

Kenneth Lysons | Brian Farrington

PROCUREMENT AND SUPPLY CHAIN MANAGEMENT

Tenth Edition



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Procurement and Supply Chain Management



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Tenth Edition

Procurement and Supply Chain Management

KENNETH LYSONS

MA, MEd, PhD, Dipl.PA, Ac.Dip.Ed.,
DMS, FCIS, FCIPS, FInst M, MILT

BRIAN FARRINGTON

BSc(Econ), MSc, PhD, FCIPS



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KAO Two
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Harlow CM17 9SR
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Tel: +44 (0)1279 623623
Web: www.pearson.com/uk

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Dedications

I dedicate this book to my family. They mean everything to me. In particular, to Joyce, my wife, who has unstintingly supported me throughout my career. She is without comparison.

I also dedicate this book to the memory of Kenneth Lysons. Ken's devoted wife, Audrey, and their family continue to be a source of inspiration to me. This relationship has extended over many years and is greatly valued.

Brian Farrington

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Preface

Dr Brian Farrington is the author of the tenth edition of this acclaimed book. The output of any book is influenced by many sources, including:

- professional feedback from lecturers at Universities and Colleges; their views are invaluable
- the Chartered Institute of Procurement and Supply’s education syllabus and the Institute’s continual quest to enhance standards
- legal challenges to procurement decisions
- emphasis on environmental and socially responsible procurement
- feedback from learners and practitioners
- the author’s international consultancy experience
- the recognition that a procurement specialist has to exercise the highest moral and ethical standards and that some fall short
- the challenge presented by cyber security.

There are two new chapters, thanks to the foresight of Pearson.

Public Sector Procurement is a new chapter, recognising the public sector’s impact on the global economy. Public accountability means that scrutiny of decisions is far more open than the private sector.

Sustainability and Socially Responsible Procurement is a new chapter, recognising that this is a highly challenging global issue wherein procurement has great influence. More initiatives are necessary.

There has been a serious recasting of much of the content. There is an unrivalled opportunity for procurement specialists to manage risk, finance and corporate performance. The author seeks to instil in all procurement specialists the fact that effective and innovative procurement pays a significant part in the management of economies and corporate performance.

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Writing a book of this complexity requires the support, advice and patience of many people. The challenges, frustrations and achievements are never solely down to the author. I am indebted to many organisations and people who have materially assisted. By exception, Joe Anwyll, has provided me with constant professional opportunities and challenges. These have kept me focused.

Sandra Small has, again, risen to every challenge I have faced her with. The changes made to this edition have presented Sandra with severe timescales and technical issues. She has risen to these with unquestionable diligence and expertise.

Joyce, my wife, has tolerated, with the utmost goodwill, my absolute focus on getting the tenth edition of the book finished to meet an exacting deadline.

It would be remiss not to acknowledge the 'new' relationship with the Pearson team in India. The help and support of Bincy Menon, Agnibesh Das and Vinay Agnihotri have been vital. It can truly be said to have been an experience! Louise Attwood's attention to detail during the copyediting process has ensured the book is of the highest quality.

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Part 1

Introduction and strategy

Chapter 1

The scope and influence of procurement

Learning outcomes

This chapter aims to provide an understanding of:

- how to define procurement
- how to define supply chain management
- strategic roles of procurement
- procurement as organisational buying
- the strategic scope of procurement
- integrated supply chain management
- procurement and change
- world-class procurement
- the status of procurement and supply management
- reflections of procurement positioning in business
- the scope of procurement in the public sector

Key ideas

- Procurement as a function, process, supply or value chain link, a relationship, discipline and profession.
- Procurement as a strategic business activity.
- Definitions of purchasing, procurement and supply chain.
- Globalisation, information technology, changing production and management philosophies as factors in the evolution of procurement.
- Characteristics of world-class procurement.
- Leverage, focus and professionalism as factors contributing to the status of procurement within an organisation.
- Procurement as a business change agent.
- Procurement as a key influencer on business decisions.

Introduction

The first edition of this book was published in 1981. This, the tenth edition, is published in 2020. The procurement profession has achieved some notable successes. These include:

- it is recognised by many as a profession
- a dramatic improvement in academic standards and research
- active involvement at a corporate strategy level
- career opportunities on an international basis
- Chartered Institute of Procurement & Supply impact on standards
- wide-ranging, positive initiatives to deliver corporate goals.

Despite the successes, there remain critical allegations related to facets of procurement performance where failures are apparent. These include:

- absence of long-term strategies to support corporate goals
- an inability to play a decisive role on major projects, including ICT and construction
- a failure to impose robust contract terms and conditions on suppliers and contractors
- an inability to conduct due diligence and to identify high level risks in the supply chain
- inadequate involvement and influence on contract management activities
- an inability to adequately evaluate procurement workloads and staff to meet the forward business challenges.

Throughout this book, procurement is the focus term, recognising that the function has other descriptors, including purchasing and buying.

The author is resolute in his belief that procurement warrants corporate recognition. The key purposes of the book are to inform, motivate and convince our readers that the highest personal standards and knowledge impact on performance.

1.1 How to define procurement

CIPS Australia¹ motivated a debate on an agreed procurement lexicon. The following statements were proposed:

Procurement is the business management function that ensures identification, sourcing, access and management of the external resources that an organisation needs or may need to fulfil its strategic objectives.

Procurement exists to explore supply market opportunities and to implement resourcing strategies that deliver the best possible supply outcome to the organisation, its stakeholders and customers.

Procurement applies the science and art of external resource and supply management through a body of knowledge interpreted by competent practitioners and professionals.

The author offers two more definitions of procurement.

Procurement is a pro-active, strategic corporate activity to ensure a continuing supply of goods and services to enable world-class organisational performance.

Procurement manages supply chain risks through effective negotiation of contracts, cost and price models, quality and other essential supply characteristics.

1.2 How to define supply chain management (SCM)

Investopedia² define supply chain management (SCM) as ‘Supply chain management is the management of the flow of goods and services and includes all processes that transform raw materials into final products. It involves the active streamlining of a business’s supply-side activities to maximise customer value and gain a competitive advantage in the market place.’

Techopedia³ define SCM as ‘The management and oversight of a product from its origin until it is consumed. SCM involves the flow of materials, finances and information. This includes product design, planning, execution, monitoring and control.’

1.3 Strategic roles of procurement

The strategic ability and contribution of procurement is the differentiator that sets the function apart from a transactional modus operandi. Boeing, in developing its 787 Dreamliner, expanded the role of procurement from outsourcing parts to outsourcing entire subsections. It has been estimated that nearly all of the jet’s design and fabrication, along with some 40 per cent of the estimated \$8 billion in development costs, is being outsourced to subcontractors.

1.3.1 Due diligence

Due diligence is a structured methodology to help determine that a supplier has the necessary qualities to become a partner of the buying organisation. The term ‘due diligence’ is more usually associated with financial reviews in takeover situations. Within a procurement context it includes consideration of the supplier’s:

- financial robustness, including working capital
- competence and availability of key personnel resources
- reliance and extent of sub-contracting
- history of legal disputes and litigious actions
- experience of partnering relationships
- existence of a robust 5-year business plan
- history of insurance claims
- IT system robustness.

Conducting due diligence requires specialist knowledge and skills. It also requires liaison and collaboration with in-house specialists in areas including finance, legal and security.

1.3.2 Risk management of the supply chain

Identifying supply chain risks and developing acceptable risk mitigation strategies is a hallmark of a strategically focused procurement operation. All supply chain risks fall into one of three categories:

- 1 Those risks that only the supplier can manage
- 2 Those risks that only the buying organisation can manage
- 3 Those risks that must be jointly managed by the supplier and the buying organisation.

Examples of risks that fall into category 1 are:

- Having a robust business continuity plan
- Ability to match resource planning to programme deliverables
- Contractual relationships with sub-contractors
- Design, inspection and testing
- Having available sufficient working capital
- Through-life product support.

1.3.3 Relationship management

The adversarial way of business life is an outdated concept, a fact that some procurement operations need to realise. The skill of managing relationships with key strategic suppliers necessitates attention to, for example:

- conducting regular blame free reviews of contracts
- a joint commitment to continuous improvement
- sharing long-term business goals
- active involvement of senior people at both organisations
- negotiations based on genuine business objectives
- the provision of accurate and timely business and contract management data.

1.3.4 Continuous improvement of supplier performance

All sectors of the economy have competitive challenges, sometimes from off-shore organisations. The procurement community have a strategic role to motivate suppliers to continually improve their performance. The performance on long-term contracts can be incentivised to reward the supplier's investment and initiatives. The contract can require continuous improvement as an obligation. In some situations, the buying organisation may jointly invest in new technology, providing the supplier agrees to appropriate ownership of intellectual property and perhaps licensing upon payment of a royalty on sales.

1.3.5 The supplier's investment in 'right first time'

An organisation's reputation for quality is a prime business consideration. The law courts regularly try cases where non-compliance with the specification is at issue. Suppliers have expert knowledge, or should have, of the goods or services they provide. The supplier can add value to a procurement by ensuring that the specified quality can be satisfied or exceeded. The supplier can also advise on through-life costs, maintenance support, inspection and testing and continuous improvement. When the procurement specialist is engaged in pre-qualification processes there should be a penetrating analysis of the bidder's quality management attributes.

1.3.6 The supplier's investment in inventory

The rapid business approach to just-in-time has focused attention on who pays for inventory in the supply chain pipeline. Buying organisations are naïve to believe this is a 'free of charge' service willingly entered into by the supplier. There are costs involved,

including strategic warehousing facilities, distribution network costs, danger of product changes, working capital costs and so on. The concept of consignment stock is a proven concept in manufacturing, with some suppliers very adept of completely satisfying the buyer's needs for line side stock.

1.3.7 The supplier's investment in procurement expertise

It is a strange phenomenon that when buyers visit potential suppliers they often fail to probe the supplier's investment in procurement expertise. When the author engages with clients engaged in a tendering exercise and the supplier makes a presentation, it is most unlikely that there will be a procurement specialist on their team. Why? It can only be concluded that their procurement operation is not seen as contributing to a competitive edge.

1.4 Procurement as organisational buying

Organisational buyers have been defined by Marrian⁴ as:

Those buyers of goods and services for the specific purpose of industrial or agricultural production or for use in the operation or conduct of a plant, business, institution, profession or service.

Organisational buyers are those who buy on behalf of an organisation rather than for individual or family use or consumption. Organisational buyers can, as shown in Table 1.1, be considered to belong to one of four buying groups, each of which can be further subdivided.

Some of the categories in Table 1.1 may overlap. Thus, in the National Health Service, some supplies may be bought centrally by government agencies, regionally by health authorities and locally by hospitals themselves.

Table 1.1 A typology of organisational buyers

<i>Types of organisation</i>	<i>Characteristics</i>	<i>Examples</i>
Industrial/producer organisations	Purchase of goods and services for some tangible production and commercially significant purpose	Manufacturers: primary (extractive) producers – agriculture, forestry, fishing, horticulture, mining
Intermediate organisations	Purchase of goods and services for resale or for facilitating the resale of other goods in the industrial or ultimate consumer markets	Distributors, dealers, wholesalers, retailers, banks, hotels and service traders
Government and public-sector organisations	Purchase of goods and services for resale or use by organisations providing a service, often tangible, and not always commercially significant at national, regional and local levels	Central and local government, public utilities
Institutions	Purchase of goods and services for institutions that buy independently on their own behalf	Schools, colleges, hospitals, voluntary organisations

1.4.1 Procurement as supplier management

Supplier management may be defined as:

That aspect of procurement concerned with rationalising the supplier base and selecting, coordinating, appraising the performance of and developing the potential of suppliers and, where appropriate, building long-term collaborative relationships.

