Organization of purchasing activities
Skills
+
Motivation
+
Organizing
(roles and responsibilities)
Two basic organizational structures

Centralized structure

Decentralized structure
Both structures have their pros...

Centralized
- strategic focus
- proximity to organizational decision makers
- greater buying specialization
- planning and research resources
- common procedures and policies
- standardization
- economies of scale
- common suppliers

Decentralized
- business unit autonomy
- clear roles and responsibilities
- simple reporting
- broad job definition
- easier communication and consideration to unit’s needs
- hides purchasing costs
- speed of response
- local expertise
- local suppliers
...and their cons

<table>
<thead>
<tr>
<th>Centralized</th>
<th>Decentralized</th>
</tr>
</thead>
<tbody>
<tr>
<td>lack of unit focus</td>
<td>communication difficult</td>
</tr>
<tr>
<td>job boredom</td>
<td>operational vs. strategic focus</td>
</tr>
<tr>
<td>minimizes differences in</td>
<td>sub-optimization</td>
</tr>
<tr>
<td>requirements</td>
<td>no economies of scale</td>
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<tr>
<td>one-way knowledge sharing</td>
<td>overlapping work</td>
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<tr>
<td>distance from users</td>
<td>limited expertise (part-time buyers)</td>
</tr>
<tr>
<td>high visibility of costs</td>
<td>lack of standardization</td>
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<tr>
<td>common suppliers behave</td>
<td>reporting at low level in organization</td>
</tr>
<tr>
<td>differently in different areas</td>
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</table>
Benefits of centralization

Number of Subunits committed to the centralized operating model
(driven by concrete demonstrations of savings potential)
...and time costs money as well

- Case study for Finnish Government
  - Decentralized tendering process takes on average 167 hours, a centralized one 598 hours
  - If you consider the time spent in tendering as person-years (1600 h, cost of 56 000 €), then…
  - The cost of the average decentralized tendering process, which takes 167 working hours to complete, is \((167/1600) \times 56 000 \, \text{€} = 5845 \, \text{€}\)

- Multiple overlapping tendering processes quickly increase costs compared to tendering one contract for the whole government
Different structures for different operations

- **Strategic activities**
  - policies and procedures
  - purchasing strategy
  - performance evaluation

- **Tactical activities**
  - specifications
  - supplier selection
  - contract management

- **Operative activities**
  - ordering
  - follow-up
  - expediting

Centralize

????????

Decentralize

Beker & Faes, 2000
Where to draw the line of centralization? -purchasing decoupling point-

Centralized purchasing

Need 1
Need 2
Need 3

Specification
Supplier
Contract
Order
Order
Order

Approved vendor list

Need 1
Need 2
Need 3

Specification 1
Specification 2
Specification 3
Supplier
Contract
Order
Order
Order

Beker & Faes, 2000
Where to draw the line of centralization? -purchasing decoupling point-

**Contract management**

- Need 1
  - Specification 1
  - Supplier 1
  - Order

- Need 2
  - Specification 2
  - Supplier 2
  - Contract
  - Order

- Need 3
  - Specification 3
  - Supplier 3
  - Contract
  - Order

**Decentralized purchasing**

- Need 1
  - Specification 1
  - Supplier 1
  - Contract 1
  - Order

- Need 2
  - Specification 2
  - Supplier 2
  - Contract 2
  - Order

- Need 3
  - Specification 3
  - Supplier 3
  - Contract 3
  - Order

Beker&Faes, 2000
Different products need different management?

- Bottleneck
- Strategic
- Non-critical (C,D)
- Leverage (A,B)
Best structure often situational
- case Turner Broadcasting -

Office supplies

Printing services

2 suppliers

100 suppliers
Buyer specialization brings benefits - case Motorola -

Software license costs -50% by negotiating 1 global contract
(originally 65 contracts $80” costs)
Other alternatives

- Teams with...
  - Supplier participation
  - Customer participation
  - Crossfunctionality
- Consortia or group buying
Hybrid has many pros in theory

Centralized

Pros

Cons

Decentralized

Pros

Cons

Hybrid

Pros

Cons
Frequencies of structures differ

- "Mixed forms” and hybrids
  - in mixed form responsibilities divided based on situation
    - often has been developing without much plans
  - in hybrid purchasing (strategy & tactics) is centralized and implementation (operative) is decentralized

- Centralized
  - centralized purchasing function responsible for most of planning, implementation and responsibility

- Decentralized
  - purchasing decision making and responsibility decentralized (each unit buys for their own needs)

- Outsourced
  - large part of purchasing activities handled by an outsider
Talent
62% feel their teams lack the skills needed to deliver their procurement strategy

