

Negotiations in Procurement



You can motivate suppliers to offer their best price by starting the relationship as a conversation, not a competition (den Butter and Linse)



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Introduction

Procurement plays an important role in the supply chain. As a business process it has transformed from a simple buying function to overseeing an integrated set of management functions (den Butter and Linse, 2008). Consequently, the level of importance and dimension of negotiating have changed over the years: its scope has changed from predominantly price-oriented to focusing on economical, sustainable, relational and reputation aspects (Zartman, 2008).

In procurement, negotiations have often been viewed as a less preferable alternative to auctions: the latter generally enables the achievement of better prices and economists have claimed that auctions are effective means of increasing value (Harvard Law School, 2011). In addition, it is very difficult to document procurement's specific contributions to organisational objectives resulting from negotiations: it is hard to identify cost-savings or performance improvement (e.g. improved working capital or reduced financing costs) achieved through negotiations (den Butter and Linse, 2008). At the same time while auctions reversed the supplier-buyer relationship, allowing suppliers compete for customers' business, it became evident that for buyers there was no promise of quality and service. This highlighted the need for a more meaningful relationship for the two parties which can be fulfilled by negotiations (Subramaniam, 2009).

Academic research also challenges the conventional wisdom suggesting that suppliers tend to prefer negotiations because they offer greater price confidentiality and a better chance of establishing long-term customer relationships. Thus, there is a better incentive for buyers to offer best prices via negotiations, not auctions (den Butter and Linse, 2008). In the long run, negotiations can turn out cheaper option than auctions. Harvard Business School Prof. Ian Larkin found that companies that procure via auctions paid between 3% to 5% more than those that enter exclusive negotiations with only one vendor. Organisations are likely to regularly work with the same subset of potential suppliers and from there a request for a procurement bid suggests that you see your potential suppliers as largely equal. As a result, suppliers can treat customers who choose an auction route less favourably than those who choose to maintain relationships through negotiations (den Butter and Linse, 2008).

Definition

Negotiation is defined as a process of "communication with the objective of reaching an agreement by means, where appropriate, of compromise". A successful negotiation is one that accomplishes this goal (CIPS: Negotiation) and that secures supplies, materials and services of the right quality, in the right quantity, at the right time, from the right source and at the right cost (Zartman, 2008).

Successful Application

Negotiation requires preparation. For example, it is important to set goals, alternatives and exit strategies. It is also essential to practice the art of negotiation in low-risk situations before getting into a discussion where stakes are very high. It is a good idea to have an independent observer who can provide constructive feedback (Weiss and Hughes, 2011).

Steps to Successful Application

- Diagnose the situation.
- Accurately analyse buyer expectations.
- Assess the bargaining power of all parties.
- Set objectives for the negotiation: ideal outcomes, realistic outcomes, fall back strategies.
- Decide on the negotiation strategy: approach, style of communication, concessions, venue.
- Recognise the trading factors: things the buyer can trade and things the supplier can provide or concede.

CIPS: Negotiation

Hints and Tips

- It is important to plan a communication strategy: agenda, objectives, strategies to handle disagreements and the motivation of the other party (Weiss and Hughes, 2011).
- When the competition in the market is not very stiff, the buyer's position becomes difficult as the supplier becomes the sole provider of the service or good. If this is the case suppliers can identify a 'best alternative to the negotiated agreement' (BATNA) (CIPS: Negotiation).
- Negotiation is most suitable where there is limited competition (CIPS: Negotiation).
- The success of negotiation can depend on whether its style and method is suited to the culture of the negotiating party. For example, in some cultures eye contact is seen as honest whilst in others it is perceived as being aggressive (Weiss and Hughes, 2011).
- The success of negotiations can depend on the balance of the potential mutual benefit and the balance of power (CIPS: Negotiation).

Potential Advantages

- Negotiations work fairly fast and provide a good value-for-money option in working out a deal for a buyer and contractor (CIPS: Negotiation).
- Negotiations give time for an exchange between a buyer and provider, thus offering more scope to interact and share significant pre-contract information (Goldberg, 1977).
- Very often, providers have information about the market that buyers can benefit from and hence, the interaction in negotiation helps a buyer to leverage that advantage. This communication and coordination cannot be achieved through an auction or bidding (Bajari et al., 2006).

Potential Disadvantages

- Negotiations almost never lead to the desired outcomes for both parties (CIPS: Negotiation).
- There is a risk that suppliers would refrain from a long-term relationship with the buyer if they feel that they could have struck a better deal or that they have incurred a loss following negotiations (CIPS: Negotiation).
- Negotiated contracts generally go to sellers who are more reputable and experienced. This in turn takes away from providing equal opportunities (Bajari et al., 2006).

Performance Monitoring

- Analysis of leverage: direct comparison of the first offer extended to the supplying party and the final agreement drawn, provides an idea of how successful negotiations were (Latz, 2004).
- Objective standards: comparing a standard market rate of goods/service/salary with the agreement, a good way to measure the success of negotiations (Latz, 2004).

Case Studies

- To manage and negotiate vendor contracts globally Cisco created a Vendor Management Office (VMO). The VMO worked towards managing strategic relationships with IT vendors globally and within the first three quarters of its inception in 2004 registered cost savings of US\$33m (Cisco IT Case Study, 2007).
- After handling IT supplier negotiations in-house for five years IBM decided to hand out its IT contract renewal management function to Siwel. This outsourcing of IT-related negotiation activities helped IBM to achieve a 19% reduction in spend while retaining full access to the information on usage, future requirement and insights related to the IBM software (Friedman, 2010).
- The project of 'rebuilding Iraq', worth US\$680m, was awarded to Bechtel Corporation (the engineering, construction, management and development services company) following negotiations between the republican administration and Bechtel. Due to the lack of competitive bidding, this decision raised serious issues of transparency (Bajari et al., 2006).

CIPS Source Downloads

- CIPS: How to negotiate professionally
- CIPS Australia: The psychology of negotiation: A brief introduction
- CIPS: Negotiation
- CIPS: Tendering and Post Tender Negotiation
- CIPS: Savings
- UWE, CIPS & KPMG (2002) I-SAVE: Independent savings analysis verification and evaluation

Further Reading/Reference

Web Resources

- WTO: Negotiations in Government procurement http://www.wto.org/english/tratop_e/gproc_e/negotiations_e.htm
- An overview of negotiation <http://www.enotes.com/topics/negotiation>
- The nuts and bolts of negotiation <http://hbr.org/product/nuts-and-bolts-negotiation-hbr-article-collection/an/2486-PDF-ENG>
- Having extreme negotiations <http://blogs.hbr.org/2011/09/in-our-november-2010-issue/>
- Cross-border negotiations <http://hbswk.hbs.edu/archive/3714.html>

Books

- Negotiation, Harvard Business Essentials, ISBN 978-1591391111

- Negotiation, Roy J. Lewicki, David M. Saunders & Bruce Barry, ISBN 978-0073381206
- Bargaining for Advantage, G. Richard Shell, ISBN 978-0143036975
- Getting to Yes, Roger Fisher, ISBN 978-0143118756
- Negotiation Genius, Deepak Malhotra & Max Bazerman, ISBN 978-0553384116

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Video

Using supply market intelligence to improve negotiations

https://www.youtube.com/watch?feature=player_embedded&v=wxLEhPdk4P0

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