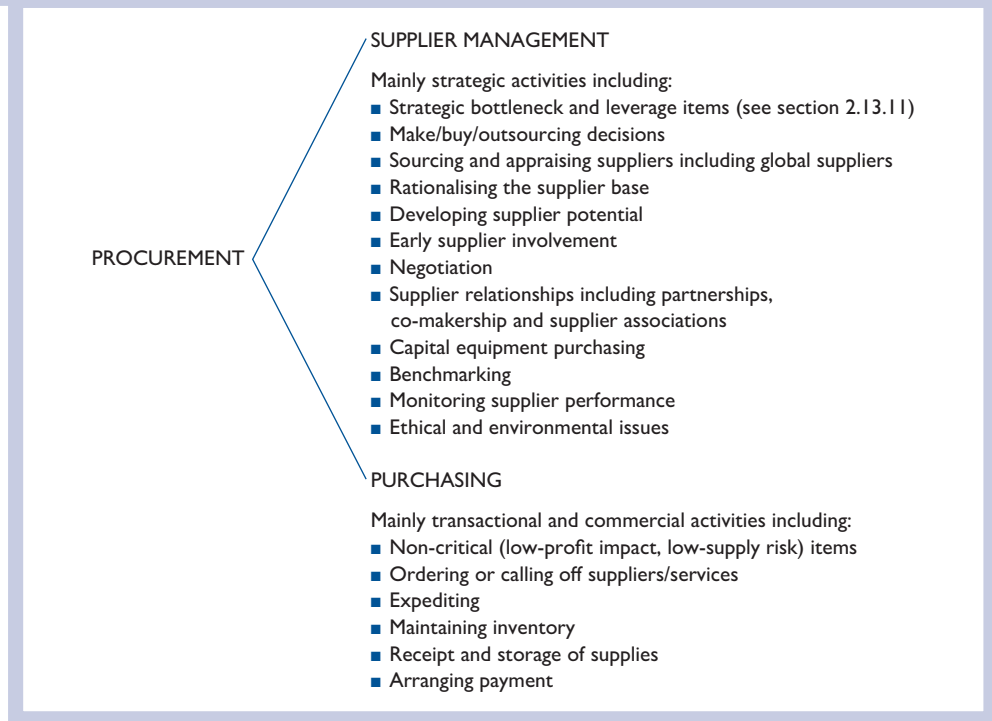
Supplier management is a more strategic and cross-functional activity than ‘buying’, which is transactionally and commercially biased. The relationship between procurement purchasing and supplier management is shown in Figure 1.1.

1.4.2 Purchasing as external resource management

The following is the view of Lamming:⁵

The new strategic function will probably not be called purchasing – that is much too limited a word. The connotations of purse strings and spending money have no relevance to the setting up and management of strategic interfirm relationships. This task is concerned with ensuring the correct external resources are in place to complement the internal resources. Perhaps ‘external resource managers’ is a term that future purchasing managers will adopt.

Figure 1.1 The relationship between procurement, supplier management and purchasing



1.5 The strategic scope of procurement

The strategic scope of procurement will vary according to the nature of the organisation's business activities. The author has consulted in, for example, a gold mining organisation and an international deep-sea communication cable laying organisation. The strategic variables were quite different. The principles of strategic scope are illustrated by Figure 1.2.

Each of the key areas shown in Figure 1.2 is analysed and shown in tabular form in Tables 1.2 to 1.7. Table 1.2 provides indicative areas of financial strategic considerations including the corporate strategic relevance. All the considerations and relevance are pertinent to procurement decision making. Table 1.3 concentrates on the legal strategic considerations of important relevance to procurement decisions making. Table 1.4 examines supply chain risks, including the corporate strategic relevance. All these considerations should be within the scope of procurement influence and action. Table 1.5 deals with operational strategic matters again emphasizing the areas in which procurement can play a major role. Table 1.6 raises the technology strategic considerations, outlining the potential scope and influence of procurement. Table 1.7 deals with managing obstacles to change and emphasizes the continuing potential influencing skills of procurement specialists.

1.5.1 Finance – strategic scope of procurement

Table 1.2 provides indicative areas of financial strategic considerations for procurement.

Figure 1.2 Strategic scope of procurement – key areas

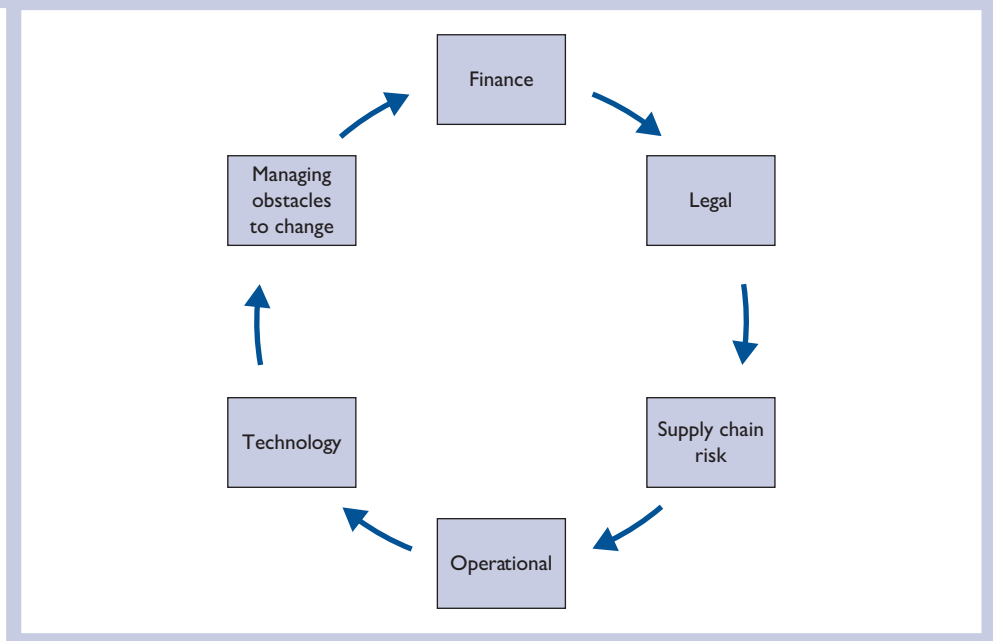


Table 1.2 Indicative areas of financial strategic considerations for procurement

<i>Financial strategic consideration</i>	<i>Corporate strategic relevance</i>
1 Supplier payment terms	Cash flow
2 Bought in price of goods & services	Competitiveness in market place
3 Contract termination costs	Provision for termination costs
4 Currency fluctuations impacting on bought in price of goods & services	Decision to forward buy currency
5 Delivery late on goods, services and for projects	Product launch/payment of damages to customers
6 Changes in scope of specification	Impact on selling prices
7 Payment of supplier 'up-front' fees	Vulnerability if no guarantee in place
8 Late payment to suppliers	Supplier applies 'stop' on deliveries

1.5.2 Legal – strategic scope of procurement

Table 1.3 provides indicative areas of legal strategic considerations for procurement.

1.5.3 Supply chain risk – strategic scope of procurement

Table 1.4 provides indicative areas of supply chain strategic considerations for procurement.

Table 1.3 Indicative areas of legal strategic considerations for procurement

<i>Legal strategic considerations</i>	<i>Corporate strategic relevance</i>
1 Apply buying organisation procurement Terms & Conditions	Supplier's obligations and liabilities very clear
2 Product liability accountability	Reduces corporate exposure to product liability claims
3 Clarity of specifications	Management of quality standards
4 Apply damages for suppliers' non-performance	Resistance of claims for corporate non-performance
5 Bank/parent company guarantees	Provides safeguards for specified events
6 Supplier's insurance provision	Management of risk exposure
7 Supplier's key personnel provision	Reduces risk associated with knowledge and skills provision
8 Jurisdiction	No exposure to off-shore jurisdictions

Table 1.4 Indicative areas of supply chain strategic considerations for procurement

<i>Supply chain risk strategic considerations</i>	<i>Corporate strategic relevance</i>
1 Single, dual or multiple sourcing strategy	Continuity of supply and competitive forces
2 Extent of off-shore sourcing	Exposure to supply chains
3 Financial failure of strategic supplier(s)	Idiosyncrasies Cost of resourcing and delay in supply of goods and services
4 Force majeure events	Delays to supply
5 Contract management effectiveness	Early warning of supply chain issues
6 Business continuity safeguards	Exposure to serious delays in provision of goods and services
7 Supplier conflict of interest	Exposure to secret/confidential data disclosure
8 Cost of goods and services	Exposure to margin erosion

1.5.4 Operational – strategic scope of procurement

Table 1.5 provides indicative areas of operational strategic considerations for procurement.

1.5.5 Technology – strategic scope of procurement

Table 1.6 provides indicative areas of technology strategic considerations for procurement.

1.5.6 Managing obstacles to change – strategic scope of procurement

Table 1.7 provides indicative areas related to managing obstacles to change considerations for procurement.

Table 1.5 Indicative areas of operational strategic considerations for procurement.

<i>Operational strategic consideration</i>	<i>Corporate strategic relevance</i>
1 Forecasting future demand for goods and services	Continuity of supply and long-term contracts in place
2 Accurate up-to-date data on inventory and supply	Production and service planning
3 Procurement and supply chain IT systems robustness	Provision and management of data
4 Quality management	Guarantee of high-quality goods and services
5 Make or Buy strategy	Known reliance and risks using third parties for supply of essential strategic goods and services
6 Supplier partnering	Absence of adversarial supplier relationships
7 Authority to enter into contracts with third parties	Procurement control of contractual commitments, including delegated authority for emergency purchases
8 Field failures of products – emergency responses	Reputational management

Table 1.6 Indicative areas of technology strategic considerations for procurement

<i>Technology strategic considerations</i>	<i>Corporate strategic relevance</i>
1 Conduct continuous procurement research into technology improvements	Awareness of technology improvements/new technology available
2 Supplier obligations for continuous improvement	Ensure technology supply is not static
3 Financial investment with strategic suppliers to enhance technology	Joint development of technology with potential benefits of joint IPR ownership
4 Management of Intellectual Property Rights	Minimise risk from IPR hostage scenarios
5 Availability of supplier IPR products and services when new products/services are introduced	Continuity of supply
6 Supplier guarantee/warranty provision	Reputational management
7 Early supplier engagement in our technology research and development	Partnering collaboration
8 Supplier promotional support for new technology introduction	Financial assistance with new technology launch
9 Political environment	Awareness of political environments in end markets
10 Outsourcing to access high-cost technology	Manage cost of introducing new technology

Table 1.7 Indicative areas related to managing obstacles to change considerations for procurement

<i>Managing obstacles to change strategic consideration</i>	<i>Corporate strategic relevance</i>
1 Avoiding fixation on existing suppliers	Competitive forces applied to market supply
2 Ensuring product samples are robustly tested	Alternative source of supply
3 Avoidance of malpractice with existing suppliers	Robust audit processes
4 Management customer preferences	Promotion of new/enhanced products
5 Right to terminate contracts for convenience	Flexibility for changing suppliers
6 Willingness to increase annual performance obligations	Continuous improvement
7 Change in buyer's category management portfolio	Persistent strategy review on sourcing strategies
8 Relevant use of small/medium enterprises	Social responsibilities

1.6 Integrated supply chain management

Procurement and supply chain management reflects a growing emphasis concerning the strategic business importance of suppliers. Supplier relationships are gradually shifting from an adversarial approach to a more cooperative approach with selected suppliers. The activities that the modern procurement organisation must undertake require a different mindset than that traditionally adopted. Supplier development, partnering, supplier–design involvement, the use of full-service suppliers, lifecycle costing, long-term supplier

contracts and relationships, strategic cost management and integrated Internet linkages and shared databases are now seen as ways to create new value within the supply chain. Procurement is attracting high-quality people who aspire to senior business positions once they have established their credibility in dealing with challenging procurement scenarios.