Outsourcing
12% of CPOs are looking to increase outsourcing of category management/strategic sourcing and
26% of CPOs are looking to increase outsourcing levels of operational buying

Disruptive technology
CPOs are investing heavily in solutions to support their functions
Nearly half of respondents are investing in cloud based computing to support procurement activities

Cost focus
CPOs view cost reduction as a key business strategy over the next 12 months

Deloitte CPO survey 2016
CPOs will continue their focus on generating value through traditional levers over the next 12 months:

- Consolidating spend: 43%
- Increasing level of supplier collaboration: 39%
- Increasing competition: 32%
- Restructuring existing relationships: 31%
- Reducing total life cycle/ownership costs: 30%
- Specification improvement: 29%
- Restructuring the supply base: 25%
- Reducing transaction costs: 21%
- Reducing demand: 17%
- Outsourcing of non-core: 14%
Regardless of the changes made to organizational structure...

...CEOs expect cost savings!
Current trend: centralization
Structures changed periodically

- Change in purchasing structure often related to demands of new corporate strategy
  - Linked to overall organizational changes

- Challenge is to maximize benefits and minimize problems of given structure
  - Implementation often more important than the actual choice of structure?

- Change always requires top management support
Difficult to change "the way we do things"

It took over a year to decide to purchase toilet paper jointly
Compliance a key implementation issue in centralization

Maverick purchasing 5-50%

Off-contract buying of goods and services for which an established procurement process is in place based on pre-negotiated contracts with selected suppliers

Typical in indirect spend
Why might YOU be a maverick buyer?

- Let’s say you work for a big multinational company. It has negotiated centralized contracts for these purchase categories that you sometimes need to order:
  - Business travel (Flights, hotels, etc.)
  - IT equipment (Laptops, workstations, software, mobile phones)
  - Printing services (For brochures, calling cards, advertising material etc.)
  - Office supplies and office furniture

- Why might you decide to buy off-contract (e.g. a product not included in the contract or from a supplier outside the contract)?
Maverick buying

- Off-contract buying of goods and services for which an established procurement process is in place based on pre-negotiated contracts with selected suppliers
  - most often associated with indirect materials and MRO items (e.g. office supplies, travel, printing, IT hardware and software)
  - typical in organizations with low spend visibility

- Causes increased purchasing costs and reduced purchasing leverage
  - higher prices, inflated transaction costs, also supplier may suffer
  - undermines negotiation power, seen as a “nuisance customer”
<table>
<thead>
<tr>
<th>#</th>
<th>Benchmarks</th>
<th>Mean</th>
<th>Minimum</th>
<th>Maximum</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Percent that track the purchase of goods or services that occurred outside the preferred process or system (maverick spend, rogue spend, etc)</td>
<td>55.65%</td>
<td></td>
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<tr>
<td>2</td>
<td>If 'Yes', frequency maverick spend metrics are reviewed</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Monthly</td>
<td>40.63%</td>
<td></td>
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<td></td>
<td>Quarterly</td>
<td>28.13%</td>
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<td></td>
<td>Semi-Annually</td>
<td>3.13%</td>
<td></td>
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<tr>
<td></td>
<td>Annually</td>
<td>9.38%</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Other</td>
<td>18.75%</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Other List: Ad Hoc basis (8 responses); Internal auditing</td>
<td></td>
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<tr>
<td>3</td>
<td>Of the total number of purchase order's released in the last fiscal year, percent created after goods and services were received</td>
<td>13.13%</td>
<td>0.00%</td>
<td>6%</td>
</tr>
<tr>
<td>4</td>
<td>Percent of organizations that reported their after-the-fact purchase orders increased, decreased or did not change from the previous fiscal year</td>
<td></td>
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<tr>
<td></td>
<td>Increased</td>
<td>9.28%</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Decreased</td>
<td>48.45%</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Did not change</td>
<td>42.27%</td>
<td></td>
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<tr>
<td></td>
<td>If 'increased' or 'decreased', percent of change from the last fiscal year (estimate)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Percent increased</td>
<td>8.85%</td>
<td>0.10%</td>
<td>3%</td>
</tr>
<tr>
<td></td>
<td>Percent decreased</td>
<td>9.33%</td>
<td>0.00%</td>
<td>0%</td>
</tr>
<tr>
<td>5</td>
<td>Maverick/rogue spend as a percent of total spend for the last fiscal year</td>
<td>13.02%</td>
<td>0.01%</td>
<td>6%</td>
</tr>
</tbody>
</table>
$14 million in office supplies

- Fully compliant $3.5 million
- Noncompliant $10.5 million
  - Wrong vendor $4 million
  - Right vendor $6.5 million
    - Wrong items $3 million
    - Wrong terms $3.5 million
      - Lost savings $0.7 million
      - Lost savings $0.5 million
  - Lost savings $1.1 million

- Internal compliance
- External compliance

Total lost savings $2.3 million or 16% of total office supply purchases

Kulp et al., 2006
NHS hospitals wasting £500m a year on 652 different types of gloves and 21 types of A4 paper

By DANIEL MARTIN

The NHS is throwing half a billion pounds down the drain every single year by paying over the odds for hospital equipment.

