needs to be negotiated. Spending time and effort to conduct briefings and pass along to others what they have learned about a supplier is difficult. Getting functional groups and other affected individuals on both sides together at the same time for transition and launch activities can be even more difficult, particularly if they are scattered across functions or business units.

### View that transition is something that smart people can figure out as they go

At many companies, there is an assumption that smart, motivated individuals will figure out ways to work with supplier counterparts as the relationship progresses. Unfortunately, this is often a recipe for conflict and missed opportunities. The beginning of a new relationship with a supplier, or of new relationships among individuals from both customer and supplier around a new contract, is a delicate time. First impressions matter greatly. Missed deadlines are often quickly assumed to be evidence of lack of commitment (as opposed to poor planning or organizational churn). Mismatched expectations can quickly produce a self-perpetuating cycle of frustration. Important insights and lessons learned during the negotiation process are lost, and at best must be re-learned at the cost of unnecessary problems, delays and conflict.

## Enablement

Some companies manage negotiation-implementation transitions simply by creating a template for capturing important deal information during negotiations, and ensuring its transfer to key individuals who have been identified in advance. For example, a standard "deal summary" template might include sections on supplier information, key components of the contract, and important "hot spots." Negotiators are responsible for filling out this template and posting it to the company intranet for access by implementation and supplier management staff. Such a template can be made more robust with software that automatically rolls up important information from already-created documents, eliminating the need to re-enter or recompile data. More formal implementation of the practice includes detailed agendas for internal hand-off meetings, and joint launch sessions with suppliers. Negotiators and relationship management teams are held accountable by senior management for participating in such activities.

Joint launch meetings or working sessions are typically utilized by companies at the beginning of new relationships with suppliers, or when major new contracts are signed. Events often include joint planning sessions, joint training workshops, business-focused team building activities, and operational planning sessions. Some companies and their suppliers choose initially to bring senior people together for planning, leaving the development new policies and procedures to sub-groups to work on in the first month or two of a new relationship.

## Bottom Line

- The beginning of a new relationship is a critical time; early impressions are difficult to change. Joint launch activities help to ensure these relationships get off to a good start.
- The lack of a structured transition from negotiators to those who need to manage a relationship sows the seeds for unmet expectations and conflict later.
- Complex negotiations are often a forum for important learning. Without effective transition processes, valuable knowledge remains with the negotiation team, requiring others interacting with a supplier to “re-learn” lessons.

## 20 best practices for negotiating and managing key supplier relationships

### Evaluation and Selection

1. **Supplier assessment is a two-way activity**
   Focus is not only on evaluating the ability of a supplier to deliver, but also on jointly exploring possible challenges of working together and soliciting supplier input on what the customer could do to ensure a successful partnership.
2. **Supplier selection is based on multiple factors**
   Suppliers are evaluated and selected not only on the basis of price, but also on indicators of their ability to work as collaborative partners.
3. **A database captures current and potential supplier profiles**
   Detailed supplier profiles are used to inform the evaluation and selection process. In particular, information about past performance and interactions with a supplier is logged by those who have worked regularly with that supplier.
4. **Protocols clarify how business unit customers and corporate sourcing should interact during supplier selection and negotiations**
   Guidelines are clearly defined for who is responsible for doing what, who has the authority to make which decisions, and who needs to be consulted for their input on which issues and decisions.