Three conclusions may be reached about this new era. First, the reshaping of the role of procurement in the modern economy has been necessary in response to the challenges presented by worldwide competition and rapidly changing technology and customer expectations. Second, the overall business impact of the procurement function is increasing, particularly for firms that compete in business environments characterised by worldwide competition and rapid change. Third, procurement must continue to become more sensitive to, and integrated with customer requirements, as well as with operations, logistics, human resources, finance, accounting, marketing and information systems. This evolution will take time to occur fully, but the integration is inevitable.

The above has been adapted from an article in *Solar Energy Market Express*.⁶ Fearon⁷ gives a more detailed exposition of professional development and published literature in his historical evolution of the procurement function.

The author has identified seven strategic stages of development that procurement must pass through to become a competitive weapon in the battle for markets (see Table 1.8).

Other attempts to trace the evolution of procurement are those of Syson⁸ and Morris and Calantone⁹ who each identify three stages. Syson refers to 'the changing focus of procurement as it evolves from a purely clerical routine activity to a commercial stage in which the emphasis is on cost savings and finally a proactive strategic function concerned with materials or logistics management.' Morris and Calantone differentiate between (i) clerical, (ii) 'asset management' and profitability and (iii) 'core-strategic' function stages.

Jones,¹⁰ however, criticises the above approaches on two grounds. First, they are non-operational and merely indicate the stage of development of procurement activity, the criteria for which may differ from one procurement organisation to another. Second, the models have a restricted number of development measurement variables. In an attempt to remedy those deficiencies Jones suggests a five-stage development model using 18 measurement criteria. The five stages of procurement development measured on a scale of 1–5 are shown in Table 1.9.

The procurement profile shown in Figure 1.3 enables the stage of development reached by a particular organisation to be identified and assessed on a scale of 1–5. The profile also indicates areas where further development is required, as measured in the 18 criteria shown in Figure 1.3. Appropriate strategies to meet identified shortcomings can then be devised.

Table 1.8 Procurement and supply chain strategic phases – Farrington model

<i>Stage</i>	<i>Strategic description</i>
Stage 1 'Traditional'	Procurement & Supply Chain (PCS) are treated as disparate activities, hence there is no unified strategic approach, nor is there a 'function' strategy. There is no exposure or liaison with corporate strategy development or operational application. This exposes the organisation to significant risks, supply delays, contractual non-performance and passive responsiveness to other function instructions.
Stage 2 'Awakening'	PSC managers have a rudimentary awareness of strategic planning and have attempted to change strategic direction where vital goods and services are concerned. There will be no positive change unless the Board of Directors agree and support new strategic actions that will have their support. Learning & development is a requirement. The costs of change are unknown.

Table 1.8 *Continued*

<i>Stage</i>	<i>Strategic description</i>
Stage 3 'Implementation'	PSC have been designated as activities where collaboration/integration will be positive in all operational and financial respects. There is a comprehensive plan for strategic change, linked to defined objectives and timescales. The intent is to, initially, focus on strategic suppliers, giving careful thought to long-term contracts and partnering behaviour.
Stage 4 'Systems development'	It is recognised that PSC management requires comprehensive, timely and accurate data. Accordingly, project funding is available to integrate PSC systems with appropriate corporate systems. The new systems will be designed to link wherever possible with strategic suppliers' systems with the aim of enabling continuous supplier performance. In-house ICT have PSC as a vital customer, warranting the highest level of support in accordance with KPIs.
Stage 5 'Leadership'	PSC are recognised as strategic leaders in key commodity groups. Learning & development and recruitment strategies ensure strategic leadership is evident and that exacting performance is achieved. PSC have a strategic involvement when corporate strategy is considered in the short, medium and long-term.
Stage 6 'Global reach'	The PSC has global reach and has in place long-term strategic contracts that include logistics, cost-management, continuous improvement, partnering behaviour, active supply market research, quality management, environmental management and cutting-edge technology.
Stage 7 'Standards challenge'	The PSC performance is under constant review against known thought leaders and best-in-class. PSC management demonstrate continuous performance achievements. The high-level reviews include supplier performance against contractual obligations and strategic one-off projects. There is interchange between corporate departmental heads thereby ensuring the broadest understanding of PSC challenges and opportunities.

Table 1.9 Procurement development stages and performance capabilities

<i>Stage of development</i>	<i>Capabilities</i>	<i>Estimated organisational contribution</i>
Stage 1 Infant	Fragmented procurement	None or low
Stage 2 Awakening	Realisation of savings potential	Clerical efficiency. Small savings via consolidation 2–5 per cent
Stage 3 Developing	Control and development of procurement price/ negotiation capabilities	Cost reduction 5–10 per cent
Stage 4 Mature	80/20 recognised Specialist buyers Cost reductions Commencement of supplier base management	Cost reduction 10–20 per cent Acquisition costs 1–10 per cent
Stage 5 Advanced	Devolution of procurement Strong central control Supply chain management	Cost reduction 25 per cent Cost of ownership Acquisition cost and supply chain management 30 per cent + Leverage buying Global sourcing Understanding and practice of acquisition cost and cost of ownership

Figure 1.3 Purchasing profile analysis

Measurement area	Stage of development				
	1 Infant	2 Awakening	3 Developing	4 Mature	5 Advanced
Activity breakdown analysis					
Purchasing organisational structure					
Purchasing services					
Function position in the business					
Extent of training/development of buyer					
Relative remuneration levels					
Measurement of purchasing performance					
Standard of information systems					
Computer technology					
Standard of operating procedures					
Interface development (buying centre)					
Buying process involvement					
Buyer characteristics/development					
Degree of purchasing specialism					
Supplier interface development					
Policy on ethics					
Hospitality					
Quality of buyer-supplier relationship					

1.7 Procurement and change

There are a number of drivers influencing and demanding changes in procurement, including those detailed in the following sections.

1.7.1 The challenge to manage escalating costs in purchasing goods and services

In the twenty-first century a number of pressures on costs manifested themselves. Not the least of these has been the volatility in the cost of oil, feeding its way into most supply chain costs. The continuing escalation of acts of terrorism, culture tensions, displacement of people from Africa, tensions in the EU all impact on costs and economic confidence. The related impact on the cost of living and consequent demands for wage increases are signs of potentially troubling times. The traditional emerging economies supplying, for example, the retail sector cannot escape the pressure on costs, noting that this sector has its own cost pressures. Adding to all this is the impact of difficulties in the financial services sector, making the cost and availability of capital a factor in investment decisions and availability of working capital.

1.7.2 The public sector focus on driving out inefficiencies in public expenditure

Some of the greatest changes in procurement in the 1990s and early in the twenty-first century have been in public expenditure. The large amounts of spend in central and local government have often been tackled through the aggregation of requirements. While significant improvements in procurement have been made there remain challenges to further improve value for money. It can be postulated that procurement will have to adapt across departmental boundaries and that classic silos of procurement will have to be abolished.

1.7.3 The increasing trend to outsource manufacture and services

There has been a rapidly growing trend to outsource a wide range of manufacturing and service delivery. This trend has challenged procurement departments to improve their management of tender processes, due diligence, negotiation with different cultures, managing outsourced contracts and applying open book methodologies. Procurement as a function is not immune from outsourcing actions.

1.7.4 The recognition that procurement is a significant contributor to corporate efficiency

Enlightened organisations have recognised that procurement can contribute to corporate efficiency. An example is long-range business planning which requires input on long-range costs, availability of strategic materials and supplies, supply chain developments and trends in service delivery; for example, voice recognition technology as an anti-fraud measure.

1.7.5 The positive impact of global sourcing

It may be argued that the retail sector has a long-standing expertise in global sourcing and coping with long-range supply issues. Their challenge includes responding to fashion changes and a cycle of product selection for the seasons of the year. The challenge for

other buyers is their ability to find excellent suppliers wherever they are in the world. International airlines have used global sources to provide equipment and services. The challenges for procurement include how to structure their organisation. It is not uncommon for retailers to set up a buying and supply organisation in the Far East.

1.7.6 The enhanced use of information technology and e-procurement

The IT revolution has impacted on procurement. What developments lie ahead? The drivers for change in procurement must surely include the objective of eradicating paper. In one procurement process each tender document weighed in excess of six kilograms. The resultant tenders were heavier! Secure networks that facilitate a whole electronic procurement system, through to payment, is a far-reaching objective for the global economy. E-procurement is in its relative infancy with relatively few reverse auctions, electronic tendering and knowledge storage and gathering strategies.

1.7.7 The redressing of procurement power

Many suppliers have grown by acquisition and have assumed to themselves a power that has affected buyer's pricing, output allocation and other restrictive practices. The procurement profession has been relatively unsuccessful in countering this power, for example by forming effective buying clubs, although the public sector has taken significant initiatives in setting up consortia.

1.7.8 The challenge to outdated traditional practices

It is always difficult to look within. The procurement profession itself must challenge outdated traditional practices. A movement from transactional operations to strategic activities would be desirable in many organisations. Defensive posturing that involves keeping stakeholders in the dark by denying them access to information, for example, the status of tendering processes, is unprofessional. An effective challenge to traditional practices would be useful in the construction sector where quantity surveyors handle the complete procurement cycle to the total exclusion of procurement specialists.

1.8 World-class procurement

The term 'world class' was popularised by the book *World Class Manufacturing* by Schonberger,¹¹ published in 1986. Schonberger defined world-class manufacturing as analogous to the Olympic motto '*citius, altius, fortius*' (translated as faster, higher, stronger). The world-class manufacturing equivalent is continual and rapid improvement.

Twelve characteristics of world-class supplier management were identified by the Center for Advanced Procurement Studies,¹² namely the following:

- Commitment to total quality management (TQM).
- Commitment to just-in-time (JIT).
- Commitment to total cycle time reduction.

- *Long-range strategic plans* that are multidimensional and fully integrated with the overall corporate plan, including the organisation's supply strategy, and related to customers' needs.
- *Supplier relationships*, including networks, partnerships and alliances. Relationships include such matters as supply base rationalisation and the segmentation of suppliers as 'strategic', 'preferred' and 'arm's length'. Relationships with strategic suppliers include a high level of trust, shared risks and rewards, sharing of data and supplier involvement in product improvement.
- *Strategic cost management* – this involves a total life acquisition approach to evaluating bids and the use of IT to support a paperless and seamless procurement process across the whole supply chain.
- *Performance measurements*, including regular benchmarking with and across industries. Performance measures are developed in consultation with customers, other organisational units and suppliers.
- *Training and professional development*, including identification of required skills for higher-level procurement posts and the maintenance of employee skills inventories.
- *Service excellence* – procurement is proactive, anticipates customers' needs and demonstrates flexibility.
- *Corporate social responsibility*, especially regarding ethical, environmental and safety issues and support of local suppliers.
- *Learning* – world-class procurement recognises that learning and education are critical factors in continuous improvement.
- *Management and leadership* – although listed last, this is probably the key factor. Procurement executives earn and enjoy top management support and recognise the importance of transformational change. Such leaders have vision, foster open communications, treat others with respect and develop the potential of both their staff and suppliers.