Some trusts are paying half as much again as others for the same medical supplies - leading to massive waste at a time when nurses' jobs are under threat and some operations are being rationed.

A scathing report by the National Audit Office found that even in the same hospital, different departments are needlessly buying lots of different types of the same product - at massively varying prices.

http://www.dailymail.co.uk/health/article-1352598/NHS-wasting-500m-year-paying-odds-medical-supplies.html
Different forms of MB

- Lack of contract/ process awareness → Unintentional MB
- Lack of ability to use contract or process → Forced MB
- Behaviour guided by own interests or habits → Casual MB
- Perceived superiority of an alternative offer → Well-intentioned MB
- Perceived superiority of own buying skills
- Opportunism → Ill-intentioned MB
- Resistance to change

TOTAL MB (%)
“If you look at those ministries that have a high usage rate, they are those ministries that see purchasing as important. So it starts from the top, directly from there. Where it is centralized and they actually execute purchasing professionally.”

“Well for example if we are booking a meeting package, and we get the request from management that they want a certain place which is not part of [the central unit’s contracts]…or then that there simply is no room left, …there is not always room so we have to go somewhere else.”

“But they are a bit… we have communicated these things to them…but people forget things, e-mails get deleted…that sort of thing… if they wanted, they would find the information… “

“Yes, especially in the buyer level, they look more at the price tag, they do not think about the total cost of ownership. They just look at the price of an individual item, and nothing else matters. They justify it by saying they could get it cheaper from the store next door.”

“Maybe on a smaller scale if you talk about this sabotage type behaviour, buying intentionally…I think it is more of the situation that when you have the contacts to the suppliers, you have long history and all, then related to that is some sort of treatment, it is nice to get the wine bottle at Christmas and all.”
Control needed to materialize savings - *case purchasing compliance at GSK* -

- Huge lost savings annually due to non-compliance
  - internal and external compliance issues

- 3-phase process to improve compliance
  - gathering data
  - identifying causes of non-compliance
  - designing conformance mechanisms
But is MB always a bad thing?

In what types of situations could it be beneficial for the organization?
No PO, No PAY!
(without a purchasing order you pay it yourself)

Three strikes and your out!
(notice, warning, fired...)
There are never too many control mechanisms...?
### How to reduce maverick buying?

<table>
<thead>
<tr>
<th><strong>E-procurement systems</strong></th>
<th>Works best against:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• E-systems provide spend visibility to detect and analyze maverick spend and create targeted remedies</td>
<td>All forms of MB</td>
</tr>
<tr>
<td>• Invest in e-procurement systems that do not allow deviations from set prices, products and suppliers during the purchasing process</td>
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<tr>
<th><strong>User involvement</strong></th>
<th>Casual, well-intentioned and ill-intentioned MB</th>
</tr>
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<tbody>
<tr>
<td>• Involving end-users when creating product specifications for contracts – ensures fit with user needs</td>
<td></td>
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</table>

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<thead>
<tr>
<th><strong>Communication, guidance and training</strong></th>
<th>All forms of MB</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Easy and visible channels to inform users of existing contracts</td>
<td></td>
</tr>
<tr>
<td>• Clear and unambiguous guidelines on purchasing procedures</td>
<td></td>
</tr>
<tr>
<td>• Training users on purchasing practices, contracts and e-systems</td>
<td></td>
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</tbody>
</table>

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<thead>
<tr>
<th><strong>Incentives and monitoring</strong></th>
<th>Unintentional and Ill-intentional MB</th>
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</thead>
<tbody>
<tr>
<td>• Incentives for those who negotiate contracts based on the usage of contracts rather than negotiated savings</td>
<td></td>
</tr>
<tr>
<td>• User-targeted sanction systems often not efficient</td>
<td></td>
</tr>
<tr>
<td>• Monitoring requires detailed visibility – only realistic with very advanced e-procurement systems</td>
<td></td>
</tr>
</tbody>
</table>

(Based on research by Kulp, 2006; Karjalainen & van Raaij, 2011; Holma et al. 2015; Kauppi and van Raaij, 2015)
Readings