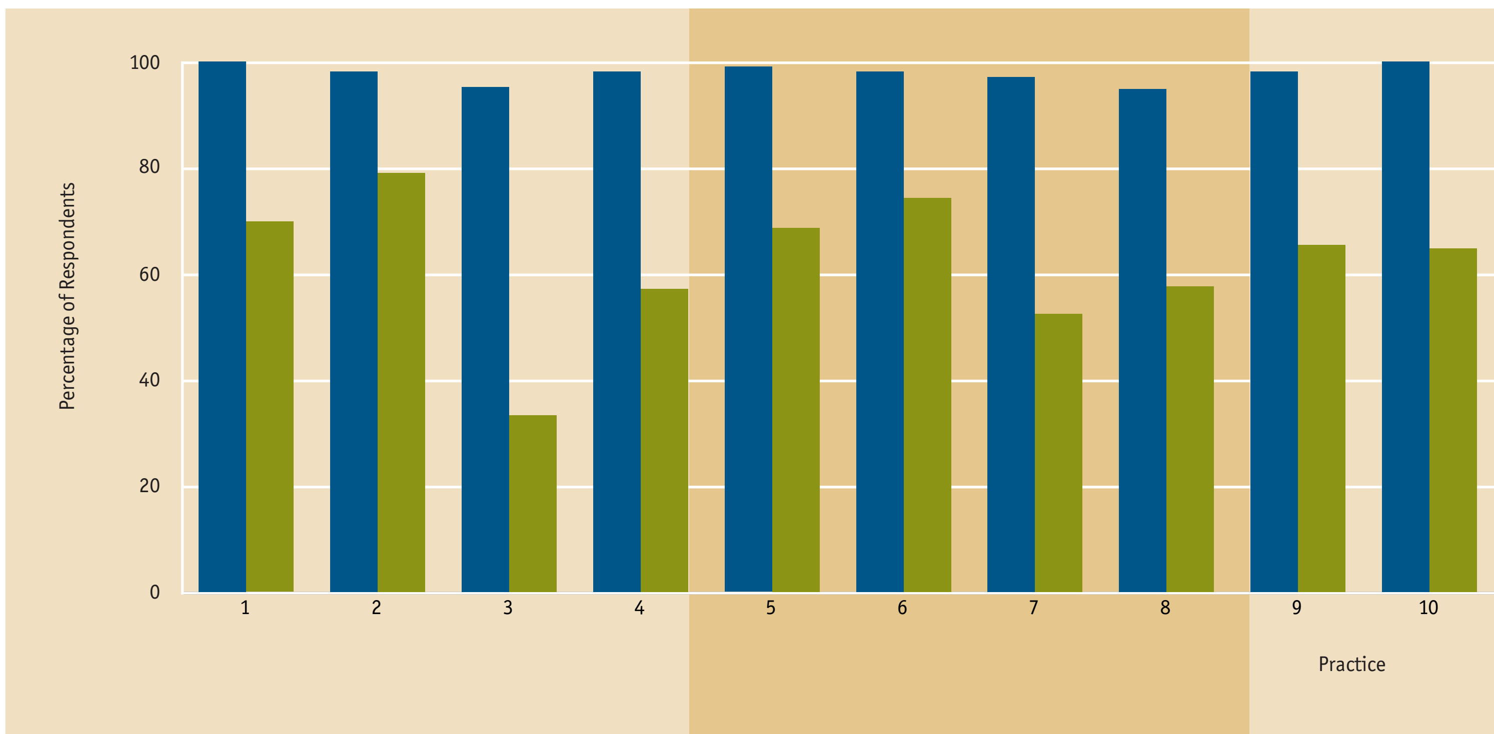
### Negotiation

5. **Supplier negotiations are managed as a collaborative process**
   Focus is on maximizing value for both sides, while coercive tactics aimed at "squeezing the last dollar" out of suppliers are avoided.
6. **Negotiation is used as an opportunity to build a strong foundation for a good working relationship**
   Focus is as much on setting the stage for working together effectively once a deal is signed as it is on arriving at specific contract terms.
7. **Negotiators are assessed and compensated based on overall quality of the deal**
   Assessments and incentives are based on multiple dimensions beyond price, including, for example, total value created, positive or negative impact on the relationship, value created for the supplier, and the like.
8. **Formal transition activities are conducted when new supplier relationships are established**
   Such events involve anticipating and jointly planning for challenges, agreeing on decision-making and escalation procedures for when disagreement or conflict arises, and jointly defining shared performance and relationship health metrics. Transition and joint launch events may also occur when major new contracts are signed.

### Post-Deal Relationship Management

9. **Relationships with suppliers who work with multiple business units are managed in a coordinated fashion**
   Communication and decision-making procedures are developed and implemented to ensure effective internal and external coordination.
10. **Suppliers are encouraged to share innovations**
    A mechanism exists to enable suppliers to suggest product or process innovations and provides incentives for doing so.

## Comparison of value and implementation



11. A relationship manager is dedicated to each strategic supplier relationship
Dedicated relationship managers act as internal advocates for suppliers, serve as a resource and escalation point for suppliers, and facilitate coordination among different internal groups who interact with a given supplier.

12. A formal mechanism enables joint strategic planning with suppliers
Such a mechanism enables companies and their key suppliers to share information about their respective strategies, find ways to help each other meet important goals, and better align long-term plans.

13. Enterprise sourcing strategy is aimed at creating and preserving long-term relationships with suppliers
Such a focus ensures companies maximize the value of supplier relationships where a long- term time horizon is critical to facilitating joint planning and joint investment.

## Performance Monitoring

14. Regular supplier relationship assessments are conducted
Assessments are conducted against metrics for business performance and the health and quality of the working relationship.

15. Relationship assessments are two-way
Focus is not only on supplier performance, but also on assessing whether the customer has met their obligations and on diagnosing problems jointly and finding opportunities for mutual gain.

16. Assessment data is reviewed and analyzed systematically and jointly with suppliers
A formal mechanism exists to ensure that problems or opportunities uncovered by assessments are acted upon.