Ultimately, world-class procurement depends on trading with world-class suppliers. World-class suppliers will tend to mirror the characteristics of world-class procurement listed above. Research reported by Minahan¹³ indicates that, to be considered 'world class' suppliers must excel in such areas as competitive pricing, quality and lead times; these attributes are 'just the price of entry to get into the game'. The research identified the following three characteristics of world-class suppliers:

- *continuous improvement* – world-class suppliers have a formal and proven commitment to achieve year-on-year products and process improvements
- *technology and innovation* – world-class suppliers are technology leaders in their respective industries, providing customers with next-generation technologies and a 'leg-up' on their competition
- *adaptability* – world-class suppliers are willing to invest in new equipment, develop new technologies and rework their businesses to better support the strategies of their customers.

World-class supplier management is therefore concerned with:

- searching for suppliers with the above characteristics or the potential to achieve them

- providing such suppliers with specifications of the purchaser's expectations relating to products and services and agreeing how supplier performance will be measured against expectations
- recognising outstanding supplier performance by such means as the award of long-term contracts and sharing the benefits of collaborative innovation or performance that enhance the purchaser's competitiveness.

Strategic procurement partnerships are partnerships of equals in which suppliers are regarded as a source of the competitive edge responsible for a major share of product costs. As Saunders¹⁴ rightly observes:

For a firm to reach world class standards in serving its own customers, it is vital to achieve world class standards in controlling its network of suppliers.

1.9 The status of procurement and supply management (PSM)

Within a particular organisation the status of PSM is influenced by leverage, focus and professionalism.

1.9.1 Leverage

Traditionally, leverage of procurement has been focused on enhancing profitability. This is relevant in a manufacturing or purchase for resale context, but is irrelevant for procurement in a central and local government environment where procurement has a direct impact on the quality of public services being offered. The same can be said of procuring goods and services for the National Health Service.

The greatest scope for savings lies in the areas of greatest expenditure. For many organisations these areas are labour and materials. Labour is usually outside the scope of procurement unless outsourcing activities are being considered. Within this context, outsourcing call centres to the Far East has reduced some labour costs by more than 20 per cent for European-based organisations. Similarly, when labour is outsourced within Europe under TUPE (Transfer of Undertakings Protection of Employment) regulations, labour costs have also been reduced by more than 20 per cent. This is achieved by finding smarter ways of working and redeploying the labour to other roles. There is also the factor of the labour becoming more productive by using advanced IT systems. These cost improvements require a short-term investment by the new provider of services.

Expenditure on materials and services that are purchased from third parties is where professional buyers must demonstrate their effectiveness in obtaining value for money. The benefits can be highlighted in organisations driven by the profit motive. It is the case that:

- assuming other variables remain constant, every pound saved on procurement is a pound of profit
- for many reasons, such as increased defects or poorer deliveries, a pound off the purchase price does not necessarily represent a pound of profit
- when purchases form a high proportion of total costs, a modest saving on bought-out items will result in a similar contribution to profits as would a substantial increase in

sales; so, as shown below, a 4 per cent reduction in purchase costs makes the same contribution to profits as a 20 per cent expansion in turnover.

Sales			
Then	Now	Increase	Extra profit
£	£	%	£
100,000	120,000	20	2000 (assuming 10 per cent on turnover)
Procurement			
50,000	48,000	-4 (i.e. a saving)	2000

This argument must, however, be used carefully.

- Cost reduction can be counter-profitable if the result is lower quality or higher expenditure on production.
- The total cost of ownership (TCO) approach emphasises that not just the purchase price but also all costs associated with the acquisition, use and maintenance of an item should be considered.
- As the proportion of expenditure on supplies and the complexity of bought-out items varies widely from organisation to organisation, it follows that there will be a corresponding variance in the contribution of procurement to profitability.

The profit contribution may be low, for example, in the pharmaceutical industry where the ingredients of a patent medicine can be insignificant compared with the costs of marketing the product. Conversely, it will be significant in the motor vehicle industry where the proportion of material costs to total factory costs is high.

Procurement as a factor in profitability is likely to be critical where:

- bought-out items form a high proportion of total expenditure
- short-run prices fluctuate
- judgments relating to innovation and fashion are involved
- markets for the finished product are highly competitive.

Procurement will be less critical, though still important, where:

- bought-out items form a small proportion of total expenditure
- prices are relatively stable
- there is an absence of innovation in operations.

Within non-manufacturing organisations the savings resulting from value-for-money efficiency procurement may allow increased expenditure in other areas.

1.9.2 Focus

Syson¹⁵ states that the position of procurement within a particular organisation depends on whether the focus of the function is transactional, commercial or strategic. Each of these foci is appropriate to sustaining commercial advantage for different types of enterprise: ‘in terms of effectiveness, the key question is whether the correct focus exists. In terms of efficiency, how well are the key tasks discharged?’ Over time, the focus of procurement may, as shown in Figures 1.4 and 1.5, change from transactional to a procedure perspective. The more procurement becomes involved in commercial and strategic areas, the greater will be its effectiveness and consequent standing within the organisation.

In Figures 1.4 and 1.5 it will be noticed that as PSM moves from a transactional to a pro-activity focus, performance measures also change from efficiency to effectiveness.

- *Efficiency* is a measure of how well or productively resources are used to achieve a goal.
- *Effectiveness* is a measure of the appropriateness of the goals the organisation is pursuing and of the degree to which those goals are achieved.

Syson¹⁶ refers to the level of the procurement department, implying that the level at which procurement is placed in a hierarchical structure reveals its status within that

Figure 1.4 Positioning graph strategies/policies

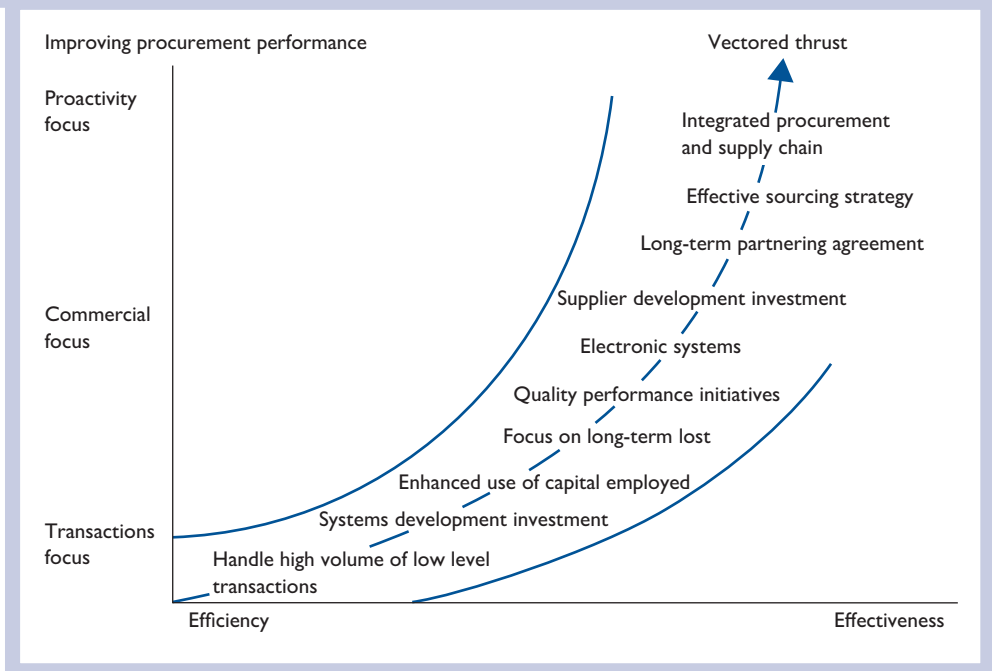
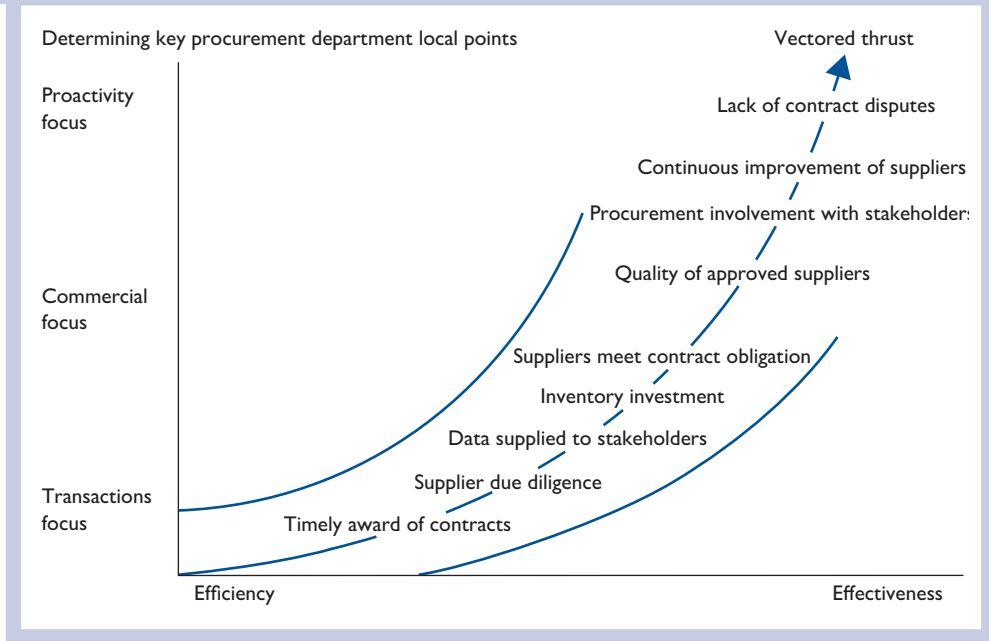


Figure 1.5 Positioning graph: measures of performance.



company. From a different perspective, broadly similar considerations will apply in determining the recognition given to procurement by other supply chain members.

A somewhat different approach to determining the internal status of procurement is provided by the three laws propounded by Farmer:¹⁷

- 1 Procurement increases in perceived importance in direct relationship with the reduction in length of the product lifecycle times.
- 2 Procurement is perceived to be important when the business concerned interfaces significantly with a volatile market(s).
- 3 Procurement is important whenever the organisation concerned spends a significant proportion of its income on procurement goods and services in order to allow it to do business.

Empirically, the importance of procurement both organisationally and within the supply chain is indicated by structural and influential factors.

Structural factors

These include:

- the job title of the executive responsible for PSM
- to whom and at what level the executive in charge of PSM reports
- the total spend for which PSM is responsible
- the financial limits placed on PSM staff to commit the undertaking without recourse to higher authority
- the committees on which PSM staff are represented.

Influential factors

Ibarra¹⁸ has identified network centrality, power and innovative involvement as important influential factors in the determination of status.

Network centrality, like formal authority, implies a high position in a status hierarchy and also varying degrees of access to and control over valued resources. As stated in section 3.2.1, procurement is frequently a key activity in materials management. Procurement is also central in supply chains, as indicated in section 3.10.

Power may be considered from two aspects: the sources of power and the use of power. The sources of power are briefly considered in section 4.1.4. The use of power may be defined as the ability to affect outcomes.

The executives in charge of PSM may have all the five sources of power identified by French and Raven in section 4.1.4. Executives also derive power from having access to information or occupying a boundary-spanning position that links organisations' internal networks to external suppliers and information sources.

Innovative involvement, as Ibarra shows, may be either administrative or technical and may itself be an indicator of power as any change in the status quo requires an individual to use power and mobilise support, information and material resources to overcome resistance to change. Persons with a high position in the organisation are more likely to be successful innovators than those further down with less or little power.

Technical innovators are directly related to the primary work activity of an organisation and include the introduction of new products, services and production technologies.

Administrative innovations involve changes in structure and administrative processes and are more directly related to internal management than the other types of innovation. Kanter's¹⁹ observation that 'corporate entrepreneurs have often to pull in what they need for their innovation from other departments or areas, from peers over whom they have no authority and who have the choice about whether or not to ante up their knowledge, support or resources to invest in or help the innovator' is of relevance to both supply chain management and the centrality of procurement within it.

The status of PSM in any organisation depends on two key factors. First, the ability to impact positively on the bottom line of corporate strategic planning and, second, recognition by PSM of the value of its contribution to profitability and competitive advantage and being able to market that contribution to top management and other supply chain members.

1.9.3 Professionalism

As long ago as 1928, Carr-Saunders and Wilson²⁰ made a distinction between professionalism and professionalisation. *Professionalism* is traditionally associated with certain attributes, including:

- skill based on theoretical knowledge
- prolonged training and education
- demonstration of competence by means of tests and examinations
- adherence to a code of professional ethics.

Professionalisation is associated with the development of associations that seek to establish minimum qualifications for entrance to a professional practice or activity, enforce appropriate rules and norms of conduct among the members of the professional group

and raise the status of the professional group in the wider society. Thus, attempts to raise the external perception of procurement have included:

- the establishment of institutions concerned with promoting the concept of ‘professional’ procurement, such as the Chartered Institute of Procurement and Supply (CIPS) in the UK and the Institute of Supply Management (ISM) in the USA (in 2004, over 42 national procurement associations were affiliated to the International Federation of Procurement and Materials Management)
- the development of undergraduate and postgraduate courses with a procurement content
- the establishment of ‘chairs’ in procurement or logistics at some universities
- research into PSM and related fields
- the publication of textbooks and specialist journals relating to procurement, such as *Supply Management (UK)*, *European Procurement Management* and the *International Journal of Procurement and Supply Management*, as well as, in the logistics field, *Logistics Focus* and the *International Journal of Logistics*
- published codes of ethics (see Appendices 1 and 2).

Notwithstanding the enhanced status of procurement in the UK by the granting in 1992 of a Royal Charter to the then Institute of Purchasing and Supply, the occupation has to surmount difficulties in its quest for professional status.

Such difficulties include:

- no regulation of entry – it is not necessary to have a professional qualification in procurement to enter the occupation
- procurement practitioners are at all levels of evolution, so those with only an operational or transactional knowledge of procurement might experience difficulty in moving to strategic procurement
- limited powers to enforce ethical standards.

The general problem, however, is what constitutes the academic content. Procurement is a hybrid subject that draws heavily on other disciplines to build its knowledge base. Such disciplines include accounting, economics, ethics, information technology, marketing, management and psychology.

Even the study of subjects such as negotiation can be enhanced by knowledge of the approaches to negotiation in such fields as politics and industrial relations.

Cox²¹ regards much contemporary academic work relating to procurement as ‘unscientific’, characterised by uncritical accounts of what procurement practitioners do, untheoretical research and the development of ‘fads and short-term fixes’. Such academic work is often regarded as irrelevant by procurement practitioners. Cox therefore calls for a proactive, scientific approach to the academic study of procurement. He believes that such an approach will involve the use of systematic theory to provide general laws and the application of deductive and inductive reasoning to respectively ‘construct optional procurement strategies based on “fit for purpose” awareness of business and market processes and indicate the optional role for procurement in business’.

The change in emphasis from procurement as a reactive administrative activity to one that is proactive and strategic has resulted in numerous lists of the skills and attributes that procurement staff should possess in order to maximise their contribution to the achievement of organisational goals.

In a client survey, in Europe (2018) by Farrington²² the following ten procurement areas were identified as most relevant at a corporate level:

- 1 Management of supply chain risks
- 2 Access to latest technology
- 3 Competitive purchase prices
- 4 Effective supplier relationship management
- 5 Timely decision making
- 6 Cash flow
- 7 Demonstrable procurement skills
- 8 Forecasting of forward procurement prices
- 9 Zero defects on incoming goods and services
- 10 Contribution to corporate strategy.

A study, by Giunipero and Pearcy²³ based on a review of relevant literature and a rating by 136 procurement/supply management professionals identified 32 skills required of a world-class purchaser. These skills were categorised under seven headings:

- 1 Strategic
- 2 Process management
- 3 Team
- 4 Decision making
- 5 Behavioural
- 6 Negotiation
- 7 Quantitative.

Examples of strategic, behavioural and quantitative skills are:

<i>Strategic skills</i>	<i>Behavioural skills</i>	<i>Quantitative skills</i>
Strategic thinking	Interpersonal/communication	Computational
Supply base research	Risk-taking/entrepreneurship	Technical
Structuring supplier relationships	Creativity	Blueprint reading
Technology planning	Inquisitiveness	Specification development
Supplier cost targeting		

Whittington²⁴ has stated that ‘the buying task as we know it will disappear . . . Organisationally, procurement will often find itself in a place called “distribution functionality” or “strategic supply” located where the customer is’. She also believes that the procurement professional of the future will be concerned with three types of tasks:

- *facilitating* that is, team leadership and providing the ‘proper blending and use of all necessary skills’
- *contract negotiating and developing* that is, procurement people – this will still be required – to write and negotiate advantageous contracts for the organisation
- *technical expertise (computer skills)* that is, the challenges of procurement on the Net and funding products in the world of cyberspace as well as other EDI tasks.

This view is supported by Lamming (see section 1.4.2) and others. In the Kolchin study referred to above, almost two-thirds of the respondents believed that the designation of procurement would change. The three most cited new names were ‘supply management’, ‘sourcing management’ and ‘logistics’.

1.10 Reflections on procurement positioning in business

Procurement specialists should, at all times, question the progress being made by procurement and its positioning in business. There is a plethora of academic studies, independent reviews by audit authorities and consultancy organisations linking their findings to the subliminal message that procurement can make things a lot better.

Volvo have said: ‘The awarding of business to a supplier is one of the most important decisions made by Volvo Purchasing. It directly impacts our ability to deliver to the customer, remain competitive and deliver future developments through projects’. This statement puts the role of procurement in a very positive corporate context. Procurement is in control of its destiny. The highest standards of professional practice, personal standards of procurement staff and delivering positive corporate change are necessary facets of success.

1.11 The scope of procurement in the public sector

Public sector procurement is the subject of Chapter 12. Within the public sector there are nuances when compared with the private sector. The scope of public sector procurement includes:

- compliance with the organisations ‘standing orders’
- compliance with all regulatory requirements
- ensuring competition is founded on ethical standards
- public visibility of procurement processes and contract awards
- issuing invitations to tender and pre-qualification documentation
- exposing cost drivers behind the contract price
- negotiation
- providing expert advice to ministers, officials and appointed representatives
- contract management
- achieving supplier’s compliance with goods and service specifications.

Discussion questions

- 1.1 Procurement often lacks a strategic focus and, in consequence, is viewed as an administrative function. Do you agree? Why?
- 1.2 Taking one example of ‘an important purchase’ in your organisation, prepare a flow chart showing the processes involved in procuring that purchase. Can you then identify the decision points?

- 1.3 Name four procurement risks that exist in your organisation.
- 1.4 What do you believe will be the business challenges facing procurement over the next decade?
- 1.5 In what significant ways does public sector procurement differ from private sector procurement?
- 1.6 There are major advantages transferring technical specialists into procurement whereby they can add their expertise to commercial decisions. Would you agree with this? Why?
- 1.7 How does procurement contribute to managing corporate risks?
- 1.8 Many procurement actions are conducted electronically. What do you foresee as the next major development in this regard? When you answer this, think about reverse auctions and their impact on negotiation of price and cost.
- 1.9 Would it be true that when procurement is effectively organised and operated the balance of power can never be with a supplier?
- 1.10 In what ways is it helpful for a buyer to have technical knowledge of the categories they procure?
- 1.11 Do long-term contracts present less, equal or more risk to a buying organisation than short term contracts?

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Chapter 2

Strategic procurement

Learning outcomes

With reference, where applicable, to business and procurement, this chapter aims to provide an understanding of:

- strategic thinking
- what is strategy?
- strategy development
- levels of organisational strategy
- corporate strategy
- growth strategies
- business-level strategy
- strategic management
- strategic analysis
- important environmental factors
- internal scrutiny
- strategy formulation
- the evaluation of alternative strategies
- strategy implementation
- post-implementation evaluation, control and review
- strategic procurement and supply chain process models

Key ideas

- Strategies are a key ingredient of business success.
- Mintzberg, Johnson and Scholes and the definitions of strategy.
- Mintzberg's ten schools of strategic development.
- Rational planning, incremental and emergent views of strategy.
- Growth, stability, combination and retrenchment strategies.
- Strategic procurement and procurement strategy.
- Environmental and internal scanning to strengthen strategic formulation and challenge.

- Linking procurement strategies to corporate strategic objectives.
- Critical success factors.
- Vision and mission statements and business, procurement and supply objectives.
- Lifecycles, scenario planning, cost–benefit, profitability and risk analysis as approaches to the evaluation of strategies.
- Portfolio planning with special reference to Kraljic and Kamann.
- Policies and strategy implementation plans.
- The CIPS procurement and supply chain model.

Introduction

Procurement occurs within a corporate environment, wherein there will be a long-term business strategy. Procurement also occurs in relatively small organisations, sometimes on a single site. In many of these situations, long-term business planning may not exist, or if it does, it will be at a superficial level. Understanding and contributing to delivery of the strategy is a vital driver for procurement. Wheelen and Hunger¹ have produced a checklist for conducting a strategic audit of a corporation. Within the ‘Internal Environment: Strengths and Weaknesses’ is a checklist for ‘Operations and Logistics’. It is an excellent prompt for procurement specialists (noting carefully that they use the term ‘purchasing’) and consists of the following:

- a What are the corporations’ current manufacturing/service objectives, strategies, policies and programmes?
 - i. Are they clearly stated or merely implied from performance or budgets?
 - ii. Are they consistent with the corporation’s mission, objectives, strategies and policies and with internal and external environments?
- b What are the type and extent of operations capabilities of the corporation? How much is done domestically versus internationally? Is the amount of outsourcing appropriate to be competitive? Is purchasing being handled appropriately? Are suppliers and distributors operating in an environmentally sustainable manner? Which products have the highest and lowest profit margins?
 - i. If the corporation is product-oriented, consider plant facilities, type of manufacturing system (continuous mass production, intermittent job shop, or flexible manufacturing), age and type of equipment, degree and role of automation and/or robots, plant capacities and utilisation, productivity ratings, and availability and type of transportation.
 - ii. If the corporation is service-oriented, consider service facilities (hospital, theatre or school buildings), type of operations systems (continuous service over time to the same clientele or intermittent service over time to various clientele), age and type of supporting equipment, degree and role of automation and use of mass communication devices (diagnostic machinery, video machines), facility capacities and utilisation rates, efficiency ratings of professional and service personnel, and availability and type of transportation to bring service staff and clientele together.