## Termination

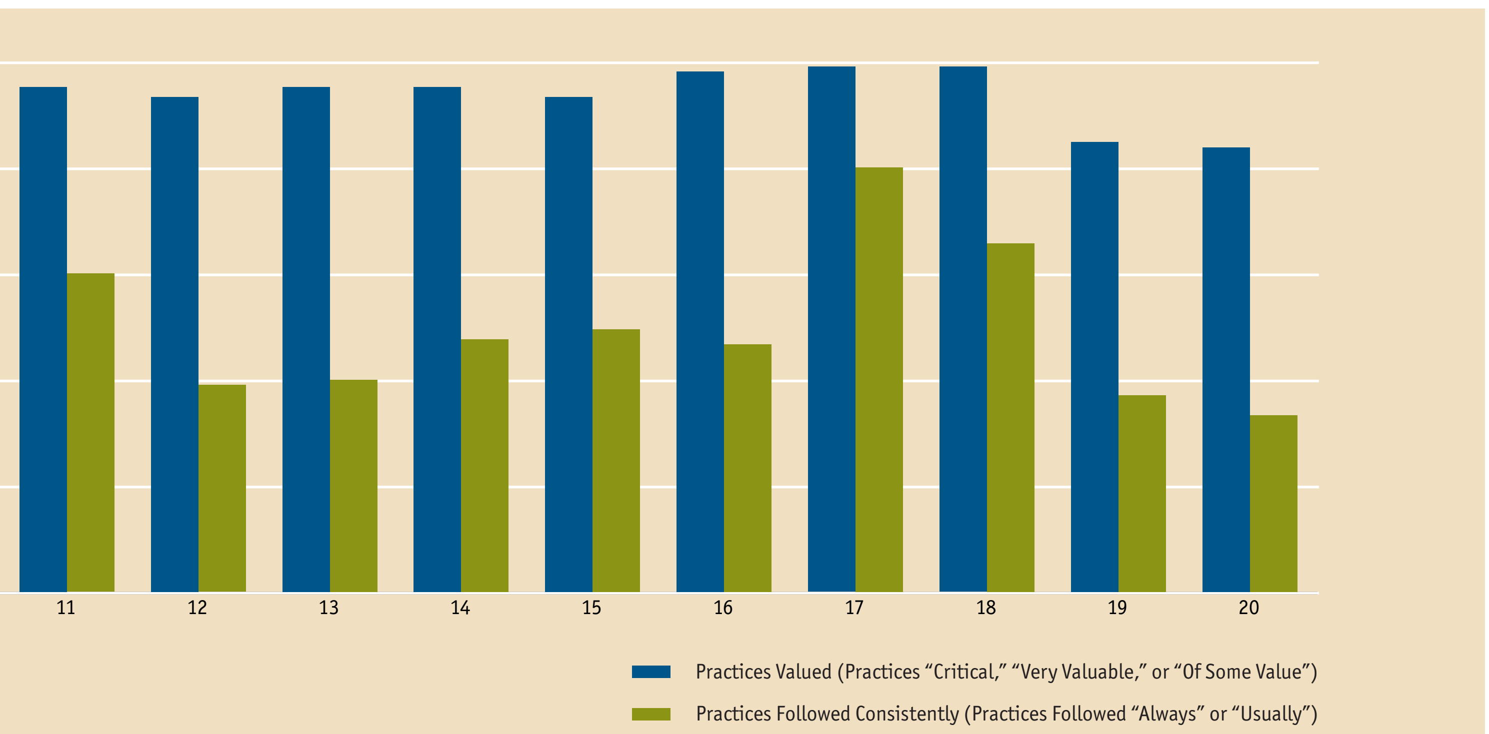
17. Termination based on changes in strategy or business needs occurs in a way that minimizes negative impact
Such termination decisions are made in consultation with suppliers, with significant advance warning, and with efforts to mitigate impact to both parties.

18. Termination decisions are negotiated and communicated in a respectful, collaborative manner
Termination of supplier relationships is conducted in a way that preserves the potential for the parties to work together in the future, and minimizes potential for damage to a company's reputation.

## Portfolio Governance and Management

19. Supplier relationships are segmented into relevant tiers
Tiers are based on clearly defined criteria such as strategic importance and the cost of switching suppliers. A mechanism is created to help determine which tier suppliers fall into and how suppliers should be managed, depending on tier.

20. Complex supplier relationships are managed within a well-defined, formal governance structure
A governance structure, supported by relationship management processes, exists to manage relationships with key suppliers who are also customers and/or channels, and/or alliance partners.



## About Vantage Partners, LLC

Vantage Partners helps the world's leading companies to effectively structure, launch, and manage their most critical business relationships. Vantage helps companies build the necessary systems and structures, tools, skills, and mindset, to consistently and on an on-going basis, create and capture value through collaboration. A spin-off of the Harvard Negotiation Project, Vantage brings over twenty years of research and hands-on experience consulting to Alliance, Procurement, and Sales groups in a wide range of industries throughout the world. The Directors of Vantage Partners have published several popular books, as well as numerous articles in publications such as the Harvard Business Review and Sloan Management Review.

To learn more about Vantage Partners or to access our online library of research and white papers, please visit www.vantagepartners.com

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