- c Are manufacturing or service facilities vulnerable to natural disasters, local or national strikes, reduction or limitation of resources from suppliers, substantial cost increases of materials, or nationalisation by governments?
- d Is there an appropriate mix of people and machines (in manufacturing firms) or of support staff to professionals (in service firms)?
- e How well does the corporation perform relative to the competition? Is it balancing inventory costs (warehousing) with logistical costs (just-in-time)? Consider costs per unit of labour, material and overhead; downtime; inventory control management and scheduling of service staff; production ratings; facility utilisation percentages; and number of clients successfully treated by category (of service firm) or percentage of orders shipped on time (if product firm).
 - i. What trends emerge from this analysis?
 - ii. What impact have these trends had on past performance and how might these trends affect future performance?
 - iii. Does this analysis support the corporation's past and pending strategic decisions?
 - iv. Do operations provide the company with a competitive advantage?
- f Are operations managers using appropriate concepts and techniques to evaluate and improve current performance? Consider cost systems, quality control and reliability systems, inventory control management, personnel scheduling, total quality management (TQM), learning curves, safety programmes and engineering programmes that can improve efficiency of manufacturing or of service.
- g Do operations adjust to the conditions in each country in which it has facilities?
- h Do operations consider environmental sustainability when making decisions?
- i What is the role of the operations manager in the strategic management process?

A critic of Wheelen and Hunger would point to the paucity of procurements' inclusion in 'Operations and Logistics'. Dr Farrington has developed SPA (strategic procurement audit) to test procurement's ability to withstand an SPA. The top 12 facets are:

- 1 Does a comprehensive procurement strategy exist?
- 2 Is there a linkage between the corporate and procurement strategies?
- 3 Is there a global dimension to procurement?
- 4 How is supply guaranteed in times of shortage?
- 5 How are long-term contract prices forecast and managed?
- 6 Is the procurement strategy founded on expert supply chain knowledge?
- 7 Does outsourcing feature in the strategy?
- 8 How is genuine partnering behaviour incorporated in the strategy?
- 9 How are single sourced supply situations evaluated for risk?
- 10 What are the strategic provisions for inventory in our contracts?
- 11 Have all intellectual property considerations been taken into account?
- 12 At what frequency is the strategy reviewed, and who is involved in the review?

2.1 Strategic fit between the supply chain and competitive strategies

Chopra and Meindl² logically argue that:

a competitive strategy will specify, either explicitly or implicitly, one or more customer segments that a company hopes to satisfy. To achieve strategic fit, a company must ensure that its supply chain capabilities support its ability to satisfy the needs of the targeted customer segments. There are three basic steps to achieving this strategic fit, namely:

- 1 Understanding the customer and supply chain uncertainty
- 2 Understanding the supply chain capabilities
- 3 Achieving strategic fit.

2.2 What is strategy?

Strategy, derived from the Greek word *strategia*, means ‘generalship’. Ohmae³ argued that ‘what business strategy is all about is, in a word, competitive advantage. The sole purpose of strategic planning is to enable a company to gain, as efficiently as possible, a sustainable edge over its competitors. Corporate strategy thus implies an attempt to alter a company’s strength relative to that of its competitors in the most efficient way.’ In the public sector, the strategy is concerned with providing a range of public services that deliver value for money, with all that this implies.

2.2.1 Definitions – Mintzberg

Mintzberg⁴ observes that the word ‘strategy’ ‘has long been used implicitly in different ways even if it has been traditionally used in only one’. He provides five different definitions of strategy: plan, ploy, pattern, position and perspective.

- 1 As a *plan*, strategy is some sort of consciously intended course of action, a guideline (or set of guidelines) to deal with a situation. From this perspective, strategy is concerned with how leaders try to provide organisational direction and predetermined courses of action. It is also concerned with cognition (knowing), or how plans or intentions are initially conceived in the human brain.
- 2 As a *ploy*, strategy is a specific manoeuvre intended to outwit an opponent or competitor.
- 3 As a *pattern*, strategy is a stream of actions demonstrating consistency in behaviour, whether intended or not intended.
- 4 As a *position*, strategy is a means of locating an organisation in an environment. The positional approach sees strategy as ‘a mediating force by which organisations find and protect their positions or “niches” in order to meet, avoid or subvert competition in the external environment’.
- 5 As a *perspective*, strategy is a concept or ingrained way of perceiving the world. Mintzberg points out that ‘strategy in this respect is to the organisation what personality is to the individual’ – that is, distinct ways of working deriving from the culture or ideology of the undertaking that become the shared norms, values and determinants of the behaviour of the people who collectively form the organisation.

Mintzberg's five definitions help us to avoid attaching simplistic meanings to strategy. As he observes:⁵

Strategy is not just a notion of how to deal with an enemy or set of competitors in a market. . .

A good deal of confusion. . . stems from contradictory and ill-defined uses of the term strategy. By explicating and using various definitions, we may thereby enrich our ability to understand and manage the processes by which strategies form.

2.3 Strategy development

2.3.1 Mintzberg's ten schools

Mintzberg *et al.*⁶ have identified ten 'schools' that have appeared at different stages in the development of strategic development, which they classify under three headings: prescriptive, descriptive and configuration.

Prescriptive schools are concerned with how strategies *should* be formulated, rather than how they actually are. Mintzberg's three prescriptive schools are shown in Table 2.1.

Descriptive schools are concerned with representing how, in reality, strategies are formulated rather than how they 'ought' to be made. Mintzberg's six descriptive schools are shown in Table 2.2.

The *configuration school* emphasises two aspects of strategy. The first describes 'organisational states' and their surroundings as *configurations*. An organisation 'state' implies entrenched behaviour. Configurations are therefore relatively stable clusters of characteristics relating to a particular school. Thus, 'planning' is predominant in mechanistic conditions of relative stability and 'entrepreneurship' in more dynamic configurations of start-up and turnaround. The configuration school, therefore, can integrate the preceding nine schools as it recognises that each school represents a particular configuration contingent on its time and context.

The second aspect is concerned with *transformation*. The configuration school sees strategy formation as a process of transformation or 'shaking loose' entrenched behaviour so that the organisation can make the transformation or development to a new state or configuration. The key to strategic management, therefore, is to sustain stability but periodically recognise the need for change to a new configuration.

Table 2.1 Mintzberg's prescriptive schools of strategy formation

Designation	Strategy formation process
The design school	Strategy making as a process of <i>conception</i> – that is, abstract thinking or reflective activity. Strategy making is an acquired, not a natural or intuitive, skill and must be learned formally
The planning school	Strategy formation as a <i>formal</i> process – that is, a course of action or procedures
The positioning school	Strategy formation as an <i>analytical</i> process – that is, strategy formation is the selection of generic, specifically common, identifiable positions in the marketplace based on analytical calculations

Table 2.2 Mintzberg's descriptive schools of strategy formation

<i>Designation</i>	<i>Strategy formation process</i>
The entrepreneurial school	Strategy formation as a <i>visionary</i> process – that is, strategy exists in the mind of the leader as a vision of the organisation's long-term future
The cognitive school	Strategy formation as a <i>mental</i> process – that is, strategy formation takes place in the mind of the strategist as a process of perceiving, knowing and conceiving the environment in an objective way, distinct from emotion or volition
The learning school	Strategy formation as an <i>emergent</i> process of learning over time, in which, at the limit, formulation and implementation become indistinguishable
The power school	Strategy formation as a process of <i>negotiation</i> – that is, strategy is shaped by political games involving transient interests and coalitions of those holding internal or external power who seek to arrive at a consensus on strategy by means of persuasion, bargaining and sometimes direct confrontation
The cultural school	Strategy formation as a <i>collective</i> process – that is, strategy formation is a process of social interaction based on beliefs and understandings shared by organisational members
The environmental school	Strategy formation as a <i>reactive</i> process – that is, adapting to the environment rather than by initiating changes in the environment

2.3.2 Strategic drift

Market types have an impact on procurement; a phenomenon not always recognised.

- (i) Slow-cycle markets are those in which products have strongly shielded positions where competitive pressures do not easily penetrate the firm's sources of strategic competitiveness. This is described as a monopoly position, such as that held by IBM for many years.

The impact on procurement may be:

- no pressure to negotiate prices to drive down costs
- tolerance of suppliers who fail to innovate
- insistence that suppliers comply with specifications without challenge
- buyers trapped in traditional procurement practices.

- (ii) Standard-cycle markets where business strategy and organisation are designed to serve high-volume or mass markets. The likely focus is on market control as in the automobile and appliance industries. Market dominance is achieved through capital investment, superior learning and the use of expert resources. Eventually, competition is attracted by high profits. Examples are Coca-Cola, Ford and Boeing.

The impact of market dominance on procurement may be:

- long-term contracts with static scheduled deliveries
- reliance on large-scale suppliers
- narrow concentration of buyers on category procurement
- complacent procurement behaviour based on power positioning.

(iii) Fast-cycle markets are characterised by perpetual innovation and shorter product cycles. When a dominant firm fears competition, they seek to counter attack before the competitive advantage is eroded. An example of fast-cycle markets is Komatsu challenging Caterpillar's dominance.

The impact on procurement may be:

- a challenge to continually seek supplier's innovation
- application of value engineering
- aggressive negotiation for cost reduction
- constantly changing supplier base.

World-class procurement is founded on a recognition that, regardless of the market type, procurement must challenge suppliers to provide continuous improvement, drive out unnecessary costs and invest in relationship management.

2.4 Levels of organisational strategy

As shown in Figure 2.1, in a typical large, diversified business, strategies are formulated, evaluated and implemented at three levels.

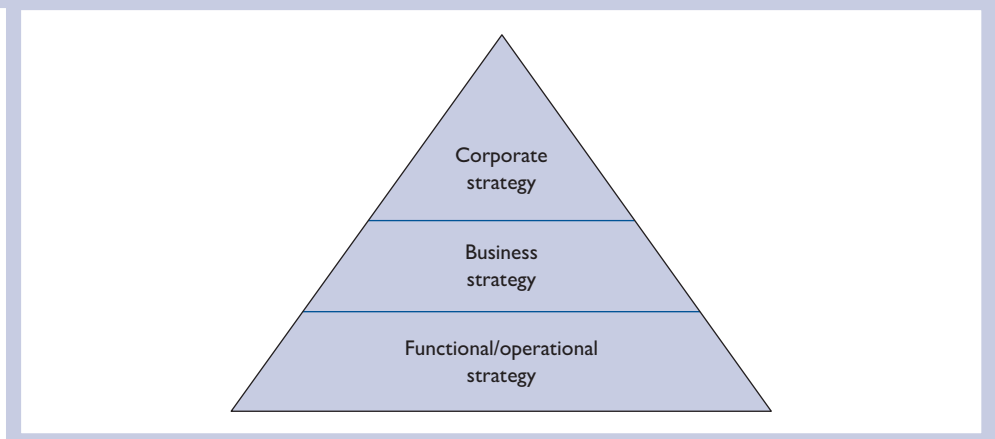
For non-diversified undertakings and those with only one line of business, corporate and business strategies are normally synonymous.

2.5 Corporate strategy

Generally, corporate strategies are concerned with:

- determining what business(es) the enterprise should be in to maximise profitability
- deciding 'grand' strategies (see below)
- determining the 'values' of the enterprise and how it is to be managed.

Figure 2.1 Levels of organisational strategy



- coordinating and managing major resources and relationships between the enterprise, its markets, competitors, allies and other environmental factors
- deciding on business locations and structures.

Because corporate strategies provide long-term direction, they change infrequently. Corporate strategies are usually less specific than those at lower levels and, consequently, are more difficult to evaluate.

2.6 Growth strategies

These are adopted when an organisation seeks to expand its relative market share by increasing its level of operations. Growth strategies can be classified as shown in Figure 2.2.

2.6.1 Integration strategies

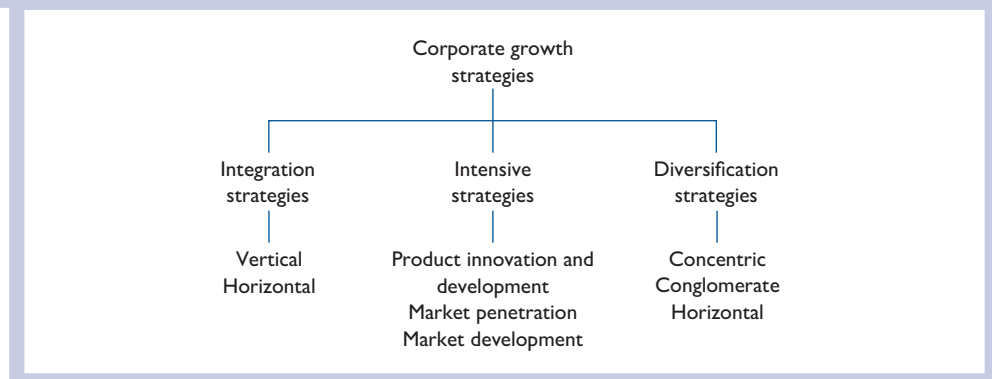
Vertical integration strategies reflect the extent to which an organisation expands *upstream* into industries that provide inputs (*backward integration*), such as a car manufacturer acquiring a steel rolling mill, or *downstream (forward integration)* into industries that distribute the organisation's products, such as a car manufacturer acquiring a car distribution chain.

Backward integration

Backward integration seeks to ensure continuity of supplies by owning or controlling suppliers. David⁷ has identified the following conditions that might cause an organisation to adopt a backward integration strategy, all of which have procurement and supply applications:

- when an organisation's present suppliers are especially expensive, unreliable or incapable of meeting the firm's needs for parts, components, assemblies or raw materials
- when the number of suppliers is few and the number of competitors is many

Figure 2.2 Growth strategies



- when an organisation competes in an industry that is growing rapidly (in a declining industry, vertical and horizontal strategies reduce an organisation's ability to diversify)
- when an organisation has both the capital and human resources needed to manage the new business of supplying its own raw materials
- when the advantages of stable prices are particularly important (this is a factor because an organisation can stabilise the cost of its raw materials and the associated price of its product via backward integration)
- when present suppliers have high profit margins, which suggest that the business of supplying products or services in the given industry is a worthwhile venture
- when an organisation needs to acquire a needed resource quickly.

A further important factor may be:

- to reduce dependence on suppliers of critical components.

Forward integration

Forward integration can:

- avoid dependence on distributors who have no particular allegiance to a particular brand or product and tend to 'push' items that yield the highest profits
- provide production with stable, continuous and predictable demand requirements
- provide cost savings by eliminating intermediaries or distributors.

Some disadvantages of vertical integration include:

- difficulties in balancing capacity at each stage of the supply chain as the efficient scale of operation of each link in the supply chain can vary, so, when internal capacity is inadequate to supply the next stage it will be necessary to supply the deficiency by buying out and, conversely, excessive capacity gives rise to the need to dispose of the surplus
- high investment in technology and development may inhibit innovation and change due to the need to redesign, retool and retrain.

Backward or forward integration often call for highly diversified skills and abilities, such as manufacturing, transport and distribution, which require different business capabilities.

For the above reasons, many manufacturers – particularly in car and food manufacture – have abandoned vertical integration in favour of:

- outsourcing
- tiering of suppliers, e.g. Tier 1 supply direct to original equipment manufacturer (OEM)
- long-term partnerships or joint-venture agreements with suppliers
- *Keiretsu* strategies (*Keiretsu* is the Japanese word for 'affiliated chain' and such chains comprise mutual alliances that extend across the entire supply chain of suppliers, manufacturers, assemblers, transporters and distributors)
- the creation of virtual companies that use suppliers on an 'as needed' basis.

Horizontal integration

Horizontal integration focuses on expanding operations by acquiring other enterprises operating in the same industry or merging with competitors. Examples of horizontal integration are mergers, acquisitions and takeovers aimed at:

- reducing competition
- increasing economics of scale
- transferring and integrating resources and competences.

2.7 Business-level strategy

A strategic business unit (SBU) has been defined⁸ as:

An operating unit or planning focus that groups a distinct set of products or services that are sold to a uniform set of customers facing a well-defined set of competitors.

Generally, business-level strategies are concerned with:

- coordinating and integrating unit strategies so that they are consistent with corporate strategies
- developing the distinctive competences and competitive advantages of each unit
- identifying product market niches and developing strategies for competing in each
- monitoring products and markets so that strategies conform to the needs of product markets at their current state of development.

The selection of a business strategy involves answering the strategic question ‘How are we going to compete in this particular business area?’

One approach to business-level strategy is the competitive strategy of Michael Porter.⁹

2.7.1 Porter’s competitive strategy

Competitive strategies are based on some combination of quality, service, cost and time. Porter’s typology identifies three strategies that can be used to give SBUs a competitive advantage.

- *Cost leadership* – operating efficiencies so that an organisation is the low-cost producer in its industry. This is effective when:
 - the market comprises many price-sensitive buyers
 - there are few ways to achieve product differentiation
 - buyers are indifferent regarding brands (Coke *v* Pepsi).

Some potential threats to this strategy are that:

- competitors may imitate this strategy, thus driving profits down
 - competitors may discover technological breakthroughs
 - buyer preferences may be influenced by differentiating factors other than price (see also section 3.8.1).
- *Differentiation* – attempting to develop products that are regarded industry-wide as unique (see also section 3.8.2).

- *Focus* – concentration on a specific market segment and within that segment attempts to achieve either a cost advantage or differentiation. Because of their narrow market focus, firms adopting a focus strategy have lower volumes and therefore less bargaining power with their suppliers.

2.7.2 Functional strategies

These are concerned with the formulation of strategies relating to the main areas or activities that constitute a business – procurement, finance, research and development, marketing, production/manufacturing, human resources and logistics/distribution.

Functional strategies are expected to derive from and be consistent with corporate and business strategies and are primarily concerned with:

- ensuring that the skills and competencies of functional specialists are utilised effectively
- integrating activities within the functional/operating area, such as procurement and marketing
- providing information and expertise that can be utilised in the formulation of corporate and business strategies.

The selection of functional strategies involves answering the strategic question ‘How can we best apply functional expertise to serve the business needs of the SBU or organisation?’

Strategic procurement and procurement strategy

Strategic procurement is the linking of procurement to corporate or business strategies.¹⁰ Some comparisons between procurement at the corporate and functional levels are shown in Table 2.3.

Some procurement decisions, such as those relating to the acquisition of capital equipment, outsourcing and entering into long-term partnership alliances, are generally made at the corporate/business level, often on the basis of information or recommendations from procurement at functional or operational levels. As stated in Chapter 1, the extent to which procurement is involved in the formation of organisational strategies is largely dependent on the extent to which procurement is perceived by top management as contributing to competitive advantage. The procurement executive who reports directly to

Table 2.3 Procurement strategy at corporate and functional levels

<i>Corporate/business level</i>	<i>Functional/operational level</i>
Formulated at higher levels in the hierarchy	Taken at lower levels in the hierarchy
Emphasise procurement effectiveness based on widespread environmental scanning. Some of this information will be communicated upwards from functional level	Emphasise procurement efficiency based on information from a more limited environmental scanning. Some information obtained from suppliers etc. may be communicated upwards
Corporate strategy must be communicated downwards	Integrated with corporate strategies so far as these are communicated and understood
Focused on issues impacting future long-term procurement requirements and problems	Focused on issues impacting current tactical procurement requirements and problems

the chief executive is clearly in a stronger position to influence organisational strategy than one lower in the hierarchy who reports to a materials or logistics manager. Irrespective of their level of reporting, procurement staff should contribute to corporate strategy by the provision of supply market intelligence on the basis of which decisions can be made and to competitive advantage by improving the effectiveness of the function.

Kraljic¹¹ states that a company's need for a supply strategy depends on:

- the strategic importance of procurement in terms of the value added by the product line and the percentage of materials in total costs
- the complexity of the supply market, gauged by supply scarcity, pace of technology and/or materials substitution, entry barriers, logistics cost or complexity and monopoly or oligopoly condition.

Kraljic claims that:

By assessing the company's situation in terms of these two variables, top management and senior purchasing executives can determine the type of supply strategy the company needs both to exploit its purchasing power vis-à-vis important suppliers and reduce its risk to an acceptable minimum.

2.7.3 Procurement strategy

Procurement strategy relates to the specific actions that procurement may take to achieve the objectives of the business. Some examples are shown in Table 2.4.

Table 2.4 Procurement strategy examples

<i>Situation</i>	<i>Solution</i>
A manufacturing company keeps failing to win work in the Far East because they cannot guarantee 'local content' by purchasing goods in the local Far East market	Revision of procurement strategy to include sourcing study in the Far East with the deliberate aim of purchasing at least 30 per cent of goods in Far East market
An international airline with a 'Buy British' strategy is not providing internationally competitive sources of supply, thereby reducing financial operating margins	Revision of procurement strategy to actively research international supply markets and locate new sources that offer competitive prices and world-class supply
Corporate procurement failing to meet the specific needs of SBUs where each SBU Managing Director is accountable for R.O.C.E. (Return on Capital Employed)	Revision of procurement strategy and organisation to create SBU procurement whose sole focus will be the SBU profitability
There are insufficient funds to refresh IT platform and lack of IT strategic and operational skills	Adopt an outsourcing strategy through which a credible third party will refresh the IT platform and IT support services, having accepted stringent contractual obligations for a long-term contract
An international financial institution has corporate procurement but use of the corporate agreements is not mandatory. Each operating company makes its own arrangements on key 'commodity' purchases, including travel	Corporate procurement briefs all locations of the benefits of corporate agreements and makes their use mandatory
An Atomic Electricity Generating organisation tenders, every year, the supply of scaffolding and specialist engineering support services	Agree that a long-term strategy through the tendering and award of a 5–7-year contract in return for static pricing and contract performance

2.7.4 Global procurement strategy

This is discussed in Chapter 15.

2.8 Strategic management

Strategic management, as shown in Figure 2.3, refers to the processes of strategic analysis, formulation, evaluation, implementation, control and review.

2.9 Strategic analysis

A useful definition is:¹²

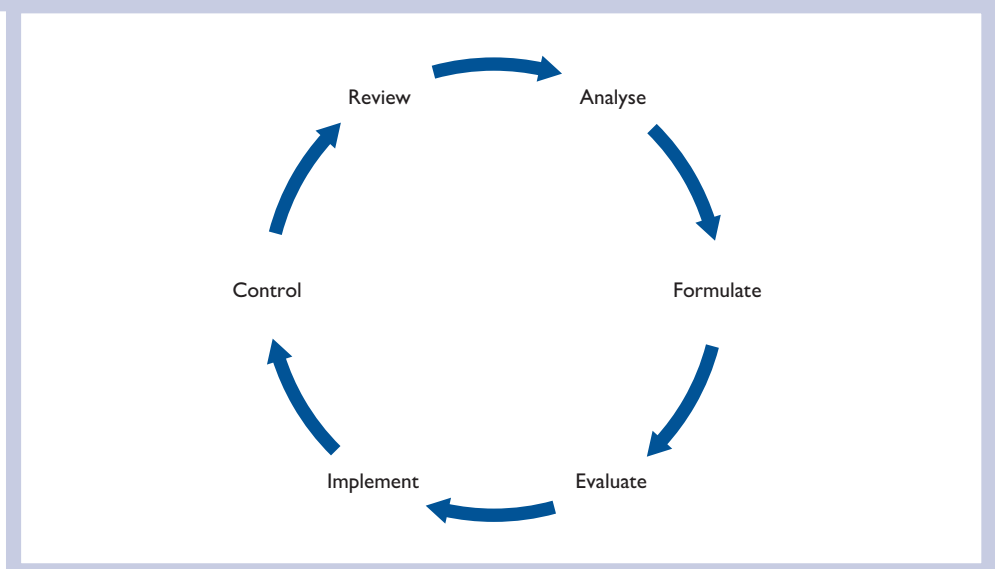
Developing a theoretically informed understanding of the environment in which the organisation is operating together with an understanding of the organisation's interaction with its environment in order to improve organisational efficiency and effectiveness by increasing the organisation's capacity to deploy and redeploy its resources intelligently.

The tools of strategic analysis include environmental scanning, Porter analysis, scenario analysis, organisational appraisal, critical success analysis, gap and strengths, weaknesses, opportunities, threats (SWOT) analysis.

2.9.1 Environmental scanning

Some writers regard 'the environment' as relating to all factors relevant to strategic management that are outside the boundaries of a particular organisation. Others think of the environment as encompassing both external and internal environments.

Figure 2.3 The cycle of strategic management



Environmental scanning has been described as ‘a kind of radar to scan the world systematically and signal the new, or unexpected, the major and minor’.¹³ Choo¹⁴ states that organisations monitor their environments to:

understand the external forces of change so that they may develop effective responses which secure or improve their position in the future. They scan to avoid surprises, identify threats and opportunities, gain competitive advantage and improve short-term and long-term planning.

2.10 Important environmental factors

Important external environmental factors relating to the strategy of an organisation are sector, industry and macro-environmental.

2.10.1 Sector

Sector relates to whether the enterprise is located in the private, public or voluntary sectors of the economy.

The *private sector* includes single traders, partnerships and companies owned by private investors. There is a wide variety of such undertakings that can be loosely classified according to their primary function into:

- *primary*, or extractive, organisations, such as agriculture, mining, fishing
- *secondary*, or manufacturing and assembly, organisations, such as food or car manufacturers
- *tertiary*, or distributive, organisations, concerned with the physical distribution of goods from producers to consumers, such as transport, wholesalers, retailers or providers of services, such as schools, hospitals.

The *public sector* in the United Kingdom comprises national government, local government, government-owned and controlled agencies and corporations and monetary institutions. The armed forces and the National Health Service commits large amounts of expenditure to their activities.

The *voluntary sector* describes bodies that are independent of government and business and are non-profit making, such as charities and churches.

Because of the wide variety of enterprises, some writers prefer to use the term ‘organisational’ in preference to ‘corporate’ strategy. Sector factors influence strategic management both at the organisational and functional levels.

At both levels, strategy is influenced by the underlying philosophy of the sector. Thus, what is known as the public–private paradox emphasises that, while business and government have much in common, ultimately they are different. Public-sector and private-sector procurement members of staff, for example, do many of the same things and are both increasingly focused on competitiveness. There are, however, substantial differences that, as shown in Table 2.5, help to determine their respective procurement strategies.

2.10.2 Industry

An industry can be defined as a group of companies within a sector offering products or services that are close substitutes for each other.

Table 2.5 Comparison of some public-sector and private-sector factors relating to procurement strategies

<i>Factor</i>	<i>Public sector</i>	<i>Private sector</i>
Aims	To provide the end users, members of the general public, with what they need when they need it and at the best value for money	To provide the enterprise with supplies that will enable it to achieve competitive advantage via positioning, cost and differentiation
Profit	Value for money spent irrespective of profit	Value for money spent commensurate with and as a contribution to profitability
Accountability	Procurement officers in central and local government are accountable and subject to audits for the spending of public money	Private procurement is accountable to the shareholders or owners of the undertaking for the spending of private money
Transparency	In the context of public procurement, transparency refers to the ability of all interested parties to know and understand how public procurement is managed	In the context of private procurement, the requirement for transparency is confined to those directly concerned, such as customers, suppliers and similar stakeholders
Procedures	In the interests of transparency, public procurement procedures are characterised by: <ul style="list-style-type: none"> ■ well-defined regulations and procedures open to public scrutiny, such as standing orders, EU directives ■ clear standardised tender documents and information ■ equal opportunity for all in the bidding process 	Fewer standardised procedures and greater flexibility on the part of procurement staff to make unilateral strategic decisions than in the public sector

Rivalry among competitors is central to the forces contributing to industrial competitiveness. It is important to understand, therefore, the factors that contribute to the attractiveness and competitiveness of an enterprise within the industry.

In a practical context, there is evidence that in the short term the enterprise can consider:

- selective tendering using penetration pricing as the strategy
- focusing on buying organisations who desire change from non-performing suppliers
- offering attractive delayed payment options to help buyer's cash flow
- aiming sales efforts to displace 'weak' suppliers
- promoting new systems to aid continuous improvement
- heavily investing in R & D to create new products/services
- radical changes to service delivery
- targeting the public sector outsourcing market where initial investment is required for replacement of legacy systems.

2.10.3 Macro-environmental factors

These are the changes in the political, economic, social, technological, environmental and legal environments that directly or indirectly affect the organisation, both sector and

industry-wise, as well as nationally and globally. These can be recalled by the mnemonic PESTEL:

- Political – the role of government, that is, regulator or participator, political ideology
- Economic – gross domestic product (GDP), labour rates, monetary and fiscal policies
- Social – social trends, socio-economic groupings, value systems, ethics
- Technological – changes, rates of technological change, costs and savings, patents
- Environmental – ‘Green’ considerations, disposal of products, atmospheric factors
- Legal – laws relating to competition, employment, the environment, consumer protection.

2.11 Internal scrutiny

This, in effect, is the internal scanning of resources, culture, value chains, structure and critical success factors.

2.11.1 Resources

Resources commonly identified are:

- *Money* enables an organisation to have the maximum choice between alternatives. An important aspect of money is liquidity or ready availability. Too much money tied up in plant or stocks may limit the ability of an enterprise to take advantage of opportunities.
- *Physical facilities* include plant and machinery. Important strategic factors are location, life, flexibility or alternative uses and the dangers of obsolescence. Such factors influence decisions regarding whether to buy or hire facilities or outsource some operations.
- *Human resources* include the specialised competences of the workforce and how easily specific attributes can be acquired or replaced. A further factor is the extent to which human resources can be replaced by technology. Non-availability of resources may limit the achievement of corporate goals and lead to the search for alternative means of acquiring them, such as via partnership agreements or outsourcing. Other resources, including patents and reputation, may provide an organisation with a competitive advantage over rivals in the same industry.
- *IT resources* facilitate rapid communication between the organisation and its external contacts, including suppliers and customers, in addition to being a source of intelligence.

2.11.2 Culture

Culture is ‘the way things are done round here’. Procurement is a vital part of an organisation’s culture. The way in which procurement conducts itself will impact on the organisation’s reputation. Examples of world-class procurement actions that enhance an organisation’s reputation include:

- conducting tender processes in a transparent manner
- providing opportunities for small companies to win contracts
- conducting negotiations in a professional manner
- not engaging in criminal or dubious personal/business practices

- adopting the highest ethical standards
- paying supplier's invoices on time
- not manipulating contracts to gain unfair price advantage.

2.11.3 Value chains and structure

These are dealt with in Chapters 3 and 4 respectively.

2.11.4 Critical success factors (CSFs)

A CSF has been defined as:¹⁵

An element of organisational activity which is central to its future success. Critical success factors may change over time and may include such items as product quality, employee attitudes, manufacturing flexibility and brand awareness.

In the design of new products, the early involvement of suppliers may be a critical success factor.

CSFs are linked to key tasks and priorities. *Key tasks* are what must be done to ensure that each critical success factor is achieved. *Priorities* indicate the order in which key tasks are performed.

Some critical success factors relating to procurement strategies include:

- total quality management
- tailored supply chains for specific categories
- just-in-time deliveries with strategic emergency inventory availability
- total cycle time reduction
- world-class supplier relationships
- complete visibility of the cost drivers on strategic purchases
- e-procurement platforms
- KPIs in place for the procurement department
- training and development of procurement staff and stakeholders
- environmental, product safety and ethical standards.

Procurement must have the objective of performing at the highest level to deliver a competitive edge to their organisation.

2.12 Strategy formulation

As we have seen, strategies can be formulated by a process of rational planning or may emerge incrementally. These two approaches are sometimes presented as conflicting, based on the concept that strategic planning is inimical to creative thinking. Instead, however, the two approaches should be seen as complementary. As Lawrence¹⁶ observes:

The essential point . . . is that strategic thinking and strategic planning are both necessary and none is adequate without the other, in an effective strategy making regime. The real challenge is how to transform today's planning process in a way that incorporates, rather than undermines strategic thinking.

Strategy formulation at corporate, business and functional levels relates to the:

- formulation of a vision statement
- preparation of a mission statement
- derivation of objectives
- application of SWOT analysis.

2.12.1 Vision statements

Vision, from a strategic aspect, has been defined as:¹⁷

A mental representation of strategy created or at least expressed in the head of the leader. That vision serves both as an inspiration and a sense of what needs to be done.

Such a vision is often the starting point for strategy formulation. The vision must, however, be communicated to others in a mission statement.

A vision statement articulates a realistic, credible and positive projection of the future state of an organisation or functions or operations within that operation.

A typical vision statement for the procurement activity might be:

To develop, as part of an integrated supply chain, world class procurement strategies, policies, procedures and personnel to ensure that, by means of effective sourcing, competitive advantage is achieved by, for example, lowered supplies costs, commensurate with quality, shortened supply cycles and good supplier relationships.

2.12.2 Objectives

Objectives are explicit statements of the results the organisation wishes to achieve. Corporate and business objectives are medium-term to long-term, strategic and general and usually cover growth, profitability, technology, products and markets. Functional or operational objectives are short-term, tactical and specific. Thus, 'elements of strategy at a higher management level become objectives at a lower one'.¹⁸

As we saw earlier, the classic definition of the overall procurement task is:

To obtain materials of the right *quality* in the right *quantity* from the right *source* delivering to the right *place* at the right *time* at the right *price*.

This definition is somewhat simplistic and, sadly, perpetuated, for the following reasons:

- the term 'right' is situational – each company will define 'right' differently
- what is 'right' will change as the overall procurement context and environment change
- the above rights must be consistent with corporate goals and objectives from which functional/operating goals and objectives are derived
- in practice, some rights are irreconcilable – for example, it may be possible to obtain the right quality, but not the right price as 'the best suppliers are often the busiest but also the most expensive'
- procurement objectives have therefore to be balanced according to overall corporate strategy and requirements at a given time; as shown in Table 2.6, procurement objectives derive from corporate objectives.